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THE BANGLADESH BANK'S  
**RURAL FINANCE EXPERIMENTAL PROJECT**  
IN CO-OPERATION WITH THE  
U S AGENCY FOR INTERNATIONAL DEVELOPMENT  
SUPPLEMENT TO  
**TERMINAL EVALUATION REPORT** 17



AUGUST 1982

**S F Ahmed & Company**  
DHAKA, BANGLADESH

# RURAL FINANCE EXPERIMENTAL PROJECT

PUBLIC ADMINISTRATION SERVICE  
McLEAN, VIRGINIA, U. S. A.

S. F. AHMED & CO.  
DACCA BANGLADESH

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REF :

DATE: 24-10-82

Mr. Kamaluddin Ahmed  
Chief Officer  
Agricultural Credit Department  
Bangladesh Bank  
Dhaka

Dear Mr. Ahmed,

A Supplement to the Terminal Evaluation Report of  
25th August, 1982 incorporating views and opinions  
of S.F. Ahmed and Company

Please refer to the Terminal Evaluation Report dated 25th August 1982, which incorporates the views and comments of Public Administration Service (PAS).

As called for in the first paragraph of the transmittal letter of the above report of August 25, 1982, S.F. Ahmed & Co. (SFA) hereby present their observations, views, opinions and recommendations in the attached supplement, which should form a part of the Terminal Evaluation Report for the purpose of distribution.

The attached supplement contains the management summaries of the following two reports prepared by SFA as referred to in the transmittal letter of August 25, 1982 and answers to 15 critical questions posed in the consultants' contract.

Institutional Survey (Sept. 1981 - March 1982)  
Borrowers Financial Survey Vol. I  
Borrowers Financial Survey Vol. II

The above reports contain detail observations and analysis and should be read in conjunction with the Terminal Evaluation Report and its attached supplement.

SFA feel that some of the comments incorporated in the above report with respect to the organisation and management of the project including some of the statements made about the previous consultants are incorrect, mis-leading and do not reflect the true picture.

Copies of this report if distributed to other local and international agencies may mislead them about the success of the project and that of joint venture operation in the field of consultancy in Bangladesh.

Inspite of all the differences and problems encountered as mentioned in the above report all of the project work, we would like to report, have been duly completed.

SFA have had the opportunity of working with a number of other large and prestigious firms of USA, UK and other countries for almost 20 years and their experience of such joint venture in consultancy was not only pleasant but was mutually beneficial to both SFA and the expatriate consultants.

Since the comments about the management of the project and previous consultants have no relevance to the evaluation of the major issues of the project, we are presenting our views on those issues in a separate letter of this date.

If you need any further information or would like to discuss with us any of the issues, please do not hesitate to contact us.

Yours sincerely,



S.F. Ahmed  
Team Leader &  
SFA Representative



A SUPPLEMENT TO THE  
TERMINAL EVALUATION REPORT  
OF 25TH AUGUST 1982  
INCORPORATING THE FINDINGS,  
VIEWS, OPINIONS AND RECOMMENDATIONS  
OF S.F. AHMED & CO.

1.0 Objective of RFEP

1.1 "The basic objective of the Project and the objective of the Consultant in providing consultant services is to identify and develop a financially viable institutional rural credit and savings system or systems successful at extending and recovering credit from small farms including tenants and share-croppers/landless, and other small rural producers not presently reached by institutional credit. Corollary objectives are that the successful credit system identified be self-financing and capable of mobilizing capital through rural savings programs and other means". (Consultant's contract dated 29th May 1981).

2.0 RFEP Experience & Major Findings

2.1 Eight different models were used to test a number of policy, organisational and procedural variables such as credit interest rates, saving interest rates, village outlets, savings promotion measures, multiple loan purposes, simplified forms and procedure, loan supervision, personnel policies and incentives, local planning, group lending, etc.

2.2 From the analysis of data for the years ending on 30 September 1981 and 31 March 1982 it appears that RFEP as a whole has been a viable operation and has been making increasing profits from 1.9% to 3.3% taking into account more than adequate provision for bad and doubtful debts and excluding the incentive payments of  $\frac{1}{2} + \frac{1}{2}$  made on lending and recovery to the participating institutions. The operational cost data as a percentage of average monthly loan outstanding balance for the above two periods are as follows :

	<u>Year ending</u>	
	<u>30.9.81</u>	<u>31.3.82</u>
Administrative cost	6.4%	4.9%
Profit before provision for bad debts	5.7%	8.2%
Profit after provision for bad debts	1.9%	3.3%

This trend of reduction in operational cost and increase in the overall profit is likely to continue if the existing outlets maintain the same pace of operation.

- 2.3 A significant majority (71.63%) of borrowers were found to be viable in the sense that they have been able to accumulate enough surplus to meet their loan liabilities after deducting their total payments from total receipts of 1981 and adding the value of its stock to the surplus/deficit thereof.
- 2.4 The experiment has brought out positive evidences about borrowers engaging in new and/or extended productive ventures. Borrowers Financial Survey revealed that about 12% of the total borrowers engaged in new activities on account of RFEP credit; 62.34% of these borrowers also achieved viability (Table V.13). No borrowers however ventured into any new activity with 36% interest loan. Approximately 61% of such borrowers used 30% loan.
- 2.5 About 85% of the borrowers have increased the scale of operation of their activities through the use of RFEP credit (Table VI.1.2). Needless to say that such production opportunities would have been greater with lower interest credit. The desired circumstances would warrant besides low interest institutional credit inputs of various types such as technical know-how, marketing information and other physical inputs like equipment, fertilizer and raw-materials.
- 2.6 Since one of the main reasons for non-borrowing and dropping out was found to be the higher interest rate it can be deduced that more rural producers could join the program if the interest rates would have been more favourable. (Table IV.3.1 and IV.3.2).
- 2.7. The target group demand for credit would vary from borrower to borrower based on his economic infrastructure and the type and scale of activities he is engaged in. Target group demand for the entire rural Bangladesh could be approximated as follows. Total Rural Household = 13.5 million. Target Group Household 63% of the above = 8.5 million. At Tk. 3000/- estimated average demand, total target group demand would stand at Tk. 25.5 billion.
- 2.8 At least 61.11% of the total borrowers derived economic benefit from RFEP credit by increasing their income, consumption and/or net worth (Table VI.2.12). Needless to say that the ratio is likely to increase if the credit would have been cheaper than what was offered in the RFEP. Lower interest rates show a higher ratio of such borrowers compared to 30% and 36% rates of interest (Table VI.2.12.1).

- 2.9 Over 90% RFEP credit reached target group borrowers as revealed by the following Continuous Surveys conducted by the consultants :

	<u>Period</u>	<u>% of Target Group Hit</u>
Continuous Survey I	May - Aug. 1981	90.00%
II	Sept- Feb. 1982	89.14%
III	March-May 1982	92.01%

- 2.10 The experiment provided adequate information to indicate that a viable rural credit and savings system could be developed. It was however not possible to identify an independently self-financing system without the back up of any subsidy or aid which could be replicable nation wide. Even after a lapse of 4 years of experimentation with the models, none of the outlets/ models could mobilize adequate funds to continue financing the system, without the funds lent by their parent institutions for the program from their other resources. Approximately 15% of the total outstanding loans were covered by saving deposits. Since a financial institution should lend only about 50% of such deposits (in order to maintain its liquidity position to cover demand for withdrawals including statutory deposit requirement), the effective coverage of RFEP lending by RFEP deposits could be considered some where around 7%. In our opinion source and cost of funding, and the whole question of money supply for rural finance operation has not been adequately covered in the experiment. As a result the fundamental problem of self financing the proposed rural finance operation has not been solved.
- 2.11 The models tested various credit delivery operations, type of lending, etc, but did not also cover the behavioral and operational response of incentives adequately by way of a positive and/or negative reinforcement.
- 2.12 The participating institutions in the experiment were all nationalized commercial banks who were fully owned by the government. Government owned institutions like in all other countries and unlike a privately owned banking organisation do not have the same profit motive or criteria for carrying on the business of banking and financing. Most of these organisations involved themselves in the experiment because of the insistence

of Bangladesh Bank and a very high rate of incentive (almost 67% of funds lent to and recovered from the target group) offered to them under the experiment. The management and the employees of these organisations have very little incentive in carrying on the rural finance operation at the cost of their children's education and family inconvenience.

- 2.13 Since the involvement in this experiment constituted a very small and insignificant slice of the participating institution's total business, it was not possible for these institutions to frame a new set of personnel policies and salary scales for the employees involved in the project other than the common national policies and pay scales which the institutions were legally bound to follow. Any such attempt in changing the policies would not only be discriminatory and unfair to other employees of the institutions but would also create a lot of management, administrative, personnel and legal problems.
- 2.14 These institutions also had to work within the legal and administrative frame work of a government organisation besides other legal and customary requirements of the country.
- 2.15 No private commercial bank (there were none until recently except the foreign banks) has taken any interest in the experiment or is likely to participate in any rural finance scheme in the near future, until and unless the private institutions in the country are given the necessary opportunity and facilities and are able to enlarge their financial base and operation for expansion in the rural areas. This would need a major change in the policy of the Govt with respect to banking in general and rural finance in particular. Until such time the banking in the private sector is developed it would be difficult to attract the private sector banks to participate in the rural finance operation, no matter how large the profit incentive is.
- 2.16 There would, therefore, be no other alternative but to depend on the nationalized commercial banks for such operation and any system designed should take cognizance of the constraints enumerated above.

2.17 Since the experiment was conducted in a controlled environment, inasmuch as other financial institutions were not allowed to compete RFEF in the region and the borrowers did not have a choice but to borrow at the only interest rate offered by RFEF in that outlet or region and since the total funds offered for lending was far too short of the total demand for credit of the region, it would not be fair to conclude that the rural producers were as comfortable or happy to borrow at higher rates of interest as the lower ones. Please refer to Borrower's Financial Survey Report for impact of credit on production, income, consumption and net worth of borrowers.

### 3.0 Funding of Rural Finance Operation

3.1 Credit systems designed to extend credit to rural producers as a stand alone operation based on either outright grants or loans have not succeeded in developing sources of funds for self-financing in the form of mobilization of interest bearing and interest free deposits and floats. As a result the liquidity and financing of such a program depends solely on the amount of grant or loan available and it faces the danger of coming to an abrupt halt when the grant or loan money is exhausted. A partial mobilization of finance through saving accounts bearing high rates of interest can not provide a cost of fund base to operate reasonably and profitably within the normal bounds and forces of the money market, such as the lending interest rates charged by other institutions and programs. The system should have the means of mobilizing non-interest bearing deposits in ratios greater than those of interest bearing ones in order to reduce the cost of fund. Any credit system developed for rural producers should of necessity be integrated with the total money system so that such credit operation is dependent and based more on the factors and the forces governing the local and the national money supply and market, rather than make it dependent solely on a temporary grant or loan.

3.2 Even though there has not been any study made of the rural money supply, it stands to reason to assume that adequate money supply and circulation exist to finance the vast network of production, procurement, storage and

distribution systems covering the goods and services produced, consumed, imported and exported by approximately 90 million people in rural Bangladesh.

3.3 Unless the non-interest bearing deposits and floats become the major sources of funds, as in the case of normal banking institutions, the cost of fund would always remain high which would adversely affect the viability of the institutions participating in this program. It may not be feasible to develop a system based on an interest structure higher than that of the money market and this system with its higher cost of fund will have to compete with other systems in the money market offering lower lending rates of interest. Needless to say that this program is rather too small a component of the total rural credit system (the current annual development budget for which is over Taka 7.8 billion) to influence and/or to bring about a change in the national interest structure of rural credit unilaterally.

3.4 There are of course other eligible sources of funds for rural finance which deserve some consideration, such as :

1. Capital issue both foreign and local
2. Grant from national budget
3. Grant in Aid from Foreign Govt./Agencies
4. Borrowed fund both foreign and local including debentures
5. Term deposit accounts, etc.

One of the manner in which capital could be gradually developed is by levying a charge on the borrowers either as a subscription to the equity or as a contribution to an interest free or low interest bearing non-withdrawable deposit or fund. Such fund could be carried over and later used to write off abnormal bad debts.

3.5 We are of the opinion that mobilization of rural deposit has not been adequately covered in the experiment. Please refer to the "Management Summary" of the 2nd Institutional Survey Report annexed herewith. We do not believe that

a full fledged credit system could be financed entirely out of rural savings, that is, out of the funds the rural population could put away as savings. Even in advanced countries like USA, savings banks have been allowed to engage in other normal banking operation in order to mobilise funds and reduce their cost of fund.

#### 4.0 Viable Interest Rate

- 4.1 We do not agree with the consistent emphasis made on the interest rate of 24% to be the panacea for a viable credit system in Bangladesh. Rate of interest should not be considered to be a fixed commodity. The important consideration should be to develop a frame work or methodology for determining the interest rate based on various factors and components, such that the interest rate can be determined at any point in time using such a frame work.
- 4.2 Any system designed would have to function within the limits of the interest structure and other conditions of the money market. It may not be possible to charge rates of interest higher than other competing projects or institutions with exclusive right for a particular region as was done for the experimental project. This will amount to discrimination of the regions involved and will create a lot of social and political problems in the country.
- 4.3 Since nationalized commercial banks do not operate on profit motive alone but take into account the social needs and other national considerations, any increase in their profit margin may not have the required impact on their performance as would have been in the case of privately owned financial institutions.
- 4.4 A higher rate of interest resulting in a higher margin of profit for the participating institutions is not an answer to developing a capital base for self financing of the program. A large chunk of this profit would disappear for the payments of taxes and dividends (contribution to the national exchequer).

- 4.5 Since no tax rebate is allowed for provision for bad debts (deduction is allowed only on actual write off), atleast 60% of such provision will have to be paid off as tax and will not be available either for future write off or for refinancing purposes.
- 4.6 Needless to say that the viability of the borrowers and their ability to pay back loans with interest will have to be seriously considered. Need for production and development in various agricultural and rural industrial sectors will have to be considered, taking into account the global requirement of national economy and development.
- 4.7 Since this program was meant for the disadvantaged poor, it would be unfair and discriminating to subject them to a much higher rate of interest than what the non-target group rural producers will pay for their loan through other rural credit programs. Such a situation would negate the main objective of this program to help the disadvantaged rural poors.
- 4.8 Since it is necessary to recover the full cost of operation to make a system viable, the only way to solve this problem of finding a reasonable and comparable interest rate would be to reduce the cost of such operation. It would be possible also to reduce operational cost by increasing the volume of business per outlet, thereby bringing in economy of scale. Table 1 shows the economy of scale in relation to administrative cost of the operation of RFEAP based on average volume of outstanding.
- 4.9 Burden of financing higher than the interest required to make it viable at the institutional level may help development of capital or financing base, provided the surplus so generated do not fall in the purview of a taxable income. If such burden however is translated in the form of a higher rate of interest, it would not serve the purposes mentioned above and the surplus would end up in the national exchequer either as tax or as contribution by the nationalised commercial banks.

Table 1

Distribution of administrative cost on the basis of average outstanding balance of loan per outlet

Average outstanding balance of loan per outlet		Number of outlets	For the year ending 31st March 1982
Over	Less than		
	300,000	38	10.0%
300,000	500,000	20	5.7%
500,000	700,000	9	5.1%
700,000	900,000	6	4.2%
900,000	1,100,000	5	4.0%
1,100,000		18	2.9%

- 4.10 About the profitability and financial viability of the institutions please refer to the "Management Summary" and chapter 5 captioned "Financial Viability" of the Institutional Survey Report September 1981 - March 1982.
- 4.11 We differ with the contention that lower interest rates or subsidies cannot help the rural poor. REEF itself is an example where 90% of the credit went to the target group borrowers and many such borrowers have benefitted from such credit. The balance 10% of such loans went to the non-target group borrowers which were all marginal cases and did not include any rural rich at all. We saw no indication whatsoever in the empirical studies made that the 12% or 14% interest bearing loans went to the pockets of rural rich. We have seen some observations made by some foreign authors based on studies conducted in other countries which hold the above view. We believe that these observations do not hold good in Bangladesh as shown by the result of this experiment.
- 4.12 We do not believe that higher savings rate alone would mobilize funds in the rural area. A higher savings rate which has a spiral effect on the cost of fund would result in higher lending rate. If the rural savings rate is made disproportionately higher than urban savings and lending rates, there will be a tendency amongst rural based urban people to borrow money from urban banks and deposit it in the rural branches and pocket the difference.
- 4.13 From the analysis it appeared that the total REEF operation for the year ended 31 March 1982 breaks even at 10.5% rate of interest which includes a cost of fund or internal rate of return element of 9.7%. Assuming the cost of fund to be zero, the breakeven point would be 9.8%. The same for the year ended 30 September 1981 would be 10.2%. It appears that administrative cost has dropped sharply from 6.4% to 4.9% over a lapse of six month period. Even though provision for doubtful debts has increased from 3.8% to 4.9% the total operational cost excluding cost of fund went down from 10.2 to 9.8%. This trend is likely to continue if the existing outlets maintain their pace of operations. The above percentages were based on average monthly loan outstanding balances for the respective periods.

4.14 Based on RREP experience and as explained in the **"Financial Viability"** chapter of the Institutional Survey, a total of 11% of the average outstanding loan should cover the operational cost of the outlet (including incentive estimated at 0.5%), the head office overhead and a generous provision for bad debts. Cost of fund and profit should be added to the above figure to arrive at the interest rate which will be viable to the institution. Cost of fund basis used by the institutions in the experiment (6.5% to 13%) is neither based on market conditions nor based on their cost of funds. Average cost of fund of major participating commercial banks is around 3% which can be approximated from their annual accounts. Cost of fund for banks engaged mainly in agricultural lending should be even lower considering a lower refinancing rate charged by Bangladesh Bank for such lending. Profit should be based on equity employed by an institution. Since a bank is expected to have a turnover manifold of its equity employed, a meagre 1 or 2% of the loan outstanding should provide a reasonable profit for the institutions.

It should however be appreciated that **all of the above cost factors** are dynamic and subject to change from time to time as their underlying factors change. Cost of fund, for example, depends on a lot of other factors such as interest rates of saving and lending of the money market, proportion of interest free deposits to that of interest bearing ones, etc. It would therefore be necessary to monitor changes in the various factors involved and have them scrutinized and normalized on a continuous basis. All of the cost components and the resultant interest rate should therefore be subject to revision based on any change in either their components or the overall situation.

## 5.0 The Proposed System

- 5.1 A permanent self-financing system, in our opinion, would need, inter alia, the following ingredients for its establishment and operation
1. Capital base in the form of grants or issue of shares
  2. Mobilisation of both interest bearing and non-interest bearing deposits (including floats) and not just saving deposits
  3. Availability of borrowed funds for lending on an as needed basis from Bangladesh Bank and other sources
  4. An economic size of operation at the outlet and head office level to suit money market conditions, including interest rate.
- 5.2 Additional funding would also be necessary to maintain at a bare minimum the momentum of the experimental project so that the financing operation is continued and maintained until such time a permanent system is identified and implemented. Further experimentation in the area of source and cost of fund should be carried out before identifying and/or developing a permanent rural finance system replicable nation wide.
- 5.3 Since the source and amount of fund available for continued operation (after the termination of the USAID fund agreement) was not known it has not been possible to design even a viable system, not to speak of a self-financing one. Lending interest rate required to sustain a viable operation for example will depend on the average balance of outstanding loan which will again depend primarily on the amount of fund lent. A viable interest rate cannot be determined unless the amount of fund available for each outlet for lending could be approximated.
- 5.4 Any system to be designed should however take into account the need and the condition of the country in general and those of the people in particular, besides the following essential factors. System designed must suit the people it is designed for and not vice-versa.
1. Self-financing
  2. Self-sustaining
  3. Dependent on available money supply within the country.

4. Based on existing monetary and economic conditions and responsive to any change thereof or change in the economic priority/perspective planning of the country.
5. Embody mechanism/process to continuously monitor and review system variables (such as interest rate, cost of fund, other cost elements, money supply, etc.) and the factors that make such variables change.
6. Mobilization and incentive plans for rural deposits and savings which would ultimately contribute to the money supply needed for rural finance.
7. Identification of activities/target groups/borrowers which would either be economically viable or would serve the purpose of national interest and development.
8. Credit delivery, recovery, savings and other operations should be both simple and fast, so that the clients are encouraged to use such system.
9. Embody incentive schemes for borrowers, savers, depositors and administrators on the basis of performance.
10. Economic viability at the farm/activity level taking into account return on investment, amortization, flexibility in the amount of borrowing and period of amortization, etc.
11. Economic viability at the borrower level taking into account evaluation of borrower's networth and ability to repay/amortize.
12. Economic viability at the industry level taking into account measured benefit to such industry against any subsidy the industry should bear to render such credit viable at the farm/activity/borrower level.

13. Economic viability at the institutional level taking into account the cost of the total operation as detailed above.
  14. Economic viability at the national level taking into account all direct/indirect measurable benefit of such credit to the economy of the country and any subsidy necessary to render such credit viable at the farm/activity/borrower/industry level.
  15. An attempt should be made to determine cost norms for the elements mentioned above, so that institutions with average efficiency will be able to make adequate profit to stay in business.
  16. Subsidy of different size and kind should be provided for different activities to control and regulate rural finance and rural activities, e.g. production of a particular crop, development of a new crop, etc.
- 5.5 Co-operatives and group formation for rural activities are essential for the development of rural industries, large scale farming, fishing, pisci-culture, seri-culture etc. and for the formation of capital base necessary for such development. It is also the policy of the Govt. of Bangladesh to encourage both co-operative and group activity. Even though formation of group is difficult and time consuming and needs organisational, procedural and training support, lending in these sectors is not only essential for the development of co-operatives and groups but also holds out a promising future for a viable credit operation in Bangladesh.

## INSTITUTIONAL SURVEY

Management Summary

## I

The Rural Finance Experimental Project was designed to identify and develop a financially viable institutional rural credit and savings system which would be successful at extending to and recovering credit from small farmers including tenants and share croppers/landless and other small rural producers not presently reached by institutional credit.

Nine lending institutions have been experimenting with 8 different models in 97 outlets at varying rates of interest.

The primary objective of this survey is to analyse institutional and financial viability of the participating institutions in detail. This study incorporates data collected through a sample survey conducted at the institution and outlet level and other data collected through monthly and periodical financial reports submitted by the institutions.

Operational characteristics of the models as amended have been described in Chapter Two including a brief commentary on the implementation of such models.

22 outlets have been included in this survey and their general characteristics have been incorporated in Chapter Three. Chapter Four includes operational performance data of all the institutions for the periods ending 30 September 1981 and 31 March 1982 and also for the two dates alongwith a comparative analysis.

Chapter Five deals mainly with the financial viability of the overall experiment and the institutions.

From the analysis of data for the years ending on 30 September 1981 and 31 March 1982 it appears that RFEP as a whole has been a viable operation and has been making increasing profits from 1.9 to 3.3% taking into account more than adequate provision for bad and doubtful debts and excluding the incentive payments of  $\frac{1}{3} + \frac{1}{3}$  made on lending and recovery to the participating institutions. The operational cost excluding cost of

fund also went down from 10.2 to 9.8%. This trend of reduction in operational cost and increase in the overall profit is likely to continue if the existing outlets maintain the same pace of operation.

During the year ending 31 March 1982 five institutions, Sonali, Agrani, Rupali, BKB, and IRDP, were able to earn profit ranging from 2.7% to 8.2% of the average monthly outstanding loan principal. Trend analysis of the years ending 30 September 1981 and 31 March 1982 shows that except for IRDP and BSBL, the seven other institutions are in a favourable condition. Operational cost of the 9 institutions vary from BKB's 6.8% to Uttara Bank's 28.9% of the average monthly loan outstanding balance for the year ending 31 March 1982.

An attempt has been made to develop norm of administrative cost of outlets using empirical data which amounted to approximately 7.1 percent of the average loan outstanding taking into account a confidence interval of 95%.

In order to improve the financial viability of the institutions the cost rates should be reduced and the best way to do it is by increasing the overall performance of the outlets e.g. increase in lending, recovery and mobilisation of deposits. Administrative cost burden can be minimised by increasing the lending operation and productivity of the outlet, cost of provision for doubtful debts by improving the process and performance of loan recovery and follow-up.

Cost of fund is however a major issue which has not been adequately covered in the experiment. The experiment was designed as a stand alone operation based on savings and borrowed funds at high rates of interest. It has not taken into account possibilities of developing sources of funds for self-financing in the form of interest free deposits and flo-ats. As a result the experiment was dependent solely on the amount of funds that could be made available by the institutions from other resources. A partial mobilisation of finance through savings accounts bearing high rates of interest could not provide a cost of fund base to operate reasonably and profitably within the normal bounds and forces of the money market, such as the lending interest rates charged by

other institutions. The systems, like other financial systems in the country, should have the means of mobilising non-interest bearing deposits in ratios greater than those of interest bearing ones in order to reduce the cost of funds.

Any credit system developed for rural producers should of necessity be integrated with the total money system so that such credit operation is more dependent and based on factors and forces governing the local and national money supply and market, rather than make it dependent solely on a temporary grant or loan. Even though there has not been any study made of the money supply in rural Bangladesh, it stands to reason to assume that adequate money supply and circulation exist to finance the vast network of procurement, storage and distribution system covering the goods and services produced, consumed, imported and exported by approximately 90 million people in rural Bangladesh.

Unless the non-interest bearing deposits become the major sources of funds, as in the case of normal banking institutions, the cost of fund would always remain high which would adversely affect the viability of the institutions participating in this program. It may not be feasible to develop a system based on an interest structure higher than that of the money market and this system with its higher cost of fund will have to compete with other systems in the money market offering lower lending rates of interests. Needless to say that this program is rather too small a component of the total rural credit system (the current annual development budget for which is over Taka 7.8 billion ) to influence or to bring about a change in the national interest structure of rural credit unilaterally.

Chapter Six deals with institutional coverage and extending credit to the target group. It also analyses major use of loan by activity.

The findings show that the volume of lending to the target group borrowers was the highest in the case of BKB, which made over 40% of the total target group disbursement. Sonali's share was the second highest with just over 15%, followed by Agrani with over 9%. Uttara's contribution of just over 1% was the lowest in this category.

Sonali disbursed one-third of the loans to the non-target group borrowers, followed by Agrani with 17.23%, while BKB's share was 15.40%. The lowest volume of lending to non-target group borrowers was recorded by Rupali with 2.59%.

Chapter seven deals with recovery of loans and reasons for overdues.

The findings of the survey reveal that Agrani's recovery position was the highest among participating institutions with nearly 63% of the amount recovered against its disbursement of 10.56% of the total loan. Uttara's recovery position is the second highest with 55.21%, closely followed by IRDP with 54.27% against their loan disbursement of 1.45% and 7.78% respectively. The lowest recovery was made by BSBL with only 32.93%, and it disbursed 7.73% of the total loan.

The disbursement recovery picture permits the hypothesis that the lower the percentage of the loan disbursed, the higher the percentage of recovery.

The amount of overdues is a function of the magnitude of the dues. The overdue position of different institutions as on March 31, 1982 shows that Agrani and Rupali have maintained a low level of overdues with 4.35% and 6.19% respectively; while BSBL's overdue position was the highest with 48.67% followed distantly by Pubali with 21.38%. The reasons of overdues are related with the failure of the enterprise for which the loan was taken, lower than expected income from the enterprise and wilful defaulters. Other reasons which of overdues include high rate of interest, diversion of loan to other activities, illness of the borrower etc.

Chapter eight shows an analysis of institutional performance on saving.

The survey reveals that BEB mobilized the highest volume of savings both from the target and non-target groups and it was interesting to note that the non-target group borrowers saved more than the target group. This holds true both in case of the institutions as well as the surveyed outlets.

Three-fourths of the surveyed outlets incharge have however expressed their dissatisfaction with the volumes of savings which indicates the untapped savings potentiality of the rural poor of Bangladesh.

Chapter nine deals with women borrowers and their share of participation in the program.

In case of women loanees their percentage to total borrowers recorded an increase of less than one percent in all institutions except one, and the percentages for BKB, IRDP and BSBL have decreased while Rupali did not show any change.

The average percentage of women borrowers to total borrowers however remained the same at 4.48%.

Chapter ten deals with training, education, salary structure, supervision and job conditions of the outlet staff and problems faced. It has been found that Rupali, Janata, Uttara, BKB, BSBL and Sonali have taken scientific and innovative approaches regarding training. They also remain dominant institutions regarding training aiming at optimistic self-financing goals. However, training at IRDP appears to be the most extensive as well as frequent, and it has been reaping excellent benefits from its training program.

All the institutions except BSBL conduct regular supervision of the outlets from the head quarters.

## II

ANSWERS TO CRITICAL QUESTIONS ABOUT CREDIT AND SAVINGS

An attempt has been made below to answer the fifteen critical questions as required under Function No. 6 of the consulting contract based on the information and analysis made so far.

QUESTION NO. 1: Do small farmers and other rural producers face production opportunities which can be exploited through institutional credit; under what circumstances? What is the target group demand for credit?

ANSWER: Yes. The experiment has brought out positive evidences about borrowers engaging in new and/or extended productive ventures. Borrowers Financial Survey revealed that about 12% of the total borrowers engaged in new activities on account of RFEP credit, 62.34% of these borrowers also achieved viability (Table V.13). No borrowers however ventured into any new activity with 36% interest loan. Approximately 61% of such borrowers used 30% loan.

About 25% of the borrowers have increased the scale of operation of their activities through the use of RFEP credit (Table VI.1.2). Needless to say that such production opportunities would have been greater with lower interest credit. The desired circumstances would warrant besides low interest institutional credit inputs of various types such as technical know-how, marketing information and other physical inputs like equipment, fertilizer and raw-materials.

Since one of the main reasons for non-borrowing and dropping out was found to be the higher interest rate it can be deduced that more rural producers could join the program if the interest rates would have been more favourable. (Table IV.3.1 and IV. 3.2).

The target group demand for credit would vary from borrower to borrower based on his economic infrastructure and the type and scale of activities he is engaged in. Target group demand for the entire rural Bangladesh could be approximated as follows. Total Rural Household = 13.5 million. Target Group Household 63% of the above = 8.5 million. At Tk 3000/= estimated average demand, total target group demand would stand at Tk 25.5 billion.

QUESTION NO. 2: Is the target group benefiting from credit at high interest rates ?

ANSWER: At least 61.11% of the total borrowers derived economic benefit from RFEP credit by increasing their income, consumption and/or net worth (Table VI.2.12). Needless to say that the ratio is likely to increase if the credit would have been cheaper than what was offered in the RFEP. Lower interest rates show a higher ratio of such borrowers compared to 30% and 36% rates of interest (Table VI.2.12.1).

QUESTION NO. 3: Can credit systems be devised to reach the target group on a large scale without being preempted by more privileged persons-how?

ANSWER: Over 90% RFEP credit reached target group borrowers as revealed by the following Continuous Surveys conducted by the consultants:

	<u>Period</u>	<u>% of Target Group Hit</u>
Continuous Survey I	May - Aug 1981	90.00%
II	Sept- Feb. 1982	89.14%
III	March-May. 1982	92.01%

However, no system can be made absolutely perfect or fool proof. A combined credit and saving system with interest differential large enough to cover the normal cost of delivery of credit in an institutional environment including reasonable cost of bad debts and normal cost of money should be the answer. Since the full cost of small credit is going to be much higher than that of larger volume credits available under normal banking, the privileged persons will not find it profitable to borrow relatively smaller amount of credit at higher interest rates than that from other institutional cheaper credits to which they have better access.

QUESTION NO. 4: How can timely repayment be induced and default minimized ?

ANSWER: There should be both positive and negative reinforcements for motivating people to make timely repayment and collection of loans. Positive rewards may include things like rebates, better credit rating for future loans for borrowers and appropriate incentive for bank employees involved. Negative reinforcements may include penal interests and poor rating for borrowers and penal action against bank employees. There should also be a concerted program of supervision of credit, bank-borrower dialogue, aggressive recovery and follow-up. Terms of loan repayment should be both feasible and convenient to the borrowers and should be subject to revision based on performance and/or circumstances beyond the control of borrowers.

QUESTION NO. 5: What are the principal institutional and management constraints to efficient operation of the financial institutions; what development or improvement is needed ?

ANSWER: One of the fundamental draw backs of most of the institutions is lack of profit orientation. Unlike in private business house where profit becomes the yardstick of measuring success or failure and becomes the principal motivating force behind its goals and objectives, most of the government owned institutions apparently lack this direction towards a measure of their achievement or success. As such there is a lack of incentive or purposeful motivation for the personnel to perform.

There is also lack of training and understanding about organisational behavior and inter-personal relationship based on the concept of motivation and stimulus-response. This deficiency is reflected amongst the personnel in their self-motivation, and in motivating others including the institution's clients. There are also serious deficiencies in training of field staffs with respect to rural banking and rural development.

Most of the Banks operating in the rural areas have been practicing almost similar banking services and facilities as practiced by them in the urban areas of the country. These banking services and facilities have been designed to cater to the needs of the city commercial and industrial houses involving large commercial and industrial operations and are not suited at all for small scale rural commercial and industrial activities based primarily on agricultural and agricultural related operation. Credit operation of the banks and the money instruments used are in most cases expensive, elaborate and unsuitable for rural environment. Banking services, facilities and customs should be improvised, designed and/or developed to suit the needs of the rural producers and traders and the type of transactions they normally involve in, in terms of their credit and capital needs.

Most of the branches of Dacca based banks operating in the rural areas has very little commitment for the development of the regions in which they are operating and in most cases funds mobilized by such branches are routed to the bank's head office for investment elsewhere. The personnel deputed in these branches are in most cases unwilling employees of the bank who have been forced to work in rural branches and whose major efforts often are directed towards relocating them to a city suburb. Very few of such employees, therefore, establish any relationship with local people and/or commit themselves towards the development of the region. The concept of a regional development bank would emphasize the need for recruiting personnel from within the region, if possible, who would have both the commitment and the interest for the development of such a region. Since such an institution would be regionalised the personnel of such a bank would normally have no hope or aspiration for moving to a city area as long as he remains in the employment of such a bank.

Bangladesh has embarked on a new policy of decentralised regional administration for control and development at the thana level. Since a thana will be a unit for administrative and development purposes, financial institutions and necessary money market should be allowed to develop for each of such independent units. Even though it may not be practicable to have an independent bank for each thana at the outset, an independent operating unit could be considered comprising of a number of contiguous thanas with equitable representation in the organisation and control from each thana. This could be in the form of a subsidiary of an existing bank, a new bank or other types of organisation such as co-operative, credit institutions, mortgage bank etc.

Banks operating in the rural area should in addition to the normal banking services and facilities practiced in the country offer specialised services suitable for rural production, storage, marketing and distribution in agricultural, agriculture-related and industrial activities, such that necessary long, medium and short term loans could be provided for the enterprises and organisational development including temporary bridge financing by way of expansion of credit through simple and innovative type of instruments similar to sola of exchange, demand draft, traveller's cheque, letter of credit, guarantee etc. This procedure of credit expansion would also create deposits, floats and short term money market, thereby increasing the velocity and circulation of money and the resultant money supply in order to sustain an accelerated development program.

To mobilise deposits out of float and temporary idle money, introduction of low interest bearing current account, day of deposit day of withdrawal saving account could be considered. This will discourage rural operators from demonitizing their temporary idle funds by making safe-keeping deposits with 'Mohajons' or put aside in their own hoarding places. Even though there has not been any study made of the money supply

in rural Bangladesh, it stands to reason to assume that adequate money supply and circulation exist in rural Bangladesh to finance the vast net work of procurement, storage and distribution system covering the goods and services produced, consumed, imported and exported by approximately 90 million rural people. Staggering of incomes of all salaried employees and income generated out of Govt. procurement and other works programmes could also be considered to stabilise money supply.

QUESTION NO. 6: Will higher interest rates on credit and savings mobilize capital in the rural sector and bring about greater availability of rural credit to the target group? Can the administrative costs of credit/savings programs be reduced to an acceptable level?

ANSWER: Higher interest rates on saving commensurate with the interest rate on credit should mobilize savings by (a) attracting more savings from the rural producers (b) attracting urban savers to transfer funds to rural credit system and (c) by discouraging the traditional money lenders from competing with the Rural Credit System.

Credit systems which have been designed to extend credit to rural producers as a stand alone operation based on either outright grants or soft loans have in most cases failed to develop sources of funds for self-financing in the form of mobilization of interest free deposits and floats. As a result the liquidity and financing of such an institution would depend solely on the amount of grant or loan available and an institution faces the danger of coming to an abrupt halt when such grant or loan money is exhausted. A partial mobilization of finance through saving accounts bearing high rates of interest could not provide a cost of fund base to operate reasonably and profitably within the normal bounds and forces of the money market, such as the lending interest rates charged by other institutions. The system should have the means of mobilizing

non-interest bearing deposits in ratios greater than those of interest bearing ones in order to reduce the cost of fund . Any credit system developed for rural producers should of necessity be integrated with the total money system so that such credit operation is more dependent and based on factors and forces governing the local and national money supply and market, rather than make it dependent solely on a temporary grant or loan.

The relative administrative cost of credit saving programmes could be reduced gradually along with a parallel development in the institutional framework, credit delivery system, personnel productivity, economy of scale, mass literacy and training, regional infrastructure, & other exogeneous & endogeneous variables. It is difficult to determine precisely as to what could be considered to be the acceptable level of such costs. Like any other goods and services, such cost at some point in time would be subject to the law of supply and demand. And the extent of acceptability (demand) would vary on the basis of the cost itself. But one thing is quite clear from the experiment, that the existing cost has been or was acceptable. The cost incurred during the experiment was acceptable to the borrowers for the extent of credit given, even though its demand at such cost could not be ascertained because of the limited scope of the experiment.

QUESTION NO. 7: Is a credit program feasible as a " One dimensional" program i.e. not integrated with the delivery of farm input and marketing services. What degree of coordination is required with other rural development activities ?

ANSWER: Agrani through small farmer service center model and Pubali through technical model made an effort to combine farm input and technical services with lending but were not very successful. The effort was however on a very limited scale.

Credit as a one dimensional program may however face other problems such as the problem of self financing as explained in answers to questions 5 and 6 above.

There has been little or no coordination during the experiment with other rural development activities. It may not be possible to devise a credit system encompassing such a coordinated approach with other rural development programs. However, the system should take stock of the development taking place in various regions in determining the type and extent of credit needed for that region.

QUESTION NO.8: Is it beneficial to channel credit and savings programs through cooperative style groups ? Do groups face more productive opportunities and offer advantages for reaching the target population ?

ANSWER: Yes. Cooperative or group should normally be a stronger economic base to carry out rural activities of larger economic size and scale and as such hypothetically it should be more beneficial to channel credit and savings through such group formations. The group could also benefit from the collective knowledge, experience and expertise of its members. Besides, because of the possibility of larger economic activity, the group can enjoy more productive, marketing and procurement opportunities. However, the performance of group lending has not been very satisfactory in the experiment except in isolated cases and IRDP.

Since there is no organised movement for group formation as in the case of cooperatives, formation of groups for the purpose of obtaining credit has been at best a trial process which requires long term education, training and other persuasive efforts to make such an organization effective, efficient and replicable nationwide.

QUESTION NO. 9: How can rural producers be motivated and organized to save regularly ?

ANSWER: Majority of the rural people may not have a saving to put away for a considerable length of time but do possess short term surpluses which should be tapped to increase rural deposits as suggested earlier in this report. The following institutional factors, inter alia, could be considered for developing rural deposits among the rural people :

- 1) Higher interest rates on savings
- 2) Reassurance as to the security of their fund
- 3) Reassurance as to the availability of such fund when needed
- 4) Literacy
- 5) Positive incentives
- 6) Better service and public relations

QUESTION NO. 10: What is the importance and income and productivity potential of agricultural, agricultural-related, and non-agricultural loans respectively?

ANSWER: All enterprises which have a round the year operation and employ the available contributory family labour would normally have more productivity, employment, profitability and viability in terms of absorbing credit and amortizing it. It appears however, that most of the agricultural activities do not fall under the above category.

QUESTION NO. 11: Are short term (seasonal) lending programs constrained by lack of longer term credit for financing physical or institutional infrastructure development?

ANSWER: Short term seasonal lending programs are purely for the purpose of providing working capital as an accommodation loan to bridge the seasonal variation in income/expenditure and receipts/payments, while longer term credit, which is normally provided for the development of physical or institutional

infrastructure, may not have any direct bearing on the short term loans; the reverse, however, may be true. There has however, been no experimentation with the longer-term financing in this project.

QUESTION NO. 12: What is the impact of expanded institutional credit on the overall operation of rural financial markets in experimental areas? Consider: (a) total credit availability (b) the increase in total credit to the target group; and (c) the percentage of credit going to the target group.

ANSWER: Needless to say, any expanded institutional credit which would mean infusion of additional funds into the rural financial market would increase - (a) total credit availability by at least the amount of expansion; (b) total credit to the target group by approximately 90% of such amount. (c) The percentage of credit going to the target group of the total credit available can not be determined because of the lack of information on credit available prior to such expansion.

QUESTION NO. 13: How should rural credit and savings programs be designed and run for maximum effectiveness/efficiency ?

ANSWER: In order to bring maximum effectiveness and efficiency besides organization, motivation, training and other related aspects mentioned above, one of the approaches could be towards directing a program which would be manned, administrated, run and ultimately owned by people with roots and a deep sense of belonging to rural Bangladesh, familiarity with the potential of the region, and having the patriotism, commitment, dedication and enthusiasm to develop the region. One other graduated approach could be towards the development of regional rural banks, provided there have been enough infrastructural educational and other developments including adequate credit needs in a particular region. Please also refer to answers to question numbers 5 and 6 above.

QUESTION NO. 14: Can credit be extended to the target group in a financially viable and eventually self-generating profitable manner? Based on interest rates, administrative costs, and recovery experience, what interest rate must be charged to ensure viability?

ANSWER: a) Yes. This has been extensively covered above.

b) Based on RFEP experience and as explained in the "Viability Analysis" chapter of the Institutional Survey, a total of 11% of the average outstanding loan should cover the operational cost of the outlet (including incentive estimated at 0.5%), the head office overhead and a generous provision for bad debts. Cost of fund and profit should be added to the above figure to arrive at the interest rate which will be viable to the institution. Cost of fund basis used by the institutions in the experiment (6.5% to 13%) is neither based on market conditions nor based on their cost of funds. Average cost of fund of major participating commercial banks is around 3% which can be approximated from their annual accounts. Cost of fund for banks engaged mainly in agricultural lending should be even lower considering a lower refinancing rate charged by Bangladesh Bank for such lending. Profit should be based on equity employed by an institution. Since a bank is expected to have a turnover manifold of its equity employed, a meagre 1 or 2% of the loan outstanding should provide a reasonable profit for the institutions.

It should however be appreciated that all the above cost factors are dynamic and subject to change from time to time as their underlying factors change. Cost of fund, for example, depends on a lot of other factors such as

interest rates of saving and lending of the money market, proportion of interest free deposits to that of interest bearing ones, etc. It would therefore be necessary to monitor changes in the various factors involved and have them scrutinized and normalized on a continuous basis. All of the cost components and the resultant interest rate should therefore be subject to revision based on any change in either their components or the overall situation.

QUESTION NO. 15: Does credit extension require a special delivery model or can it be integrated in a particular Bank's general agricultural lending?

ANSWER: A bank's general agricultural lending program may not be fully equipped to handle non-agricultural and agriculture related loans of this project. As such necessary modifications and inputs may need to be provided to such institutions for handling the credit system, assuming that the agricultural credit delivery system of such institutions is closely similar to the credit delivery system of the project.

TABLES

Source : Borrowers Financial Survey Report - August 1982

Table V.13

Distribution of viable and non-viable borrowers  
by new activities undertaken with RREP loan use

Name of activity	Frequency of borrowers		
	Viable	Non-viable	Total
Crop	40 (57.14)	30 (42.86)	70 (100.00)
Horticulture	20 (52.63)	18 (47.37)	38 (100.00)
Livestock	10 (71.43)	4 (28.57)	14 (100.00)
Pisciculture	2 (40.00)	3 (60.00)	5 (100.00)
Small trade	29 (87.88)	4 (12.12)	33 (100.00)
Small scale industry	3 (60.00)	2 (40.00)	5 (100.00)
Food processing	7 (87.50)	1 (12.50)	8 (100.00)
Transport	7 (38.89)	11 (61.11)	18 (100.00)
Others	26 (65.00)	14 (35.00)	40 (100.00)
Total	144 (62.34)	87 (37.66)	231 (100.00)

Chi sq<sub>8</sub> = 19.55

Figures within parentheses indicate percentages.

Table VI.1.2

Distribution of borrowers by scale of operation  
of activity against which RFEP loan was used

Name of activity	Scale of operation			Total
	Fresh	Increased	Unchanged	
Crop	70 ( 6.24)	812 (72.37)	240 (21.39)	1122 (100.00)
Horticulture	38 (21.84)	110 (63.22)	26 (14.94)	174 (100.00)
Livestock	14 (12.28)	97 (85.09)	3 ( 2.63)	114 (100.00)
Pisciculture	5 (20.83)	18 (75.00)	1 ( 4.17)	24 (100.00)
Small trade	32 ( 8.23)	346 (88.95)	11 ( 2.83)	389 (100.00)
Small scale industry	6 ( 6.90)	78 (89.66)	3 ( 3.45)	87 (100.00)
Food processing	8 (10.13)	70 (88.61)	1 ( 1.27)	79 (100.00)
Transport	18 (15.93)	88 (77.88)	7 ( 6.19)	113 (100.00)
Others	40 (48.19)	33 (39.76)	10 (12.05)	83 (100.00)

$$\text{Chi sq}_8 = 297.09$$

Figures within parentheses indicate percentages.

Components may not add totals due to rounding.

Table IV.3.1

Distribution of drop-outs by reason for dropping-out from RPEP by institutions

Insti- tutions	Reason for dropping-out										Total No. of drop-outs
	Procedu- ral com- pliance	Non-avai- lability of loan in time	In-ade- quacy of avai- lable loan	High in- cidence of bribe	Short re- payment period	High interest rate	Activity is not profitab- le	Loan was not gra- nted	Loan is not repaid	Others	
Agrani	6 (10.71)	15 (28.79)	5 (8.93)	-	5 (8.93)	8 (14.29)	1 (1.79)	29 (51.79)	12 (21.43)	1 (1.79)	56 (100.00) ((18.06))
BKB	27 (96.43)	7 (25.00)	1 (3.57)	-	1 (3.57)	-	1 (3.57)	-	-	-	28 (100.00) ((9.03))
BSDL	3 (15.79)	4 (21.05)	9 (42.11)	-	9 (47.37)	9 (47.37)	-	4 (21.05)	3 (15.79)	-	19 (100.00) ((6.13))
IRDP	18 (40.00)	32 (71.11)	29 (64.44)	1 (2.22)	7 (15.56)	19 (42.22)	4 (8.89)	1 (2.22)	3 (6.67)	-	45 (100.00) ((14.52))
Janata	15 (88.24)	15 (88.24)	15 (88.24)	3 (17.65)	1 (5.88)	2 (11.76)	-	-	-	-	17 (100.00) ((5.48))
Pubali	16 (84.21)	7 (36.84)	2 (10.53)	-	4 (21.05)	1 (5.26)	-	-	-	-	19 (100.00) ((6.13))
Rupali	4 (8.51)	10 (21.29)	7 (14.89)	3 (6.38)	6 (12.77)	22 (46.81)	4 (8.51)	28 (59.57)	3 (6.38)	7 (14.89)	47 (100.00) ((15.16))
Sonali	22 (64.71)	21 (61.76)	9 (26.47)	7 (20.59)	6 (17.65)	13 (38.24)	5 (14.71)	26 (76.47)	2 (5.88)	6 (17.65)	34 (100.00) ((10.97))
Uttara	1 (2.22)	2 (4.44)	14 (31.11)	2 (4.44)	4 (8.89)	7 (15.56)	5 (11.11)	27 (60.00)	8 (17.78)	12 (26.67)	45 (100.00) ((14.52))
Total	112 (36.12)	113 (36.45)	90 (29.03)	16 (5.16)	43 (13.87)	81 (26.12)	20 (6.45)	115 (37.09)	31 (10.00)	26 (8.38)	310 (100.00) ((100.00))

Figures within parentheses indicate percentages.  
Components may not add to total due to multiplicity of answers.

Table IV.3.2  
Distribution of non-borrowers by reason for non-borrowing from RPEP by institution

Insti- tution	Precedu- ral com- pliance	Non-avail- ability of loan in time	Inadeq- uacy of available loan	Reason for non-borrowing							Others	Total
				High incidence of bribe	Short repayment period	High interest rate	Activity is not profitable	Loan was not gra- nted	Loan is not required			
Agrani	112 (29.55)	129 (34.04)	50 (14.19)	7 (1.85)	35 (9.23)	49 (12.93)	26 (6.86)	103 (27.18)	55 (14.51)	42 (11.08)	379 (100.00) ((21.66))	
BKB	11 (5.00)	98 (42.24)	82 (35.34)	3 (1.29)	2 (.86)	14 (6.03)	4 (1.72)	34 (14.66)	62 (26.72)	40 (17.24)	232 (100.00) ((13.26))	
BSBL	23 (27.12)	32 (28.85)	15 (14.42)	1 (.96)	10 (9.62)	41 (39.42)	17 (16.32)	10 (9.62)	33 (31.73)	8 (7.69)	104 (100.00) ((5.94))	
IRDP	66 (51.97)	86 (67.72)	72 (56.69)	4 (3.15)	21 (16.54)	52 (40.94)	2 (1.57)	7 (5.51)	11 (8.66)	3 (2.36)	127 (100.00) ((7.26))	
Janata	79 (50.97)	77 (49.68)	72 (46.45)	11 (7.10)	10 (6.45)	80 (51.61)	21 (13.55)	2 (1.29)	26 (16.77)	7 (4.52)	155 (100.00) ((8.86))	
Pubali	125 (79.62)	82 (52.23)	48 (30.57)	13 (8.28)	48 (30.57)	16 (10.19)	5 (3.18)	2 (1.27)	3 (1.91)	19 (12.10)	157 (100.00) ((8.97))	
Rupali	50 (15.63)	84 (26.25)	48 (15.00)	44 (13.75)	35 (10.94)	94 (29.38)	15 (4.69)	105 (32.81)	67 (20.94)	48 (15.00)	320 (100.00) ((18.29))	
Sonali	9 (4.29)	38 (18.10)	29 (13.81)	9 (4.29)	9 (4.29)	22 (10.48)	9 (4.29)	57 (27.14)	60 (28.57)	28 (13.33)	210 (100.00) ((12.00))	
Uttara	-	4 (6.06)	21 (31.82)	1 (1.52)	14 (21.21)	15 (22.73)	6 (9.09)	48 (72.73)	19 (28.79)	16 (24.24)	65 (100.00) ((3.77))	
Total	515 (33.14)	628 (35.88)	437 (24.97)	93 (5.31)	184 (10.51)	383 (21.88)	105 (6.00)	368 (21.02)	336 (19.20)	211 (12.05)	1750 (100.00) ((100.00))	

Figures within parentheses indicate percentages.  
Components may not add to totals due to multiplicity of answers.

Table VI.2.12  
Net impact on borrowers

Status	Total	dnw*		dy**		dc***	
		<u>0</u>	0	<u>0</u>	0	<u>0</u>	0
Viab!e	1396 (100.00) ((71.63))	205 (14.68) ((10.52))	1191 (85.32) ((61.11))	134 ( 9.60) (( 6.88))	1262 (90.40) ((64.75))	161 (11.53) (( 8.26))	1235 (88.47) ((63.37))
Non-viable	553 (100.00) ((28.37))	272 (49.19) ((13.96))	281 (50.81) ((14.42))	143 (25.86) (( 7.34))	410 (74.14) ((21.04))	63 (11.39) (( 3.23))	490 (88.61) ((25.14))
Total	1949 (100.00) ((100.00))	477 (24.47)	1472 (75.53)	277 (14.21)	1672 (85.79)	224 (11.49)	1725 (88.51)

Figures within parentheses indicate percentages.

Components may not add to totals due to rounding.

\* rate of change of net worth over time.

\*\* rate of change of income over time.

\*\*\* rate of change of consumption over time.

Table vi.2.12.1  
 Net impact on Viable borrowers  
 by rate of interest on loan\*

Interest	Total Frequency	dnw		dv		dc	
		≤0	>0	≤0	>0	≤0	>0
12%	105 (100.00) ( ( 10.16) )	15 (14.29) ( ( 8.98) )	90 (85.71) ( (10.39) )	15 (14.29) ( (11.81) )	90 (85.71) ( ( 9.93) )	12 (11.43) ( ( 9.23) )	93 (88.57) ( (10.30) )
18%	267 (100.00) ( ( 25.85) )	33 (12.36) ( (19.76) )	234 (87.64) ( (27.02) )	28 (10.48) ( (22.04) )	239 (89.52) ( (25.37) )	27 (10.11) ( (20.77) )	240 (89.89) ( (26.58) )
24%	295 (100.00) ( ( 28.56) )	46 (15.59) ( (27.54) )	249 (84.41) ( (28.75) )	21 ( 7.11) ( (16.53) )	274 (92.89) ( (30.24) )	23 ( 7.80) ( (17.69) )	272 (92.20) ( (30.12) )
30%	219 (100.00) ( ( 21.20) )	49 (22.37) ( (29.34) )	170 ( 77.63) ( ( 19.63) )	24 (10.96) ( (18.89) )	195 ( 89.04) ( ( 21.52) )	27 (12.33) ( (20.77) )	192 ( 87.67) ( ( 21.26) )
36%	147 (100.00) ( ( 14.23) )	24 (16.33) ( (14.37) )	123 ( 83.67) ( ( 14.20) )	39 (26.53) ( (30.70) )	108 ( 73.47) ( ( 11.92) )	41 (27.89) ( (31.54) )	106 ( 72.11) ( ( 11.74) )
Total	1033 ( 100.00) ( ( 100.00) )	167 ( 16.17) ( (100.00) )	866 ( 83.83) ( (100.00) )	127 ( 12.29) ( (100.00) )	906 ( 87.71) ( (100.00) )	130 ( 12.58) ( (100.00) )	903 ( 87.42) ( (100.00) )

Figures within parentheses indicate percentages.

Components may not add to totals due to rounding.

\* Outlets charging differential rates of interest have been excluded from the estimates.

## BORROWERS FINANCIAL SURVEY

MANAGEMENT SUMMARY

## I

Background:

- I. The process of economic development in Bangladesh has been greatly hampered by the shortage of institutional credit to reach the poorest section of the rural producers in the country. In spite of being the nucleus of the nation's economic potential and activities, rural Bangladesh had until recently remained overlooked by the existing institutional credit set-up. The governments of Bangladesh and the United States launched in August, 1978, an action program to face the problem.
- II. The objective of this program, which came to be known as the Rural Finance Experimental Project, is to develop a system or systems which has/have demonstrated the ability to extend institutional credit to the poorest section of the rural producers including the landless and small producers engaged in on-farm and off-farm activities and to recover the same from them.
- III. The Borrowers Financial Survey is one of the studies designed to illuminate basic issues and to generate necessary analytical background for the formulation of future credit policies and programs for the target group.
- IV. The fundamental objective of the survey is to examine the financial viability of the borrower as to his ability to repay the loan including interest and the impact of credit on his income, economic worth and / or wellbeing to determine whether or not the borrowers derived any economic benefit from such credit. On the basis of a nation-wide survey on three separate universes viz., borrowers, drop-outs and non-borrowers a methodology has been developed to examine borrowers viability which can be used by lending institutions in future formulation of credit policies for the poorest section of borrowers. The findings of

the survey are presented below.

**Findings:**

- V. For the population of the target group it is meaningless to ask whether a particular activity or sub-activity is productive enough to enable the borrower to repay the loans. A borrower may have taken loan for an activity in which he/she did not engage the loan or even if engaged, he/she may not be able to repay the loan from the income of that particular activity but may do so from his income from some other sources. The productivity of the activity concerned cannot, thus be treated as the criterion for advancing loan.
- VI. In addition to different activities in which a borrower is involved, the capacity to repay his loan depends also on his resource endowments and demographic as well as sociological characteristics. A host of other reasons which have been discussed in section V of this report make it ineffective to determine typewise sponsoring of loan depending on intrinsic viability of an activity/sub-activity.
- VII. A significant majority (71.63%) of borrowers were found to be viable in the sense that they have been able to accumulate enough surplus to meet their loan liabilities after deducting their total payments from total receipts of 1981 and adding the value of its stock to the surplus/deficit thereof.
- VIII. The relative proportions of viable borrowers have been observed to vary directly with the size of income, the highest proportion of viability being observed in the highest income-size groups.
- IX. Borrowers have been observed to have increased their economic base in terms of change in net worth during the study period at a greater rate than non-borrowers and drop-outs. Again, viable borrowers have demonstrated a better

performance in terms of over-time change in economic well-being than their non-viable counterparts. Economic base of borrowers have also increased in terms of changes in income, consumption, and asset in the sense that the proportions of borrowers increasing their income, consumption and assets have been higher than that of increasing net worth. This holds true inspite of the fact that borrowers have increased their liability over time.

- X. The economic position of landless borrowers have been observed to be most favourably affected in terms of change in net worth.
- XI. Pattern of change in the net income of borrowers over time has been positive in the sense that the proportions of borrowers belonging to higher net income strata had been higher in the post-loan period than in the pre-loan period.
- XII. It has been revealed that a relatively higher proportion of borrowers have increased consumption than income. Pattern of expenditure on different items have also changed, specially, in relation to expenditure on food and health care.
- XIII. Considering the status of borrowers in terms of net worth, income and consumption, 1192 borrowers (61.11%) have been observed to be the net gainers of the RFEP borrowing in the sense that they had been viable even after raising the level of their net worth, income and consumption. Under the same criterion 63 (3.23%) borrowers who had been non-viable and at the same time whose level of net worth, income and consumption had been diminished were the net **losers**.
- XIV. The proportion of female viable borrowers (73.68%) have been found to be very close to that of total borrowers. The survey has revealed that the activity potential of women borrowers have increased significantly after borrowing from RFEP with most of women borrowers either increasing the scale of operation of their respective activities already

undertaken or having undertaken fresh activities.

- XV. Net worth of a significant majority of women borrowers (more than 74%) have been increased in the post-loan period over the pre-loan one. It has also been observed that viable women borrowers had increased their net worth at greater proportion and rate than their non-viable counterparts.
- XVI. Age and household size have been found to have no significant relationship with the viability of borrowers. The incidence of economically active population within a household, on the other hand, had some bearing on viability with the proportion of viable households being higher among borrowers with lower rates of dependency. There has been a direct relationship between borrowers viability and the size of arable land holding.
- XVII. A specific characteristic of the target group population of rural Bangladesh is that they are involved in multiplicity of activities/sub-activities. Accordingly, there is no significant relationship between the type of loan taken and *de facto* activity being carried out. Moreover, a significant proportion of RFEP borrowers have been found to care little about engaging in activity against which loan was taken, and about using the credit in directly productive activity.
- XVIII. Non-institutional sources of credit in Bangladesh play traditionally an important role in rural finance. This has been evidenced by the survey findings, which show that even among RFEP borrowers, the practice of borrowing from non-institutional sources prevails.
- XIX. Among reasons for non-borrowing or dropping-out from RFEP, refusal of loan application, high interest rates and procedural complicacy have been observed to rank as the most frequent ones.

- XX. Number and amount of loans taken by borrowers have been found to have little relationship with viability, with non-linear trends in proportions of viability with respect to these variables.
- XXI. Although incidental expenses have been significantly high in relation to de jure rates of interest, they do not seem to have any bearing on the viability of borrowers nor was there any definite trend in the relationship of viability with de jure rates of interest.
- XXII. There is no significant relationship between number of activities/sub-activities and viability. Due to multiplicity of borrowers' activities, it is difficult to conclude from the findings of a survey like the present one if a particular activity/sub-activity provides greater or lesser potential for the borrower to be viable. A relatively insignificant proportion of viable borrowers has been found to undertake a single activity/sub-activity financed by RFEP loan. An even less significant proportion of borrowers invested the total RFEP loan against the activity for which they applied for.
- XXIII. Certain changes in the occupational distribution of borrowers have been observed among borrowers as a result of the introduction of the RFEP. Data reveal that the percentages of borrowers with horticulture, livestock, pisciculture, small trade, small-scale industry, food-processing and transport as main occupation have increased and those with crop cultivation and 'others' have decreased after borrowing from RFEP.
- XXIV. From the point of view of scale of operation of activities, borrowing had positive impact in the sense that in almost all of the classified activities, more than 63% of borrowers have increased their scale of operation.

- XXV. Profitability is one of the most familiar criteria used to measure productivity of an enterprise. Profit is the criterion by which a private entrepreneur judges the merit of an enterprise. Accordingly the objective of the entrepreneur is to maximize profits by minimizing the volume of capital employed. The basic criterion for evaluation of an enterprise of the private entrepreneur is to secure maximum profits per unit of capital.
- XXVI. Whereas profitability measures capital productivity from the point of view of special interest of profits to the private enterprise, the ratio between capital and value added measures it from a social criterion of profitability giving what is known as product-capital ratio. Such measure of profitability appears to be more desirable for evaluation of the impact of lending by a program like the RFEP.
- XXVII. Due to the existence of different ways of defining capital, measurement of productivity co-efficient may lead to ambiguities. For example, speaking about capital, a distinction may be made between fixed and circulating capital as well as between equity capital and various types of credit.
- XXVIII. Depending on the share of exogeneous capital in the total financial involvement of an enterprise, its profitability will vary. The very fact that the method of financing influences profitability makes profitability estimate of lending under RFEP extremely difficult. For reasons already stated, there is no meaningful way of determining the real shares of exogeneous capital (RFEP loan) in the activities financed.
- XXIX. As an alternative to conventional way of measuring profitability, the investment-end-result of RFEP credit used

in different classified activities have been examined. Small trade has been observed to generate the highest rate of investment-end-result in terms of gross income followed by food-processing while transport has generated the lowest rate of result. A detailed list of activities and sub-activities identified have been set out against their respective investment-end-result in Tables VI.1.3 and VI.1.4.

XXX. Amongst different crops cultivated, batel-leaf has generated the highest rate of investment-end-result, followed by brinjal and cauliflower. The lowest of such rates was observed in case of wheat. It has been revealed that the investment-end-result of the highest proportion of farmer-borrowers cultivating most of the major crops like aus (local and HYV), aman (local and HYV), boro (HYV), wheat, potato, sugarcane, jute, mustard generated relatively lower rates of investment-end-results. Thus if sponsoring of typewise credit would have been based on productivity of the activity/sub-activity concerned, lending institutions would necessarily advance loans mainly for small trade, food-processing and cultivation of batel-leaf and brinjal the rationality of which remains open to controversy.