

The ultra poor in the Capital Market

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Abstract

This paper looks into the issue of accessibility of the capital market for the ultra poor by analyzing the extent of borrowing, their sources and uses of loan. One-fourth had access to any capital sources, and only about 5% received credit from any institutional sources. The landless, female-headed households, households depending only on female income, the wage-employed and the destitutes got less access to any kind of loan. On the other hand, access to loan had increased with increasing land. It was also higher for the households headed by male and for those depending only on male income. Endowment and personal networking with creditors were very important in getting access to any credit sources. Average interest rate paid for credit borrowed, irrespective of sources, was 17.92%. Nearly one-fifth of the total loan obtained from different sources was interest free. A maximum of 150% interest was also charged in Comilla and Jamalpur regions. Institutional loans were mostly used for investment and informal loan for crisis coping. The landless, female-headed households, wage-employed group and the destitutes, in most cases, borrowed to meet their emergencies and paid higher interest rate. Eighty-seven percent loan in Rangpur region were spent for crisis coping whereas in Comilla and Jamalpur a significant proportion of the loan was used for productive purposes.

Introduction

It is evident from different study findings that majority of the ultra poor have poor resource base like land, housing and other non-land assets. Access to capital could be one possible alternative to enhance non-land assets. There are two major sources of capital - institutional and non-institutional. Major institutional sources of capital are government-owned scheduled banks, private commercial banks, cooperatives, Grameen Bank and NGOs. The ultra poor without any resource base do not have access to any institutional credit except the NGOs, which do not require collateral. It is also evident from several studies that the ultra poor were left out from major NGO activities due to their lower credit-worthiness. All of these indirectly influence the emerging local informal money market whose interest rate exceeds many times the rate of institutional loans. The ultra poor, who practically do not have any access to institutional capital sources, are the major customers of the informal market.

In the informal money market, both the collateral-free and collateralisable types of lending can be observed. The risk of lending in the informal market is very high. That is why a personal relationship with lenders has been treated as one of the most valuable assets of the ultra poor. This report looks into the issue of accessibility of the capital market for the ultra poor by analyzing the extent of borrowing households of different types, sources and use of loan. Data used in this report were collected in December 1998 from 1,250 ultra poor households residing in five districts under 25 BRAC's RDP Area Offices. These are the households who were eligible for NGO membership but not participated in the NGO activities. In sample selection the list of all ultra poor households living in the villages of all RDP working areas but not participating in NGO activities prepared by RDP local staff in 1997 was used. The five districts selected for this study were Comilla, Jamalpur, Faridpur, Rangpur and Bogra where concentrations of the non-participating ultra poor households were highest. From each selected region five Area Offices (AOs) were sampled based on the higher frequency of non-participating households.

Access to credit

Table 1 reports results on the accessibility to credit. According to the table, less than one-fourth of the total population had access to any kind of capital. Seventy-six percent of the sample households did not have access to any source of capital. Among borrowers only 19% had access to institutional credit. Relatives, friends and neighbours were the major sources, accounting 57%. A significant number of borrowers (16%) had to go for credit to the local moneylenders. About 8% obtained it from different informal village organizations, which were not officially registered. Although the amount received from institutional sources was relatively high, no significant differences among the sources were observed.

Table 1. Access to credit by sources

Sources of loan	% of all samples	Average amount per borrower
Relatives, friends and neighbours	56.9	3,342
Moneylenders	16.0	2,375
Village organizations	7.7	3,508
NGOs/banks	19.4	4,235
Total	23.6	3,316

It may be noted that only 14% of the landless received loan from different sources, compared to 31% who owned cultivable land. For the landless, moneylenders were second after relatives as the source of loan. The borrowing patterns show that with increasing landholding the dependence on moneylender is reduced and increased their access to institutional loans. This limited access of the land-poor households to any institutional loan and their dependence on informal money market ultimately help to flourish the latter (Table 2).

Some gender variations were also observed regarding access to capital. Only 13% of the female-headed households received any kind of loan, compared to 29% by the male-headed households. The amount received by the males was significantly higher than

females. Proportionately more male-headed households received institutional loans than the female-headed households. (Table 2).

With regard to the sex of income earners, it was found that the number of borrowers was two and a half times higher among households depending only on male income than those depending only on female income. The amount received per household was also significantly higher for the former group. Higher dependence on moneylenders for the later was quite evident from the findings.

Education was also found as one of the significant factors in their access to money/capital. It was found that 39% of the households headed by literate heads received a loan, compared to 22% of the illiterates. The literate heads also received higher amounts than the illiterates but no significant differences were observed in the case of sources.

Occupation may have a serious implication on this issue. Study results showed that the disabled and the wage-employed groups had less access to loan from any source, especially from any institutional. The amount they borrowed was significantly lower. A higher dependence of the disabled on moneylenders was also observed.

The flow of capital depending mainly on its demand may vary for different regions. Results presented in Table 3 indicate that the flow of capital was higher in the Comilla and Jamalpur regions, where more than 30% of the ultra poor received loan. Proportionately, the lowest number of households in Faridpur borrowed followed by Rangpur and Bogra. The amount received by each borrower was highest in Comilla and lowest in Rangpur region.

Jamalpur was also found to be an area where the scope for receiving institutional loan was very high. The ultra poor in Rangpur and Faridpur, by contrast did not have any

access to institutional loans. Faridpur was found to be another area where 80% of the loans were borrowed from relatives, indicating the existence of extensive family ties among the ultra poor in this region. On the other hand, the dominating role of moneylenders in the capital market in Rangpur and Bogra was observed (Table 3).

The interest rates

The average annual interest rate for credit borrowed from relatives, friends, neighbours and money-lenders was 18%, which seems to be very low due to the fact that a significant proportion of loans received from all of these sources were interest free. Informal village organizations charged the highest average rate at 25%. The rates for loan received from any institutional source were lowest. Up to 150% interest rates were also charged by some of the lenders (Table 4).

Nearly one-fifth of the total credit obtained from different sources was interest free. For another one-third, borrowers had to pay a minimum interest up to 10% per annum; up to 15% were paid for another 23% of the total credit and for the rest higher rates were charged (Table 5).

One-fourth of the amount borrowed from relatives, friends or neighbours as well as 21% of loans borrowed from moneylenders were interest free. An insignificant proportion of the informal village organization loan and credit from different NGOs was also interest free. It needs to be mentioned here that in 17% of the cases where the borrowers were connected through the kinship network, interest rates charged were 25% and higher.

In the informal money market, the demand and flow of capital determine the interest rate. It is likely that a higher rate is charged in the case of lower capital outflow and for short-term loans, for which the scope of investment is limited. Regional redistribution of borrowers and the rates paid by them are presented in Table 6. The average rates paid by the borrowers in the Jamalpur region were highest (31%), followed by Bogra

(17%). In Faridpur, the rate was lowest (on average 6% and the maximum was 20% per annum). The next lowest rate was in Rangpur (Table 6).

Reasons for borrowing and use of loan

The higher dependence on wage labour and the nature of employment make the ultra poor more vulnerable in terms of income, especially during lean season. The ill health of income earners is also one of the impediments for continuous income flow. In any case, the illness of household members increases household expenditures, which may have rapidly increased the routine expenditure. Frequent floods and other types of natural disaster, a common phenomenon in Bangladesh, may also create an emergency need for borrowing. To cope with any such anticipated and unanticipated crisis, the poor will have to borrow. Results on the reasons of borrowing as presented in Table 7 show that consumption smoothing was the reason for borrowing of nearly one-third of the loans. Fifteen percent loans were taken to meet the costs of treatment. Only 13% of the loans were taken for investment in the value-added activities. Other reasons included asset creation, coping with floods, debt servicing and meeting other non-food household expenses like purchase of clothes and so on. Although food consumption was the major reason for borrowing, the amount they borrowed for this reason was relatively lower.

Broadly claimed, two major reasons for borrowing could be observed namely, crisis coping and investment. If we look into the use of loan from specific sources, we can see that two-third of the institutional loans were spent for investment. On the other hand, 82% of the loan obtained through kinship network was spent for crisis coping. Sixty percent of loans from informal village organizations were also used for crisis coping (Table 8).

Major sources of investment loans were institutional credit (47%) and relatives and friends (35.4%). On the other hand, those who borrowed for meeting emergencies used more of their kinship network. The average rate of interest paid for emergency loans

was significantly higher than that of the investment loans. The amount borrowed was also significantly higher for the latter group (Table 9).

Among reasons for borrowing, some gender variations were observed. For example, for 80% of borrowers among the female-headed households, coping with emergencies was a major reason for taking loans, compared to 68% of those of the male-headed households (Figure1). The sex of income earners is also very important. It has already been discussed in the earlier chapters that with the improvement in household welfare, female employment tends to be decreasing in rural Bangladesh. If this is true, it is likely that households depending only on male income are relatively less poor group, will require to borrow less for consumption. The present study results also support this contention (Figure 2).

Figure 1. Reasons of borrowing by gender

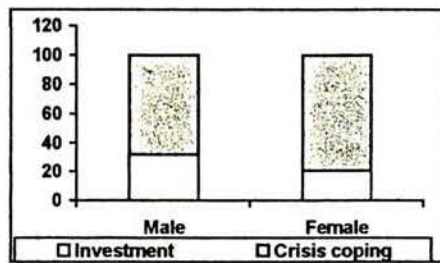
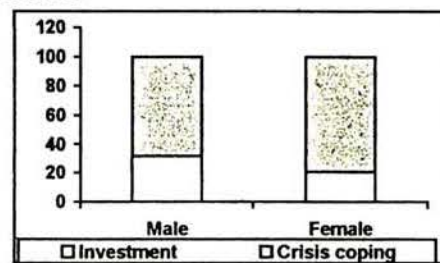


Figure 2. Reasons of borrowing and sex of income earners



The household resource base is one of the significant correlating factors in the productive use of loan. A positive trend is observed in the productive use of loan with changing landholding status and vice versa. The cost of borrowing for the land poor was significantly higher (Table 10).

Reasons of borrowing and their cost also differ significantly with occupation. Those who were self-employed or had continuous income sources borrowed less for consumption compared to the wage employed and destitutes (Table 11).

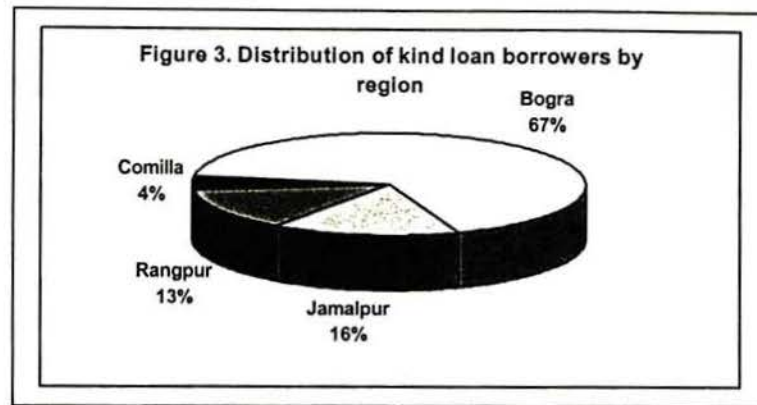
The scope of investment depends on the economic vibrancy of an area and the latter is very much related to infrastructural development of the area. The needs of the people living in different parts of the country differ accordingly. Although in majority cases,

non-productive use of loan was higher for all areas, the productive use of loan was relatively higher in Comilla and Jamalpur and lowest in Rangpur (Table 12).

Loans in kind

Vulnerability in its severe form can be traced by looking at borrowing in kind. Borrowing in kind often takes place with the disturbance in routine expenditure pattern. In 95% of the cases, consumption smoothing was the reason for borrowing. Nearly four percent of the households was found taking kind loan. A loanee borrowed, on average, 35.2 kg. of rice or paddy and had to pay back 53.43 kg after a specified period of time. Forty-two percent borrowed in kind from *Mohajans* (Table 13). Among borrowers, households with higher asset base borrowed a higher amount from other sources rather than *Mohajan*. On the contrary, the landless and female-headed households took a relatively higher proportion of loan in kind from *Mohajan* (Table 14).

Sixty-seven percent of the total loanees who borrowed in kind came from the Bogra region. Faridpur was identified as a region where none of the respondents received loans in kind (Figure 3).



The poor in the capital market: results of regression analysis

In the earlier part of this chapter, results of bivariate analysis have been presented. For a clear understanding on the accessibility criteria of getting credit from any source, a logistic regression equation was estimated. For this analysis a dichotomous variable was created. Value 1 is given for borrowing and 0 otherwise. A number of indicators describing their socio-economic status are considered as independent variables. Here an attempt has been made to isolate the influence of certain factors by controlling others. A number of variables included in the regression and their association with borrowing are presented in Table 15. All the variables included in the model are found to have significantly influenced borrowing. A higher coefficient of the Wald statistics indicates their relatively higher association. According to the table, access to loans varies significantly by region, the probable reasons for such a differential effect have already been mentioned. Higher economic dependency is also one of the important reasons for borrowing and is highly correlated with underemployment. A positive association between access to loan and household asset base, both land and non-land, and food security (the latter is defined by the number of rice meals consumed from own resources), indicates that household resource base is very important in the capital market for getting loan from any sources. The better-off economic conditions and social network of male-headed households enable them to have greater access to any resources compared to the female-headed households.

Discussions and conclusions

The ultra poor have to depend on the informal money market due to their lack of access to institutional capital sources. This chapter has described the issues of accessibility of the capital market for the ultra poor, analyzed their extent of borrowing, the sources, the reasons for their borrowing and the use of loan.

About 20% of those one-fourth who had access to any kind of capital, received loan from any institutional source which meant that only about five percent of the ultra poor got access to any institutional loan. The landless, female-headed households, households depending only on female income, the wage-employed and the destitutes got less access to any kind of loan. On the other hand, access to loan had increased with increasing land. It was also higher for the households headed by male and for those depending only on male income. The major sources of loan for all were relatives, neighbours and friends i.e., personal relationship was very important in getting access to informal sources. Positive relationship between higher access with higher asset and income indicates that endowment is important for getting access to any source. On the other hand, a high prevalence of personal network as the major source of credit implies that the poor without having any access to formal money market have to maintain a submissive relationship with the richer section of the population for several reasons. Among others, access to informal money market is the main reason.

Significant regional variations were observed in the number of borrowers and their mean amount. The ratio of borrowers to total population and their mean amount of loan were significantly higher in the Comilla and Jamalpur regions, whereas the status of Rangpur region was the lowest. None of the borrowers in Rangpur and Faridpur had an access to any institutional loan. It implies that access to capital largely depends on the economic vibrancy of a specific region and the creditworthiness of the individual borrower.

Average interest rate paid for credit borrowed, irrespective of sources, was 18%. Average rate was lowest for loan received from any institutional sources. Nearly one-fifth of the total loan obtained from different sources was interest free. A maximum of 150% interest was also charged by some of the lenders in the Comilla and Jamalpur regions, where the number of borrowers and the amount they borrowed were also significantly higher.

Regarding the reasons for borrowing, two-third of the institutional loans were used for investment. On the other hand, loans from informal sources, in maximum cases, were spent for crisis coping. In the productive utilization of loan, household resource base is very important. Results presented in this chapter also prove this hypothesis. The cost of an investment loan was found to be lower than the cost of a loan obtained for crisis coping. The landless, female-headed households, wage-employed group and the destitutes in most cases borrowed to meet their emergencies. Since the risk of lending to those without any resource base is higher, the lenders charged a higher interest rate that increased their cost of borrowing.

The use of loan in different regions shows that 87% of the loan in Rangpur region were spent for crisis coping whereas in Comilla and Jamalpur a significant proportion of the loan (41% and 32% respectively) was used for productive purposes. It implies that the scope of investment in the Comilla and Jamalpur regions is higher than in Rangpur region. Secondly, the resource base of majority of the borrowers in Rangpur region is very poor, which is inadequate for productive use of loan. There is also another implication of this result. It implies that the ultra poor in Rangpur are more vulnerable. To bring them into the mainstream process and for uplifting them special programmes will be necessary.

Table 2. Access to credit by sources and other socioeconomic indicators

Indicators	Relatives, friends and neighbours	Money-lenders	Village org.	NGOs/banks	% borrowed	Amnt (Tk.)
Landholding category						
Absolute landless	40.0	35.0	-	25.0	14.2	2,370
Only homestead	59.8	13.5	9.0	17.7	26.0	3,292
Homestead + cultivable	52.6	10.5	10.5	26.3	30.6	5,637
Sex of the hh head						
Male	56.5	15.3	8.4	19.8	29.0	3,462
Female	58.7	19.0	6.3	15.9	13.7	2,706
Education of the hh head						
Illiterate	58.6	15.4	7.5	18.4	21.8	3,145
Literate	49.1	18.6	10.2	22.0	38.5	4,087
Sex of income earners						
HHs with only female earners	55.3	25.5	2.1	17.0	12.5	1,984
HHs with male & female earners	60.0	10.0	7.5	22.5	25.5	1,974
HHs with only male earners	56.1	16.2	9.6	18.2	29.2	4,175
Occupation of the hh head						
Wage	61.5	14.0	8.0	16.5	25.5	2,928
Self	47.9	15.1	11.0	26.0	27.4	3,477
Begging/disabled/old age	50.0	41.7	-	8.3	6.7	2,022
Others	52.5	20.0	5.0	22.5	29.8	5,350

Table 3. Access to credit by sources and regions

Regions	Relatives, friends and neighbours	Money-lenders	Village org.	NGOs/banks	% borrowed	Amount (Tk.)
Rangpur	51.4	43.2	5.4	-	14.8	1,371
Comilla	69.3	7.9	5.0	17.9	38.8	6,152
Bogra	43.4	30.1	9.6	16.9	26.0	2,064
Jamalpur	53.9	1.1	11.2	33.7	32.4	3,126
Faridpur	80.0	13.3	6.7	-	6.0	2,900

Table 4. Source-wise loan received and the interest rates

Sources of loan	% to total loan	Yearly interest rate			No of cases
		Mean	Min.	Max.	
Relatives, friends & neighbours	56.9	18.08	0	150	185
Mohajan(money lenders)	16.0	18.00	0	100	52
Bank	2.2	14.29	10	15	7
Village organizations	8.0	25.12	0	150	26
NGOs	16.9	14.36	0	20	55
Total	100	17.92	0	150	325

Table 5. Source-wise loan received and the interest rates

Sources of loan	Interest free	up-to 10%	11-15%	16-24%	25-50%	> 50%
Relatives, friends & neighbours	24.9 (36)	42.7 (79)	7.0 (13)	8.6 (16)	10.3 (19)	6.5 (12)
Mohajan (money lenders)	21.2 (11)	40.4 (21)	3.8 (2)	13.5 (7)	19.2 (10)	1.9 (1)
Bank	-	14.3 (1)	85.7 (6)	-	-	-
Village organizations	7.7 (2)	38.5 (10)	15.4 (4)	11.5 (3)	23.1 (6)	3.8 (1)
NGOs	5.5 (3)	-	89.1 (49)	5.5 (3)	-	-
Total	19.1	34.2	22.8	8.9	10.8	4.3

Figures in parenthesis indicate numbers of HHs.

Table 6 . Yearly interest rates of borrowing by regions

Regions	% of borrowers	Av. interest rates (%)	Maximum (%)
Rangpur	11.4	11.86	25
Comilla	31.1	11.55	150
Bogra	25.5	16.47	146
Jamalpur	27.4	31.06	150
Faridpur	4.6	5.87	20

Table 7. Distribution of sources of loan and their uses

Uses of loan	Sources of loan				% of use	Rate of interest	Amount (Tk.)
	Relatives, friends and neighbours	Money-lenders	Village org.	NGOs			
Food consumption	55.3	27.2	9.7	7.8	31.7	21.71	1679
Treatment	77.1	16.7	-	6.3	14.8	11.65	3483
Small business	41.4	6.9	-	51.7	8.9	20.47	3783
Asset purchase	30.0	6.7	13.3	50.0	9.2	16.73	4870
Agricultural activities	14.3	21.4	21.4	42.9	4.3	10.00	3357
Debt servicing	68.4	5.3	5.3	21.1	5.8	10.79	4247
Flood	75.0	-	18.8	6.3	4.9	38.00	3022
Child marriage	75.0	25.0	-	-	4.9	10.63	3991
House building	47.8	-	13.0	39.1	7.1	13.91	4717
Others non-food expenditure	74.1	14.8	3.7	7.4	8.3	18.19	4941

Table 8 . Source-wise use of loan and the interest rates

Uses of loan	Sources of loan			
	Relatives, friends and neighbours	Mohajans /Moneylenders	Village organizations	NGOs
Investment	18.4	13.5	40	71.4
Crisis coping	81.6	86.5	60	28.6
Average amount (Tk.)	3,242	2,375	3,508	4,235

Table 9 . Sources of loan used for investment and crisis coping and the interest rates.

Uses of loan	Sources of loan				Amount (Tk.)	Interest rate
	Relatives, friends and neighbours	Money lenders	Village organizations	NGOs		
Investment	35.4	7.3	10.4	46.9	4,284***	18.09
Crisis coping	64.9	19.7	6.6	7.9	2,910	24.12*

Table 10. Use of loan by landholding category

Landholding category	Investment			Crisis coping		
	% of borrowers	Amount (Tk.)	Interest rate (%)	% of borrowers	Amount (Tk.)	Interest rate (%)
Absolute landless	22.5	3,167	13.6	77.5	2,139	20.2
Only homestead	29.7	4,238	18.9	70.3	2,893	25.5
Homestead and cultivable land	42.1	6,000	15.3	57.9	5,373	11.1

Table 11. Use of loan by occupation of the household heads

Uses of loan	Wage employment	Self employment	Begging/old age	Others
Investment	23.5	38.4	8.3	50.0
Crisis coping	76.5	61.6	91.7	50.0
Total	100	100	100	100
Interest rate (%)	19.39	17.44	12.50	13.10

Table 12. Reasons of borrowing by regions

Reasons of borrowing	Rangpur	Comilla	Bogra	Jamalpur	Faridpur
Investment	13.5	40.6	22.9	31.5	20
Crisis coping	86.5	59.4	77.1	68.5	80
Total	100	100	100	100	100
Average interest rate (%)	11.86	11.55	16.47	11.55	5.87

Table 13. Information on kind loan

% of borrowers	% borrowed from Mohajans	Amount borrowed (kg)	Amount to be given (kg)	Amount to be given (Tk.)
3.6	42.2	35.2	53.43	569

Table 14. Percentage of kind loan borrowers by their sources and other socioeconomic indicators

Indicators	% borrowed from any source	<i>Mobajan</i> <i>as source of</i> <i>borrowing</i>	Amount borrowed (kg)	Amount to be given (kg)	Amount to be given (Tk.)
Landholding category	3.6	42.2	35.2	64.8	556
Absolute landless	5.1	71.4	26.5	75.3	684
Only homestead	2.8	30.8	33.4	44.3	460
Homestead + cultivable	8.1	20.0	68.8	142.6	698
Sex of the household head					
Male	3.3	33.3	40.1	70.8	579
Female	4.1	55.6	27.9	56.0	522
Education of the household head					
Illiterate	3.8	42.9	36.4	68.1	573
Literate	2.9	33.3	18.3	19.7	319
Sex of income earners					
Households with only female earners	3.6	46.2	20.1	43.6	404
Households with male & female earners	4.9	53.8	44.1	73.7	710
Household with only male earners	3.0	31.6	39.4	73.4	555
Occupation of the household head					
Wage	3.6	56.0	24.4	50.7	483
Self	2.0	20.0	43.4	48.4	552
Begging/disabled/old age	4.5	37.5	42.7	77.7	718
Others	5.6	14.3	59.4	112.3	636

Table 15. Accessibility criteria for receiving loan: results of multivariate analysis.

Name of variables	Definition of variables	Beta coefficient	Wald statistic
ADULT_RA	Adult literacy rate	.006**	6.09
AREA	Geographical areas	.06***	26.40
ANNN	Consumption of three rice meals from own resources	.49***	7.56
DEPNDCY	Economic dependency	.14***	10.03
SEX_H	Sex of the household head (male = 1, female = 0)	.57***	10.20
LAND_REC	Land recoded (landless = 0, else = 1)	.34*	2.80
EMPLOYMT	Extent of under/overemployment	.006**	4.60
ASST	Ownership of asset (yes = 1, no = 0)	.83**	4.34
Constant		-3.96***	83.83
Log likelihood		1254.144	
Goodness of fit		1275.883	
Predicted		78.08	
Chi-Square		111.919	

*** significant at 1% level, ** significant at 5% level, * significant at 10% level