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The Story of the Grameen Bank: From Subsidised Microcredit to Market-based Microfinance

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Abstract

This paper looks at the establishment and evolution of the iconic Grameen Bank of Bangladesh. It traces the development of the Bank from its origins, providing microcredit to poor, rural women in Bangladesh, through a period of national expansion and institutionalisation, to the replication around the world of the Grameen model. In the late 1990s the Bank faced repayment problems and a developing financial crisis, and strategies were put in place to stabilise and reshape the Bank. This led in 2001 to the launch of Grameen II, which is analysed in terms of its main components and its results. Finally, the paper looks at Grameen Bank's future role as a major player in the microfinance market, and as an inspiration for those helping poor people improve their own lives.

Keywords: Microfinance, Bangladesh

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Introduction

The Grameen Bank of Bangladesh holds an iconic position in the world of microfinance. It is credited with proving that 'the poor are bankable'; the Grameen 'model' has been copied in more than 40 countries; it is the most widely cited development success story in the world; and its charismatic Founder-Director, Professor Muhammad Yunus, was awarded the Nobel Peace Prize in 2006. By the end of February 2008 it had 7.4 million clients and outstanding loans of $545 million. By any measure it is an organisation that has impacted greatly on the lives of many poor people and on ideas about microfinance, poverty reduction and international development.

The group-based lending model, targeted at poor, rural women, that is synonymous with the Grameen Bank contrasts markedly with the two other iconic microfinance institutions, *Bank Rakyat Indonesia* and *BancoSol* of Bolivia (see Hulme and Arun 2009). The original Grameen Bank model comes out of what Robinson calls a 'poverty lending' approach, rather than the 'financial systems' approach that she, the Consultative Group to Assist the Poor (CGAP), and many US microfinance specialists prefer. However, unnoticed by many observers, the Grameen Bank made dramatic changes to its services around 2001 and 2002. Its new model (Grameen II), takes it much closer to a financial systems approach. Although Professor Yunus continues to champion the idea of microfinance for poor women, most obviously through the annual Microcredit Summit, the Bank he directs increasingly lends to non-poor clients, has moved aggressively into savings mobilisation, and is very much concerned with the overall profitability of the mix of its products. Grameen II reflects not so much a reform as a revolution in the Grameen's strategy. Rather than challenging the market-based 'financial systems approach' the contemporary Grameen Bank vindicates it. But, let us start at the beginning.

Early days

As Professor Yunus reports in his autobiography (Yunus, 1999), and as Fuglesang and Chandler (1986) record, the origins of the Grameen Bank lie in the dilemma that the young Yunus found himself facing in the mid-1970s. Having completed his PhD in the USA, he had returned to Bangladesh to lecture in economics at Chittagong University. However, he found himself wondering what relevance the economic theory he taught had to the immediate needs of the thousands of hungry and deprived people he saw in rural Bangladesh. The country was slowly recovering from a vicious war of independence that had destroyed its infrastructure and its productivity and murdered much of its intelligentsia. The damage caused by the war had been amplified by the famine of 1974, and the country was dependent on food aid. Human suffering on a vast scale could be witnessed in any town or village.

Yunus could try to help people by giving them charity, but he wondered whether some of his economic theory could be applied in the field. His training postulated that if people got access to credit they could increase their profitability, or diversify their economic activities, in ways that would allow them to raise their incomes. So, if he could lend some poor people his money they could improve their lives and pay him back. Then, he could lend the money to other poor people and thus assist many more people than could be achieved by simply giving his money away.

It was an interesting theory, but his initial experiments seemed to show it was invalid. Quite a few of the men and women he lent to did not repay their small loans (sums of US$10 or 20). He thought that this was because they had either used the money unwisely (for consumption or poorly planned microenterprises) or were not trustworthy. As a result, he began to experiment with ways of (i) approving and supervising loans, to ensure they would be used for productive investments, and (ii) selecting trustworthy clients and managing them, so that they would repay their loans.

Eventually he came up with a model that worked. This had a number of features:

- Lending to poor, rural women (as they were less likely than men to use loans badly and were more reliable for repayment).
- Organising women into cells of five, that took collective responsibility for each other's loans (creating social collateral and a peer screening process).
- Establishing *Kendro* (centres) where six cells (i.e. 30 women) met, at a set time each week, to apply for loans and make repayments.
- Charging a higher rate of interest than government schemes and NGO loans programmes.
- Requiring clients to make compulsory microsavings each week (to create financial discipline and generate financial collateral for groups), and to make promises about their social conduct.
- Simple, standardised products that required regular, small repayments.
- Recruiting and training bright, young graduates to administer services (to minimise corruption).

There were many other carefully designed elements of this 'Grameen model' (see Fuglesang and Chandler (1986) for details). It certainly appeared to work, and Yunus was able to persuade the state-run Bangladesh Krishi Bank (BKB) to finance and house the experiment. Donor agencies, such as the Ford Foundation, became involved.

Expansion and institutionalisation

The early success of the Grameen model was matched by Professor Yunus's personal energy and enthusiasm. But, to expand the Bank he needed more finance and a robust organisational structure. The finance was not too much of a problem. In the early 1980s there were many foreign aid agencies in Bangladesh facing a big problem: most of the grants they made to government agencies were only weakly accounted for and they appeared to achieve little development impact. A bright, young social entrepreneur, who was gaining a reputation for assisting the poor and who monitored his programme's impacts, was just what they needed. For the next decade or so, Yunus would be able to rely on the financial support of the Grameen Bank Donor Consortium.

Achieving an effective organisational structure was, perhaps, more challenging. If he stayed with BKB, then as the Grameen Bank expanded it would be likely to take on the characteristics of the country's nationalised commercial banks: nepotistic staff recruitment and promotion, financial corruption, the politicisation of the loan portfolio, and an offhand attitude towards clients. The alternatives – registering as a Bank or as a cooperative – were not attractive. So, with great insight and careful politicking, Professor Yunus negotiated the passing of a Grameen Bank Ordinance in 1983. Quite how this was done has never been fully explained, but Yunus was a well connected member of the country's small elite and General Ershad, the country's new military dictator, was looking for ways of promoting a more popular image of his regime. The Ordinance established the Bank as a parastatal agency, overseen by a Board comprised of Yunus, a small number of state officials and a larger group of Bank clients. This gave Yunus firm personal control of the organisation, and the flexibility to modify its services and staffing as the Bank evolved.

Over the 1980s and early 1990s the Grameen Bank steadily expanded, with large inflows of donor funding. By 1991it had more than one million clients and a growing range of products – housing loans, agricultural loans and others. Alongside this, both the profiles of the Bank and of Yunus became increasingly international. The Bank was able to accommodate to the ascendancy of neo-liberal ideas of this era and to criticisms of those ideas. Yunus's eloquent narrative presented the poor as 'micro-entrepreneurs', who could seize market-based opportunities once they had access to microcredit (then seen as loans of around $50 to $200). But this was moderated: the Bank promoted women's empowerment (sometimes Yunus presented this as the poor's empowerment), collective action by groups, and social development. In effect, the Bank's narrative allowed it to present itself as extending the benefits of capitalism down to the poor whilst, at the same time, being an alternative to orthodox capitalism.

International transfer replication

As the 1980s progressed, an increasing amount of Grameen Bank senior management time was devoted to exporting the Grameen Bank model. I first became acquainted with the Grameen model in 1987, while researching rural finance in Sri Lanka. At the time it seemed that almost every NGO and donor project I visited had staff who had recently returned from a visit to the Grameen Bank. Most of these staff were very impressed with what they had seen and talked of ‘replicating’ the model. The Asian Development Bank, desperate to approve loans to Sri Lanka, dressed up its rural finance proposals as building on the Grameen Bank’s success – even though they were not using the Grameen model!

The Bank moved from mounting *ad hoc* visitor programmes to regular programmes for replicators. It targeted not only developing countries and was proud to announce Grameen transfers to the USA and Canada. By the mid-1990s Yunus was increasingly spending his time travelling overseas, sitting on the boards of Grameen replicas (such as *Amanah Ikhtar Malaysia*), visiting aid donors, and addressing academic, policy and public audiences. He energetically promoted microenterprise credit as a panacea for poverty reduction (something that intensely annoyed me, as it was so wrong) and eloquently spoke of the agency and energy of the poor (something I deeply appreciated, given that many analysts fail to point out that most poverty reduction is done by the poor themselves).

The idea of replicating the Grameen Bank around the world crystallised when the US-based group RESULTS (which runs campaigns promoting microcredit) and its Director, an experienced lobbyist, came up with the idea of a Microcredit Summit. Since 1990, the UN had convened a set of global summits that had set goals for poverty reduction, education, gender equality and other issues. The 1997 Microcredit Summit was not a UN event – it was organised by RESULTS – but it presented as a global summit, with claims of ‘microcredit is a human right’ and speeches from heads of state. It set a goal of mobilising US$21.6 billion, so that 150 million households would be able to access Grameen Bank-type loans by 2005. Some within the Microcredit Summit movement pushed for a focus on microfinance and a broader range of services but that did not suit RESULTS’ campaigning style. It needed a simple message. The Grameen Bank was a panacea, the world should replicate it!

Can the Grameen Bank go bust?

As the Grameen model was ‘exported’ overseas during the 1990s, the Bank continued to grow in Bangladesh. Client numbers grew steadily, but the portfolio grew more quickly as clients took bigger ordinary loans and new types of loans (especially housing). Those of us working in Bangladesh increasingly heard that repayment rates were falling, but that branch managers were massaging their performance figures by issuing new loans to defaulters. These were immediately used to pay off the outstanding loan and hide the problem of non-repayment. There were also criticisms of the gender achievements of the Bank: did it merely get women to take loans that they gave straight to their husbands? Then, there were criticisms of the idea that Yunus propounded, of every Grameen Bank loan being used for microenterprise, and every microenterprise being successful.

Independent fieldwork showed that Grameen Bank clients used their loans for many different purposes – business, food consumption, health, education and even dowry. Grameen loans did not go to microfirms for a single, specific investment; rather, they went into the complex financial portfolios of low-income households.

Long-time researcher on microfinance in Bangladesh, Stuart Rutherford, was one of those able to see what was going on. Grameen Bank clients paid the *kisti* (weekly repayments) on their loans not from a single microenterprise, but from patching together earnings from casual employment, self-employment, remittances and a variety of loans from other sources. But, as clients stayed with Grameen Bank, they were under pressure to take bigger, ordinary loans alongside new housing loans. As a result, they took on levels of debt they could not service from their income. To stop them from defaulting, they were issued with larger loans by Grameen branch managers to repay earlier loans. In Dhaka, rumours circulated of a meeting at which Professor Yunus asked his senior staff to tell him the true level of repayment and the scale of the 'hole' in the Bank's finances. The severe floods of 1998, and the collapse of the Bank's recently introduced agriculture loans, exacerbated the repayment problem.

Things moved from being a problem to being a crisis in 2000 when Daniel Pearl, a journalist on the *New York Times*, published an article saying that Grameen Bank was virtually bankrupt. For believers in the Bank this was either heresy or the end of the world. For proponents of the non-subsidised, financial systems approach it showed the validity of their ideas.

But a mere financial crisis was not enough to sink the Grameen Bank. An authoritative independent account of how the Bank survived is not available, but I believe a three-pronged strategy was used to stabilise and reshape it. The first prong of this strategy involved Bank staff in carefully going through the entire portfolio at the local level. They screened outstanding loans to raise repayment rates, reschedule loans and, when necessary, write-off loans that could not be recovered from borrowers or their centres. This meant that the entire Bank had to recognise significant losses. These could be absorbed by writing off parts of the Bank's asset base, but a second prong of strategy helped reduce this 'hit' on the Bank. Professor Yunus was partially able to mobilise grants from aid donors to offset these losses. Again, it is unclear precisely how this was done, but some commentators suspect it was by presenting the Bank's financial problems as being due to the floods of 1998, rather than being more systemic. The third prong of the strategy was to redesign the Bank's products, so that they became more profitable and could compete with the many other providers of microfinance in the country (many of which had prospered in the wake of Grameen's initial breakthrough). This led to what Professor Yunus has called Grameen II.

From Grameen I to Grameen II

The problems faced by Grameen Bank in the late 1990s led to its senior staff piloting a number of experiments with new products and new ways of managing service provision. By early 2001 these had been consolidated and Professor Yunus announced the launch of 'Grameen II' – the replacement of the Bank's earlier products by a new range on different terms. The components of Grameen II were designed so that (i) they should meet client demand, and (ii) they should be profitable for the Bank. Between March 2001 and August 2002 all Grameen's 1,200 branches were shifted from Grameen I to Grameen II products and systems. Accounts of this process and the practice and outcomes of Grameen II are provided by Rutherford *et al*. (2006) and Dowla *et al*. (2006).

The main elements of Grameen II are:

- A major focus on savings from members and the public. This includes voluntary savings, term deposits and the Grameen Pension Scheme (GPS) – a long-term savings programme.
- The provision of flexible 'basic loans' to members (rather than the standardised Grameen I 12-month loans). These are for variable amounts, can be repaid over three to 36 months, have negotiable repayment schedules and interest rates are determined by loan type (size, length, grace period, etc).
- The abandonment of joint liability (and the idea of social collateral).
- A poverty-focused 'struggling members' programme, that provides small, subsidised loans to beggars and encourages them to join Grameen Bank centres.

The results have been staggering. The Bank has not only been able to stabilise itself but has, in effect, relaunched itself and its trajectory. While it took Grameen 25 years to reach a client base of 2.5 million, it took only three years, from 2001, to recruit the next 2.5 million clients (Rutherford *et al*., 2006). Over the period 2002 to 2005 the Bank tripled the deposits it held (US$478 million) and doubled its portfolio of outstanding loans. The Bank's loans portfolio became smaller than its savings portfolio. It built up a large fund for bad loan provision and profits rose from 60 million Taka in 2002 to 442 million Taka (US$7 million) in 2005. This growth meant that physical expansion became essential and the Bank opened 500 new branches, so that it had more than 1,700 branches, by late 2005.

While the Bank still proclaims its mission of poverty reduction, my personal observations lead me to believe that its clientele is less economically deprived than was the case in the 1980s and 1990s. This is partly because clients have done well (perhaps through Grameen membership), and partly because of the product redesign and the drive for expansion and profitability. Many of its clients would be classed as non-poor or moderately poor by Bangladesh's official poverty line. A much smaller proportion is extremely poor (the targets for Grameen I over 1975 to 2000). The 'struggling members programme' is targeted at the extreme poor, but by December 2005 it had only 56,000 clients, against more than 25 million extremely poor people in the country. Average loan size for these members was only $6 and their average savings were $1 (Rutherford *et al*., 2006). While many poor and extremely poor people may benefit indirectly from Grameen II (through employment, increased demand for products, greater availability of local level charity) the struggling members programme appears to be either failing or tokenistic.

The future of the Grameen Bank

The Grameen Bank looks as though it has a secure future as an MFI in Bangladesh and should remain a major player in the microfinance market, alongside other big players, such as ASA and BRAC. It also seems set to remain a global icon, although there is real confusion about the message that the Bank (and Professor Yunus) project. Internationally, it is still perceived as a micro lending institution, focused on extremely poor women, despite the fact that it has adopted a market-based, 'financial systems' approach since 2001.

The confusion could be a cause for concern, but my personal analysis is more positive. Within Bangladesh, Grameen now plays an important role as a substantial MFI that meets client needs and helps to promote competition within the financial markets. Its viability is essential for this internal role, but also very important for its external role. Had the Grameen Bank collapsed, then optimism about the feasibility of poverty reduction and international development would have been dented. While the international message associated with the Bank – microenterprise credit for extremely poor women lifts them out of poverty – is now inaccurate, the broader thrust of this message – of hard working poor people using their personal agency to overcome the problems they face – is highly appropriate for the publics and politicians of rich countries. It helps the citizens of the rich world to understand that poor people are active agents in the processes of development and not passive recipients of food aid and humanitarian relief, as the media (in the USA, Europe, Japan and the Middle East) usually stereotype them. The Grameen Bank today is a very different organisation from what it was 20 years ago, but it still serves as an inspiration for those trying to help poor and low- income people in their own efforts to improve their lives.

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