

Grameen Bank, Microcredit and Millennium Development Goals

This paper traces the evolution of the ideas and practice of microcredit as pioneered by the Grameen Bank. Over the years, microcredit programmes in Bangladesh have grown, providing a wide range of services to meet the economic and social needs of its citizens, mostly poor women. It comes up with suggestions regarding the emerging issues of financial self-reliance and institutional sustainability of microcredit programmes.

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I Introduction

It has been a long journey for us. It began in 1976 with lending of \$ 27 to 42 poor people in a village next to the university campus where I was teaching economics. I had no intention of making a wave. Nor was I planning to create a bank for the poor. I had a very modest goal. I was trying to free 42 people from the clutches of moneylenders by giving them the money they owed to the moneylenders, in order to repay them and become free from exploitation.

I was teaching in Chittagong University while a famine raged in Bangladesh in 1974. It was uncomfortable to teach elegant theories of economics when people were dying of hunger. I felt totally irrelevant. I tried to make myself in some way relevant by going out to the poor people living in the village next to the university campus. Initially I looked for any little thing that I could do to make the life of a poor individual slightly tolerable. One thing led to another. I kept seeing how people suffered because they could not find tiny amounts of money to carry on with their livelihood activities. To solve this problem, they went to moneylenders. Moneylenders turned them into slave-labour with unbelievable loan conditions. I wanted to see how many people there were in the village in this situation. I made a list. The list contained 42 names, the total amount they needed was \$ 27.

Imagine the shock to the economics professor who teaches his students about the national five-year plan and the rationale for investing billions of dollars to overcome poverty. The professor did not know that people go through misery because they do not have access to pennies, let alone a whole dollar. Even if you invest those billions of dollars in big projects, this need of the poor will still not be addressed. I tried to address this problem by way of an emotional response: I gave the money from my pocket. I did not know that it would create an emotional counter-response from the people who got the money. They thought it was nothing less than a miracle. I thought if you could make so many people so happy with such a small amount of money, why not do more of the same. I decided to link the poor people in the village with the bank located in the campus, but the bank refused to get involved. They argued that the poor are not creditworthy. I pleaded with them to give me a chance to try. They refused. Ultimately when I offered to become the guarantor for these loans, they reluctantly agreed. I started giving loans to poor people in Jobra and was pleasantly surprised to see that it was working perfectly. I continued to expand the programme. Several stages later we converted the project into a formal bank, named, Grameen Bank, in 1983.

Gradually a new word, 'microcredit', was coined for these kinds of collateral-free tiny loans for income-generating activities of the poor. The Grameen idea spread all over the world.

Independent studies of microcredit programmes show that providing easy and affordable access to credit and other financial services to poor families can have a host of positive impacts on their livelihoods. A large number of impact studies done on the Grameen Bank have shown a significant impact on the lives of its members across wide range of economic and social indicators, including moving out of poverty, improved nutrition, better housing and sanitation, lower birth rate, lower child mortality, better access to education for the children, greater empowerment of women, and increased participation of women in social and political activities.

II Grameen Bank in 2003

Since Grameen became a bank it continued to expand. Today it works in almost 43,000 villages across Bangladesh and gives loans to 2.8 million borrowers, 96 per cent of whom are women. We have disbursed more than US\$ 4 billion to these borrowers in a cumulative way, of which US\$ 3.6 billion has been paid back. We lend out an average of US\$ 34 million every month as new loans. The amount of loans outstanding currently is US\$ 250 million, the recovery rate is 99 per cent.

The Grameen Bank is owned by poor borrowers and works exclusively for them. Borrowers of Grameen Bank, at present, own 93 per cent of the total equity of the bank, while the remaining 7 per cent is owned by the government. From the beginning we tried to design a system that met the needs of the poor. We identified what the main barriers for poor people to access money from conventional banks were, and set our course by reversing the principles practised by conventional banks.

Principles

(1) Grameen believes that poverty is not created by the poor, but by the institutions and policies which surround them. In order to eliminate poverty, appropriate changes have to be made in these institutions or policies. Alternatively, new ones have to be created.

(2) Charity is not an answer to poverty. It serves only to perpetuate poverty and create dependency. It takes away the initiative of an individual to break through the wall of poverty. The way to overcome poverty is to unleash the energy and creativity in each human being.

(3) The Grameen system is built on the belief that there is no difference in the ability of a poor person and any other person. The poor merely do not get the opportunity to explore their potential and so their abilities remain unutilised or underutilised. If they had the opportunity, they would be able to change their own lives.

III Beyond Meeting Credit Needs

Sixteen Decisions

(4) Grameen Bank developed a set of rules on the basis of this understanding and designed its credit delivery system accordingly. It sought to reverse policies that conventional banks applied, which created barriers to the poor. Conventional banks start with the principle that the more you have the more you can get, which provides a spring board for those who are already well off. Our principle has always been the less the person has, the higher the priority she gets.

(5) A central assumption underlying Grameen's system is the firm belief that poor people always pay back. For many of the borrowers, it is the first time that they are handling money; no one has ever trusted them with these sums of money before. For this reason they commit to pay back every penny. Many things can go wrong for a poor person, usually due to circumstances beyond his or her own control. Sometimes they may take longer to pay back, but repay they will.

(6) Lending to women brings greater benefits to the family than lending to men. If the mother is the borrower, the children are the immediate beneficiaries. Women have greater long-term vision and are ready to bring about changes in their lives step by step. They are also excellent managers of scarce resources, stretching the use of every resource to the maximum. Grameen prioritises women and today more than 96 per cent of its members are women.

Grameencredit

Over the years microcredit has come to mean many different things. For this reason and in order to avoid confusion, Grameen has begun to distinguish microcredit of the type it provides as Grameencredit. The distinguishing features of Grameencredit are:

- (a) It promotes credit as a human right.
- (b) Its mission is to help poor families to help themselves to overcome poverty. It is targeted to the poor, particularly poor women.
- (c) It is not based on any collateral or legally enforceable contracts but on 'trust'.
- (d) It is offered for creating self-employment for income-generating activities and housing for the poor, as opposed to consumption.
- (e) It is initiated as a challenge to conventional banking, which rejects the poor as 'not creditworthy'. Grameencredit rejects the basic methodology of conventional banking and creates its own methodology.
- (f) It provides service at the doorstep of the poor, based on the principle that the people should not go to the bank, but that the bank should go to people.
- (g) It requires that borrowers join a group in order to obtain loans. Loans are received in a continuous sequence, with new loans becoming available as previous loans are repaid. Loans are to be paid back in instalments as poor people find it easier to manage small repayments. A borrower may receive more than one loan simultaneously.
- (h) It comes with both obligatory and voluntary savings programmes for the borrowers.
- (i) It provides three types of loans: income-generating loans (with interest rate of 20 per cent), housing loans (with interest rate of 8 per cent), and higher education loans for the children of Grameen families (with interest rate of 5 per cent). All interests are simple interest, calculated on the declining balance method. Reaching the poor is the non-negotiable mission of Grameen credit, while reaching sustainability is a directional goal.
- (j) It gives high priority to building social capital through the formation of groups and centres and developing leadership through the election of group and centre leaders. Borrowers developed the 'sixteen decisions', discussed in Section III, through intensive discussion among themselves, which is a social agenda that they implement seriously.

While providing small loans to the poor is an economic intervention, it begins a process of transformation in the life of the individual member. A poor woman, who took it for granted that she had no worth, starts to believe in her ability to improve her own life. She works hard to bring a host of positive changes in her life.

Sixteen Decisions, a social charter which the members themselves developed, reflect the aspirations of the members. They encompass decisions relating to a woman's economic and social life, which she commits to implement. The decisions include such things as sending and ensuring that children stay in school, committing to building a good house for oneself; keeping families small; taking joint actions to help the community; not accepting or not giving dowry at weddings; drinking clean water; growing plants and vegetables and; keeping their children and environment clean.

The Sixteen Decisions thus become the platform around which the transformations of women's lives take place. Today, almost all the children of Grameen Bank are in school. Studies show that Grameen Bank members have a higher adoption of family planning practices, and therefore lower birth rate than non-members. Their housing is better and the use of sanitary latrines is higher than non-members. Their participation in social and political activities is higher than that of non-members. These changes reflect how seriously the members implement these decisions over years of membership in Grameen Bank.

Housing and Education

The objective of Grameen Bank is to bring sustainable improvements into the lives of the poor and to strive to respond to both economic and non-economic needs of its members. In addition to the income generation loans that it provides to all its members from the beginning, Grameen has over the years introduced other loans and savings products for its members. Two important non-economic needs that Grameen has tried to respond to are housing and education. Seeing the pitiable condition of the shelters of poor people, Grameen Bank began providing housing loans to the poor in 1984. Since then it has given out more than 5,70,000 housing loans, covering the costs of simple but sturdy building materials and sanitary latrine, to its borrowers. The homes, which serve not only as their abode but also workplace, are stronger and help resist external shocks of rain and storm that can destroy the livelihoods of the poor.

Grameen has also tried to support education in the families of its members. Five years ago, Grameen Bank did a survey of the families and found that almost all children are in schools, many of them had graduated from high school, many were in colleges and some went to medical or engineering schools and universities. Grameen immediately introduced another loan package for the children of members – student loans for higher education. Students who succeeded in reaching the tertiary level of education are given higher education loans, covering tuition, maintenance, and other school expenses.

In addition, scholarships are given to the children of Grameen members, with priority on girl children, to encourage them to get better grades in schools. Each year 5,000 children, at various levels of school education, receive these scholarships. A host of other Grameen companies, more than twenty to date, have been created to meet the diverse developmental needs of the poor. These companies have been designed with the poor people in mind, and several of them are focused on bringing information and communications technology to the poor.

Information Technology and the Poor

Globalisation and information technology have the potential to bring unprecedented opportunities for the poor. But in order to harness these opportunities, the poor have to be properly equipped. The IT companies created around Grameen have been designed keeping the very poor in mind. Grameen Phone has been created in collaboration with Telenor of Norway, and Marubeni of Japan, to provide mobile telephone service in Bangladesh. Grameen Phone is taking their services into rural areas of Bangladesh through Grameen Bank borrowers.

A Grameen borrower buys a handset with Grameen Bank financing and becomes the 'telephone-lady' of the village, selling telephone services to the villagers, in most places where even fixed lines did not exist before. In the process, she makes an income, on average, that is, higher than twice the per capita income in the country. By July 2003, Grameen had provided more than 30,000 poor people with mobile phones for income generation in villages across Bangladesh. Grameen Phone itself has become the largest mobile phone operator in south Asia, having reached 1 million subscribers in just seven years of operation.

Grameen Communications is taking internet services to rural areas to bring education, knowledge, and business opportunities to the poor. Grameen Energy is bringing solar energy in villages to provide energy for mobile phones, lighting for shops and homes. Grameen Software has been set up to bring international level IT opportunities in Bangladesh for the benefit of the poor. It is expected that shares of all these companies will one day be owned by the poor, once they can establish themselves as financially attractive companies and make good profits.

Whether the poor can afford IT or not depends not on the amount of investment needed by the poor or how complex IT is, but on the appropriateness of the institutional environment around the poor. Grameen Phone and Grameen Communications are examples of innovative institutions which bring IT to the villages of Bangladesh. Microcredit can provide an appropriate institutional environment. IT and microcredit both empower individuals, which makes them mutually reinforcing. Mobile phone operators in the villages of Bangladesh have been able to afford mobile phones because of microcredit. The same will apply for other IT services, applications and products.

Grameen Bank II

Grameen Bank has come a long way since it began in 1976. It sees itself as a dynamic organisation, one that has modified itself according to the various challenges and crises it faced, discarding along the way what became unnecessary or less effective. A big challenge for Grameen over the years has been to overcome the impact of natural disasters that frequently occur in Bangladesh. The worst of these was the 1998 floods during which half the country was under floodwater for two months. This presented a challenge to Grameen Bank and its members, which led it to bring many changes in the way it works.

Many Grameen borrowers, like many others in Bangladesh, lost most of their possessions and homes because of the flood. Grameen Bank took up a rehabilitation programme by issuing fresh loans for restarting income-generating activities and to repair or rebuild houses. But the members found the burden of accumulated loans too large and many began to default on their payments. This led the bank to consider ways to change itself so it could meet the needs of borrowers both during periods of normalcy as well as during period of crisis.

Grameen began to pilot test a new approach in its field sites in 2000 to come up with a new system which incorporated greater flexibility for its borrowers. All the staff of Grameen Bank participated actively in designing the new system and the transition to the new system was completed by August 2002. This

second-generation microcredit institution, which we call Grameen Bank II, is characterised by its custom-made credit service and greater responsiveness to the needs of its members.

Grameen Bank II has introduced custom made credit service for its members, whereas the earlier system provided a single-size-fits-all methodology. This feature gave the earlier system the simplicity it needed in the early stages. Recognising the maturity of members and the diversification of their needs, the new system introduced loans of different duration, suited to the members' needs. Staff members had limited ability in the past to accommodate the specific needs of members. Under Grameen Bank II, staff can design a loan product to make it a best fit for the client. Besides duration of loan, the size of weekly installments can be varied and borrowers can pay more during during peak business seasons, and pay less during the lean period.

The prime loan product of Grameen II is the basic loan. In addition, the housing loan, and the higher education loan run parallel to the basic loan. All borrowers start with a basic loan without any difficulty, and meet all their credit needs with the basic loan. If things do not go smoothly for the member, or if she faces some difficulty or problem in repaying the basic loan, according to the repayment schedule, there is an exit option. We call this a flexible loan, which is simply a rescheduled basic loan, with its own set of separate rules. The main difference with past practice is that borrowers are no longer seen as defaulters if they are unable to pay their loans. They have a legitimate way to remain within the folds of the organisation.

Pension Fund and Other Savings

Grameen Bank II has also introduced a range of attractive new savings products for borrowers. The group fund has been replaced by personal and special savings accounts. Grameen has also introduced a pension fund for the poor, which is leading both members and the bank to greater self reliance. Grameen Bank requires all borrowers with loans above Tk 8,000 (US \$ 138) to contribute a minimum of Tk 50 (US \$ 0.86) each month towards a pension deposit account. After 10 years, a borrower will receive a guaranteed amount which is almost double the amount she has put in during the 120 months. For borrowers, this is an attractive feature of Grameen Bank II.

Grameen Bank II has introduced loan insurance for borrowers to pay off a member's debt in the event of death. Once a year, on the last day of the year, the borrower is required to put a small amount of money into a loan insurance savings account. If a borrower dies any time during the next year, her entire outstanding amount is paid up by the insurance fund, which is created by the interest income of the loan insurance savings account. The family also gets back the amount she saved in the loan insurance savings account. This is also very attractive to members because of the cultural and religious stigma of leaving behind debt. The savings products of Grameen Bank II are enabling not only its members to become self reliant but have paved the way for Grameen Bank's own self reliance.

IV Sustainability and Institutionalisation of Microcredit

Grameen Bank's Self-Reliance

In 1995, Grameen decided not to receive any more donor funds and since that time it has not requested any fresh funds from donors. The last instalment of donor funding, which was in the pipeline, was received in 1998. Today, the bank's total outstanding loan is approximately US\$ 250 million. It finances 90 per cent of this outstanding loan from its own funds and from the deposits of its clients, over 82 per cent of whom are its own

borrowers. It does not see any need to take any more donor money or even take new loans from internal or external sources in future. Grameen's growing deposits will be more than enough to repay its existing loans and to run and expand its credit programme.

Ever since Grameen Bank came into being, it has made profits every year except in 1983, 1991, and 1992. It has successfully overcome the challenges of financing, sustainability and institutionalisation, but microcredit NGOs both in Bangladesh and in other countries still face these problems. Scaling up is a big problem for microcredit programmes of NGOs. The main barriers to scaling up to reach large numbers of poor people are the (a) absence of appropriate financing mechanisms, which will enable them to become big and sustainable, and (b) absence of a legal and regulatory framework, which will enable them to institutionalise their operations.

Delivering microcredit to the poor and the poorest still is primarily an NGO activity. They proved to be the best vehicles for the quick expansion of outreach of microcredit and they have matured in their management skills. But at the same time they have started facing new problems because they are not part of the formal financial structure. The most critical problem faced by NGOs today is finding money to lend out to the poor. One solution that Bangladesh found to this problem is to create a national wholesale fund: Palli Karma Shahayak Foundation (PKSF). The government and the World Bank put their money into PKSF, which in turn made this money available to NGOs. The reason NGOs in Bangladesh demonstrated a significant growth in recent years is because of the existence of this wholesale fund. Until the beginning of 2003, it had provided more than US\$ 260 million to nearly 200 NGOs in Bangladesh to carry out microcredit programmes.

Wholesale funds, like PKSF, also play an important role bringing standardisation and promoting best practices among microcredit programmes, and act as a pivot linking informal microcredit programmes with the mainstream financial system through financial intermediation. Wholesale funds can provide the resources needed to make microcredit programmes institutionally enabled them to become big and sustainable, and (b) absence of a legal and regulatory framework, at which point they can move to borrowing from more formal financial institutions.

Besides providing funds, wholesale funds may also provide loan guarantee services to partner organisations when they wish to borrow from banks and other sources. The most important service, however, would be to provide a guarantee for the public deposits collected by a partner organisation. A wholesale fund can persuade the central bank to allow the partner organisations to collect public deposits upto a limit, with its guarantee. This will open up a new source of funding for the partner organisations. Introducing a deposit insurance programme to cover the deposits in NGO microcredit programmes can be another solution. An NGO may be allowed to take public deposits provided they are 100 per cent covered under this insurance programme. Wholesale funds may organise such a programme in collaboration with the central bank, insurance companies or government agencies. The most important responsibility of the wholesale funds is to help partner organisations become formal microcredit organisations within a new legal framework.

Legal Framework for Microcredit Programmes

The absence of a legal framework for microcredit programmes continues to be a big constraint in their expansion. Microcredit institutions operate in a variety of institutional structures – NGOs, trusts, non-bank finance corporations, banks, financial companies, and so on. Programmes that have reached scale and wish to convert themselves into financial institutions are unwilling to do so because of requirements that are inappropriate for the work they are doing.

It would be useful to design the general framework of a law for setting up microcredit banks, the core elements of which can

be applied or adapted in each country. Leading NGOs running microcredit programmes have now reached a stage of development where they may seriously consider the pros and cons of converting themselves into formal financial institutions, if conducive laws are available to them. Grameen Bank became a formal bank back in 1983 under a special law passed by the parliament which I have argued should be generalised to allow NGOs in Bangladesh to create formal banks.

If the above type of legal framework is created, NGOs will come forward and convert some of their branches into micro finance banks (MFBs) while keeping the bulk of their operations under the NGO format. Transforming NGOs into MFBs is the only way to self-reliance for microcredit programmes. Creating MFBs can strengthen the financial system of a third world country by filling in the vacuum left by conventional banks, and giving a boost to the emergence of a local level grass roots economy.

Once a microcredit programme is legally allowed to accept public deposits, it can immediately solve the problem of sourcing funds for the expansion of the programme. Under the policies adopted in Grameen Bank II, new branches are financed entirely with deposits mobilised within the locality served by the branch. Grameen Bank can mobilise deposits because it is a formal bank; the NGOs in Bangladesh and in other countries cannot take deposits because NGO law does not support it. Microcredit can be funded locally at the village level, provided the legal framework is created to allow microcredit programmes (MCP) to accept public deposits. If this legal framework is created, donor funding, which has been declining steadily, can be reserved only for start-ups and to shoehorn NGO-MCPs to graduate into microcredit banks, and provide training, research and development and other technical support.

There are many NGO-MCPs with over 1,00,000 microcredit borrowers. In Bangladesh, several NGOs have more than a million borrowers. It is not easy to run large microcredit programmes when the prime source of money is donor money. The paradox of the situation is that many of these NGOs operate within areas where there is plenty of money around. They can easily access it if only they were allowed. Not only are they not allowed to take public deposits, in many countries they are not even allowed to take savings from their own borrowers. A legal framework to create an enabling environment for NGOs to convert themselves into microcredit banks will change the whole microcredit scenario.

Simultaneously a regulatory body should also be created to oversee the operation of microfinance banks and to facilitate their activities. The microfinance regulatory body should be independent from the central bank, but with participation of the central bank. This will create an environment in which microcredit institutions will queue to become formal microfinance institutions.

V Conclusion

The United Nations Millennium Summit in 2000 courageously adopted the Millennium Development Goals. The most bold and important of these goals is halving world poverty by 2015. We can only achieve this goal if we are able to make the adequate institutional, financial, and policy preparations for it. An important part of this preparation is to make microcredit available to the bottom half of the world's population. The experience of Grameen Bank in Bangladesh and other programmes like it, shows that microcredit is effective in helping poor people to use their own efforts and creativity to meet their basic needs. This can also be done on a sustainable basis. The next five years will be very critical for us in setting the stage to achieve the target of poverty reduction by 2015. I firmly believe that the world can actually achieve this target, provided we get serious about it. [37]

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