
One of the biggest problems facing the poor is access to credit. For the poor urban peddler, access to credit can mean a chance to build a bigger inventory, so she has items on hand when customers request them, and can eventually move from the insecurity of being a petty street hawker to the stability of being an established vendor. For the poor rural peasant, access to credit can mean a chance to purchase tools, a draft animal, and small capital goods that can enable him to greatly improve his productivity, diversify crops and move toward commercial farming by producing some cash crops for the market, and eventually move from marginal peasant or landless agricultural laborer to established commercial farmer. For the poor rural landless laborer, access to credit can mean a chance to learn skills, purchase raw materials (such as cloth) and tools (such as a sewing machine), and eventually move from the edge of survival to established business person. The Grameen Bank of Bangladesh is an excellent illustration of how this credit can be provided to those who need it, while minimizing the risk that resources will be wasted.

The Grameen Bank was conceived by Muhammad Yunus, a former Chittagong University economics professor, as a private nonprofit development "action and research project." Professor Yunus had become convinced from his research that the lack of access to credit on the part of the poor was a binding constraint on their economic progress, a conclusion that has been confirmed by later studies from around the developing world. Yunus wanted to demonstrate that it was possible to lend to the poor without collateral, and to determine the best system for doing so.

Yunus said in an interview that "all human beings are born entrepreneurs. Some get the opportunity to find this out, but some never get this opportunity. A $5 loan can be a ticket to exploration of personal ability. All human beings have a skill—the survival skill. The fact that they are alive proves this. Just support this skill and see how they will choose to use it."

Yunus began the operation in 1976 with—at least as legend has it—a capitalization of just $30. He was able to convince the Bangladesh agricultural development bank (BKB) to provide some initial loan money. The first loans through BKB were guaranteed personally by Yunus. A series of expansions convinced the government of Grameen's value, and the Grameen Bank was formally incorporated under government charter in 1983. The Bank continued to grow very rapidly and now has well over 1000 branch offices throughout the country and over two million members. The branch office, covering 15 to 20 villages, is the basic organizational unit, and is responsible for its profits and losses.
Since its founding, the public-cooperative Grameen Bank has enabled over two million poor Bangladeshis to start or upgrade their own small businesses. Most of these borrowers are virtually landless, and today some 95% of the borrowers are women. Borrowers are generally limited to those who own less than one half acre. Representatives of Grameen branches often go door to door in the villages they cover to inform people, who are generally illiterate and very reticent about dealing with banks, about Grameen's services.

Before opening a new branch, the new branch manager is assigned to prepare a socioeconomic report covering the economy, geography, demography, transportation and communication infrastructure, and politics of the area. Among other things, this ensures that a branch manager becomes familiar with the region and its potential borrowers before the branch begins operations.

Grameen, which alternatively means "rural" or "village" in Bengali, is incorporated as a publicly supported credit union, with borrowers owning 75% of the bank's stock and the government owning the remainder. Once borrowers reach a certain borrowing level, they are entitled to purchase one share of Grameen stock. The bank sets its own policy with strong borrower input, independent of government control. Grameen's total annualized interest rate on its basic, 'working capital' loans has been kept at 20%. The current rate of interest on home loans is 8% (Grameen has been promoting home ownership and states that its home loans are cross-subsidized by its working capital loans). The average annual inflation rate in Bangladesh has been falling over time; it was about 9.6% in the 1980s, falling to about 4.1% for the 1990s, thus the real interest rate appears to have been rising over time.

Grameen's 20% loans can be compared with traditional moneylenders' loansharking rates of 120 to 200%. These moneylenders generally have a great deal of monopolistic power. Sometimes, though by no means always, they use extraeconomic coercion to get peasants to borrow from them at these high rates of interest and to ensure repayment; built into these moneylenders' rates are such costs as wages for maintaining thugs who enforce the moneylenders' dictates. These rural moneylenders' interest rates are not the result of competitive market forces. True, the traditional system may not be as inefficient as some writers have claimed. Because they are locally based, even though they do not move in the same social circles as low-income borrowers, these lenders have access to information about the credit-worthiness of borrowers that would be very hard for traditional banks to obtain. But one of the beauties of the Grameen Bank is that it trumps these moneylenders' informational advantages by using information held by the close peers of the borrowers.
Moreover, Grameen does not just substitute for existing moneylenders. Not only do few Grameen borrowers ever receive loans from formal borrowers, but it has been estimated by Grameen that only about one-fifth are served by the informal lenders. Another two-thirds can sometimes get small interest-free loans from relatives or friends. The remainder have had no access to any form of credit. However, as microfinance has caught on in Bangladesh following the Grameen example, it is now increasingly common for a typical Grameen borrower to have available potential loans from other nongovernmental organizations offering credit, such as the Bangladesh Rural Advancement Committee. A significant percentage of Grameen borrowers also borrow from other microfinance institutions.

To qualify for uncollateralized loans, potential borrowers form five-member groups. Each member must undergo a two-week training session before any member can secure a loan, and the training sessions are followed up with weekly group meetings with a bank officer. Grameen relies on what could be called the "collateral of peer pressure." Once a member of the group receives a loan, no other member may borrow until a regular repayment record has been established; and no repeat loans are approved until all members' accounts are settled. Members know the characters of group members, and only join groups with members they believe likely to repay their loans. Dr. Yunus recently said that the credit-worthiness of the poor is now established beyond doubt, and the real "question is whether banks and credit institutions are people-worthy."

A significant proportion of new borrowers pay installments in advance, presumably to qualify quickly for a larger loan. The five-person group size was not decided arbitrarily, nor on prior insight, but on the basis of experimentation. Initially, loans were awarded directly to individuals, but this required too much staff time to control the use and repayment of the loan. After the idea of mutual responsibility was developed, large groups of 10 or more were tried at first, but this proved too large for intimate and informal peer to peer monitoring to be effective. Groups of five proved in practice to work best.

Peer oversight has contributed to Grameen's impressive ultimate repayment rate of over 90%. Grameen’s website has proclaimed a 98% repayment. However, the exact percentage of loans in default is a source of dispute, with claims that some nonperforming loans are effectively rolled over to keep the repayment rates high. The issue boiled over after a 2001 Wall Street Journal article critical of the Bank. Certainly, Grameen faced major losses after the catastrophic 1998 Bangladesh floods. But an alternative interpretation of Grameen’s recent difficulties would be to note that it is remarkable that any bank could survive such a hit. Many predicted Grameen’s
demise was a real possibility in the aftermath of the floods, as the Financial Times noted with alarm on October 1, 1998 in an article and editorial. The Grameen Bank borrowed substantial funds from public and private sources after the floods, to provide fresh loans to borrowers who lost assets. The Grameen website claims that all these post-flood loans have been fully paid off. In any case, most critics acknowledge that the Grameen repayment rate has otherwise remained at least relatively high. By contrast, the country as a whole has a repayment rate of 30 to 40%, and the Industrial Bank of Bangladesh has been infamous for having almost all of its loans to the relatively wealthy in default. The list of defaulters is said to read like a "Who's Who in Bangladesh." Still, Grameen’s small capital base remains a concern.

Group members are trained in such practical matters as bank procedures, the group savings program, the role of the center chief and the chairperson of the 5-member group, and even how to write their signatures. In addition, training has a moral component, stressing the Bank's 16 principles, or "Decisions," to be adhered to by each member. These Decisions were formulated in a national conference of 100 female center chiefs in 1984. They emphasize modern values, including self-discipline and hard work, hygiene, refusal to participate in backward practices like demanding brid al dowries, and mutual assistance. Adherence to these principles and attendance at rallies featuring the chanting of the Decisions are not formal requirements for receiving loans, but they are said to have become effective, implicit requirements.

Here is a sample from the 16 Decisions: #3- We shall not live in dilapidated houses. We shall repair our houses and work toward constructing new houses as soon as possible. #4- We shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus. #6- We shall plan to keep our families small. #8- We shall always keep our children and the environment clean. #11- We shall not take any dowry in our sons' weddings, neither shall we give any dowry in our daughters' weddings. We shall not practice child marriage. #13- For higher income we shall collectively undertake higher investments. The full list, with their pictorial presentation for villagers, may be found on the Grameen website at www.grameen.org.

There has been a major debate in the microfinance community about whether microcredit institutions should just make loans or also engage in other social development activities. Grameen is usually grouped among the minimalist institutions, but the 16 Decisions show that there is a much broader social component at Grameen as well. Other institutions have sought to actively combine other very different activities. Examples include Freedom From Hunger, which has combined credit with its basic education campaigns, and Project Hope, which has combined credit with its maternal and child health campaigns.
Much has been written anecdotally about the structure of the Grameen Bank and the beneficial impact it has had on the lives of its members. But the most solid quantitative information we have of the effects of the Grameen Bank has come from surveys conducted by Mahabub Hossain for the International Food Policy Research Institute.

The group structure facilitates the formation of cooperatives or joint ventures among the participants, encouraging ventures too large or too risky for poor individuals to undertake alone. Grameen also works to facilitate the accumulation of savings among its members through savings requirements or incentives for its borrowers to save. Hossain found that the working capital of borrowers tripled on average within 27 months.

Loans are only made for income-generating activities and have financed a wide range of activities, most of them not based on crop production. Activities financed have included dress (sari) weaving, shoe repair, livestock and poultry raising, small-scale food processing, rice trading, and grocery shopkeeping. Mahabub Hossain found that 46% of loans went to livestock and poultry raising, 25% for processing and light manufacturing, and 23% for trading and shopkeeping; thus almost no loans went to finance farm crop activities.

Opportunities for expansion of agricultural activities are limited in Bangladesh. About two-thirds of its 56,000 square miles is under cultivation, and the cost of expanding into the remaining uncultivated area is excessively high. Nearly three-quarters of the labor force is already working in agriculture, and opportunities for women are especially limited. Small scale "microentrepreneurship" offers the best opportunity for most of the functionally landless rural poor to improve their economic circumstances. In addition, it is difficult to operate the weekly or biweekly loan repayment system with loans for agriculture, which normally yield a return only at the end of a crop cycle. The Grameen Bank's focus on rural women microenterprise borrowers is probably optimal, providing the highest marginal social benefits under the conditions found in rural Bangladesh.

Starting loans are typically for about $50. The average loan size in 1994 was $140, over half the annual income of many borrowers. In 1995, loans over $100 were common, but generally did not exceed $300. Loans have generally reached the absolutely poor. Hossain found that only 4.2% of borrowers own as much as a half acre of cultivatable land. The average income of borrowers has been found to be about half the national average. Though incomes of most borrowers remain below the poverty line, they get much closer to the line. In other words, Grameen
has only slightly reduced poverty by the headcount measure, but has significantly reduced it by the
poverty gap (or income shortfall) measure (for details on poverty measures and their properties,
see Todaro and Smith, chapter 6).

Grameen borrowers have had notable success in capital accumulation. Cattle raising is a
major activity of borrowers. Hossain found that the number of cattle owned increased by 26% per
year. Though the numbers involved are small—going from 61 per 100 borrowers before becoming
a Grameen member to 102 per 100 borrowers at the time of the survey—these are impressive
improvements for Bangladesh's absolutely poor.

But completely landless agricultural laborers appear to remain significantly
underrepresented in the pool of borrowers: Hossain found that they represent 60% of Grameen's
target group but only 20% of its actual borrowers—and this includes those who reported hired
agricultural labor as a secondary economic activity as well as those who reported it a primary
economic activity. There is certainly a stigma attached to being from an agricultural-labor
household, and its incidence among borrowers could perhaps be understated—though likely not
by much given Grameen's good information about its borrowers. In any case, to be both landless
and an agricultural laborer by occupation is to be among the very most downtrodden groups in any
developing country. Note that in Bangladesh, most laborers own a small plot of land for their house,
but too little to form the basis for a viable farm. Some 60% of Bangladeshis are "functionally
landless" in this sense.

But underreaching the hired agricultural laborers is probably not the fault of the Grameen
Bank. Landless farm laborers are extremely hard to reach for any development program in any
country. They also tend to be the least educated and are probably the least well prepared to move
into viable entrepreneurial activities. The fact that the Bank has reached as many landless farm
laborers as it has is itself very impressive. These laborers also benefit indirectly from the general
development that Grameen affords, as it raises demand for labor and reduces the supply of
agricultural labor. They will need other services besides those the Grameen can provide. But they
must be the target of renewed, concerted aid efforts.

Grameen makes some loans to finance cooperative enterprises as well as to individuals.
The goal is to take advantage of economies of scale and make the use of more modern techniques
financially feasible. Though the share of such loans has been well under 10%, it has financed some
of the most impressive undertakings, including the purchase and use of power looms, rice hullers,
oil mills, and irrigation machines. But both the Bank and its borrowers have lacked the technical
expertise to make these activities viable, and this is an area of needed improvement.

Grameen's emphasis on serving poor women is especially impressive. According to Hossain's survey, half the women borrowers said they were unemployed at the time they became Grameen members (compared with less than 7% of the men). The share of women among borrowers has climbed steadily over the years and reached 94% by the end of 1995.

Is Grameen subsidized, and how much subsidy makes sense? Some argue against subsidies, so that as many total loans can be made as possible, ploughing back all the profits into new loans. Others argue that the poorest of the poor cannot afford to borrow at unsubsidized rates because they do not yet have access to sufficiently profitable activities. Jonathan Morduch offers an excellent discussion of the issues in his essay, The Microfinance Schism.”

Costs at the Grameen Bank are quite high by commercial bank standards. They have been estimated at 26.5% of the value of loans and advances. This is some 10% higher than the nominal interest rate charged, or 39% of the costs of lending are subsidized from all sources. Adding in estimated opportunity costs, Hossain has calculated an effective subsidy of 51%. But also note that about half of the excess of costs over interest receipts are attributable to the expense of opening new branches, which should be treated as a capital cost.

These high cost numbers indicate at first glance that there is room for greater economy measures. But it may also indicate that interest rates charged borrowers are at least 10 percentage points too low. We have seen that these rates are only about a tenth that charged by traditional moneylenders and that repayment rates are over 90%. Most borrowers would already be better off paying an interest rate of, say 27%, because they are either paying far more already; or they may have to rely on loans from family members that have a high opportunity cost even if no interest is paid, and that may not always be available; or the poor simply have no source of borrowing at all. Only comparatively few current borrowers may be expected to find their investments no longer profitable at a modestly higher interest rate. Note that small loans will always be more costly per dollar lent than large loans.

However, there is no doubt that a public subsidy of Grameen loans is justifiable on the basis of the loans’ effect on absolute poverty alleviation and other positive externalities. Ideally, these benefits should be quantified to get a better handle on the level of subsidy that can be supported on efficient grounds. Since funds for subsidies are limited, the more the subsidy per loan, the less subsidized loans can be made. There may be some combination of reduced operating costs, modest
increases in interest rates, and continued subsidy that is optimal for creating the most welfare gains with the available resources.

A small loans development bank like Grameen may be a vital—if not necessary—condition for improving the well-being of the poor. But it is not a sufficient condition. Bangladesh suffers many tornados and excessive floods. For example, in 1992 up to 200,000 people died in flooding following a major cyclone. For the survivors, these recurrent disasters can also wipe out years of economic progress nurtured by Grameen. As noted earlier, the devastating 1998 floods presented a particularly vivid illustration of this problem, when many microenterprises were wiped out, with a major impact on Grameen itself. Among other things, this shows that small-scale, private sector oriented projects like Grameen are not enough and must be undertaken in conjunction with large-scale projects like Bangladesh's flood control project. The implication is not that large-scale, infrastructure oriented projects should be abandoned in favor of small-scale ones, but that the two must be made to work together. Neither offers a sufficient development strategy by itself.

Only about 9% of the formal labor force in Bangladesh are women, a figure that has risen little over the past decades. The Grameen Bank has proven itself one of the few effective attempts to involve poor women in economic activities. Women borrowers have higher repayment rates than men, and are more likely to spend their increased income on their children's welfare. Rising women's incomes, self-esteem, and business clout has begun to cause some backlash in the conservative Islamic culture of rural Bangladesh, in which under the Purdah system women are expected to be secluded from social activities. Grameen and other programs, such as the nontraditional schools run by the Bangladesh Rural Advancement Committee, are seen as a challenge to this traditional status quo, over which men have traditionally presided. Schools have been burned, and women have been driven out of their villages and worse for challenging traditional cultural norms, including participating in market activities. Yunus has stated that some husbands have viewed Grameen as a threat to their authority. In some cases "the husband thought we had insulted him and were destroying his family. We had cases of divorce just because the woman took loans." A leading fundamentalist cleric in Dhaka was quoted in the Washington Post as saying, "We have no objection to improving the lot of women, but the motives of the Grameen Bank and other organizations are completely different. They want to eradicate Islam, and they want to do this through women and children." The future of the Grameen Bank will depend on a creative response to this difficult environment of economic and cultural change.

Despite challenges, today the Grameen Bank continues to break new ground in development projects. In a strikingly original scheme, a Grameen Telecom subsidiary has recently
been established, with the participation of Norwegian and Japanese telecommunications companies. The business plan is simple: to provide the poorest woman in each village with a cellular phone. Most of these villages are still without a phone system. "Now you may wonder," says Dr. Yunus, "what would the poorest woman in such a Bangladesh village want with a cellular phone? Well, everyone in the village who wants to make a call will have to come to her." The Grameen Bank is also pioneering a low-cost cooperative health insurance scheme, in which an annual fee of $1.25 provides half of the health costs for an entire family for a variety of services. Today Grameen has a large number of additional ventures, including other telecommunications, software, computing, insurance and other financial service ventures, and basic manufacturing, as outlined on the Bank’s webpage. This may ultimately prove a two-edged sword. Clearly, Grameen is attempting to fill niches that have gone unattended among the poor, or in the Bangladesh economy as a whole. But there is a risk the Bank may lose its original focus, while faring poorly in one area may adversely affect other areas. This will bear watching closely in the future.

The general value of the Grameen experience depends on whether it can be replicated and sustained. Its replicability has already been demonstrated in good measure both in Bangladesh and outside it. It has spread to villages in several regions of the country. Even so, it has still only covered less than 5% of its target group in Bangladesh. Only time will tell whether Grameen can continue to expand at its previous impressive rates. Of course, while the goal of a village banking system like Grameen must be to work itself out of a job, realistically millions of Bangladeshis will remain poor for several decades to come under the very best assumptions. But today, Grameen has many competitors in Bangladesh, including offerings from the highly rated Bangladesh Rural Advancement Committee (BRAC), as well as some less solid alternatives. While posing potential problems for institutional stability, such competition has probably benefited many of the poor.

Though on a smaller scale, other developing countries have benefited from imitating the Grameen Bank, including Malaysia, Sri Lanka, and Malawi. International organizations such as FINCA and ACCION have spawned microcredit systems in dozens of countries. The World Bank and other aid agencies have begun to pour money into the programs, and as suggested earlier many NGOs have integrated or at least supplemented their traditional work in areas such as education, health, and advocacy with microcredit programs. The Grameen approach has even been borrowed with some success as a model by some of America's inner cities, as Lewis Solomon has chronicled.

Of course, it would be unrealistic to expect Grameen to be replicable everywhere. For example, training and oversight activities are very labor-intensive, and would be hard to operate efficiently with a highly dispersed population without viable roads, let alone communications.
Corruption might engulf similar activities elsewhere. But although none of the existing replications have yet demonstrated that they can approach Grameen's scale and durability, their benefits to date are substantial. Grameen's own sustainability seems clear with a solid track record of over two decades.

No discussion of replicability and sustainability would be complete without noting that Grameen has greatly benefited from the dedication of the motivated and idealistic bank staff. The Grameen Bank "organizational culture" emphasizing service to the genuinely poor has helped maintain honorable attitudes. Importantly, staff incentives are also maintained: quick promotions have been regularly awarded to those whose performance in the field has been exemplary.

A major key to Grameen's sustainability will be to keep high motivation, anti-poverty orientation, and rewards for good work intact, and to guard against the lethargy, arrogance, and corruption that mar so many other developing country bureaucracies and quasi-public financial institutions. A system of cooperatives begun among rickshaw pullers in the 1960s and once considered a model for the country lost its vitality after it was taken over by the government in the 1970s. Grameen's continued independence may be essential to its future success.

Finally, the role of a dedicated founder like Muhammad Yunus cannot be underestimated. Dr. Yunus is a man of great ability who might have made much more money in other endeavors. Such leaders can never be fully paid for the value their works add to society, but for some potential leaders of this caliber, the prestige and renown they gain from their works might be an added incentive to pursue an altruistic career combining compassion and competence. In this case, ordinary development scholars can perhaps do no better service than to publicize their achievements.
Sources


Grameen Bank webpage, www.grameen.org


Yunus, Muhammad, and Alan Jolis *Banker to the Poor: Micro-Lending and the Battle Against World Poverty,* New York: PublicAffairs (1999)