



Microcredit:

Banking With the Poor Without Collateral

Muhammad Yunus*

Unjust System

I have long argued that poor people remain poor not because of any fault of their own, but because we have designed institutions and policies that keep them poor. No matter how hard they try or how hard they work, they remain trapped in poverty because of these institutions and policies. A major example of this is the financial institutions that we have created all over the world - two thirds of the world's population do not have access to financial services from the conventional financial institutions. That we systematically exclude poor people from financial services is tantamount to financial apartheid. By providing financial services to the very poor and poorest on terms that are suited to them, i.e. microcredit, in its essence, challenges this unjust system.

Grameen Bank

I became involved in the poverty issue not as a policymaker or a researcher, but because poverty was all around me. In 1974, I found it difficult to teach elegant theories of economics in the classroom in the backdrop of a terrible famine in Bangladesh and wanted to do something immediate to help people around me. That brought me to the issue of poor people's struggle and helplessness in finding microscopic amounts of money in support of their efforts to eke out a living.

I was shocked to discover a woman borrowing US \$ 0.25 with the condition that the lender will have the exclusive right to buy all she produces at the price the lender decides ! I decided to make a list of the victims of this money-lending "business" in the village next door to our campus. When my list was

done it had the names of 42 victims. Total amount they borrowed was US \$ 27 ! I could not think of anything better than offering this US \$ 27 from my own pocket to get the victims out of the clutches of the moneylenders. The excitement that was created by this action got me further involved in it. The question that arose in my mind was, if you can make so many people so happy with such a tiny amount of money, why shouldn't you do more of it ?

I have been trying to do just that ever since. First thing I did was to try to connect the poor people with the bank located in the campus. It did not work. The bank said that the poor are not creditworthy. After all my efforts over several months failed I offered to become a guarantor for the loans to the poor. I was stunned by the result. The poor paid back their loans every single time ! But I kept confronting difficulties in expanding the programme through the existing banks. Several years later I decided to create a separate bank for the poor to give

* Professor Muhammad Yunus is the Managing Director, Grameen Bank, Bangladesh. This is the text of the speech delivered by him at the SAARCFINANCE Governors' Symposium on Microcredit held at Dhaka on February 15, 2006 under the aegis of Bangladesh Bank.

loans without collateral. Finally in 1983 I succeeded in doing that. I named it Grameen Bank (GB) or Village Bank.

Grameen Bank in 2006

Today, Grameen Bank is reaching 5.7 million poor borrowers, 96% of whom are women. The bank is owned by the poor borrowers. Grameen Bank has 1,736 branches working in 90 per cent of the villages in Bangladesh. Total staff is nearly 17,000. The total amount of funds disbursed is US\$ 5.25 billion. Out of this, US\$ 4.83 billion has been repaid. Current amount of outstanding loans stands at US\$ 425 million. From January to December, 2005 Grameen Bank disbursed US \$ 612 million. Monthly average loan disbursement over the past 12 months was US \$ 51 million.

Projected disbursement for 2006 is US \$ 821 million, i.e. monthly disbursement of US \$ 68.40 million. End of the year outstanding loan is projected to be at US \$ 600 million. The loan recovery rate is 99.01%.

No External Funds Needed

Grameen Bank finances 100 per cent of its outstanding loan from its deposits. Over 64 per cent of its deposits come from bank's own borrowers. Deposits amount to 113 per cent of the outstanding loans. If we combine both deposits and own resources it becomes 135 per cent of loans outstanding.

In 1995, GB decided not to receive any more donor funds. Since then, it has not requested any fresh funds from donors. Last installment of donor fund, which was in the pipeline, was received in 1998. GB does not see any need to take any donor money or even take loans from local or external sources in future. GB's growing amount of deposits is more than enough to run and expand its credit programme and repay its existing loans.

By the end of December, 2005 total deposit in Grameen Bank stood at US\$ 481.22 million. Member deposit constituted 64 per cent of the total deposits. Balance of member deposits has increased at a monthly average rate of 3.83 per cent during the last 12 months.

Ever since Grameen Bank came into being, it has made profit every year except in 1983, 1991, and 1992. It has published its audited balance-sheet every year, audited by two internationally reputed audit firms of the country.

How is Grameen Bank Different From Other Banks?

Grameen Bank methodology is almost the reverse of that of conventional banking. Conventional banking is based on the principle that the more you have, the more you can get. In other words, if you have little or nothing, you get nothing which is why more than two thirds of the world's population has no access to financial services of the conventional banks. Conventional banking is based on collateral, Grameen system is collateral-free.

Grameen Bank starts with the belief that credit should be accepted as a human right, and builds a system where one who does not possess anything gets the highest priority in getting a loan. Grameen methodology is not based on assessing the material possession of a person, it is based on the potential of a person. Grameen believes that all human beings, including the poorest, are endowed with endless potential.

Conventional banks look at what has already been acquired by a person. Grameen looks at the potential that is waiting to be unleashed in a person. Overarching objective of the conventional banks is to maximize profit. Grameen Bank's objective is to bring financial services to the poor, particularly women and the poorest — to help them fight poverty, stay profitable and financially sound. It is a composite objective coming out of social and economic visions.

High Priority to Women

Conventional banks focus on men, Grameen gives high priority to women. 96 per cent of Grameen Bank's borrowers are women. Grameen Bank works to raise the status of poor women in their families by giving them ownership of assets. It makes sure that the ownership of the houses built with Grameen Bank loans remain with the borrowers, i.e., the women. Conventional banks are owned by the rich, generally men. Grameen Bank is owned by poor women.

Grameen Bank branches are located in the rural areas, unlike the branches of conventional banks which try to locate themselves as close as possible to the business districts and urban centers. First principle of Grameen banking is that the clients should not go to the bank, it is the bank which should go to the people instead.

Grameen Bank's staff meet every one of the borrowers at their door-step spread out all over Bangladesh, every week, and deliver bank's service. Repayment

of Grameen loans is also made very easy by splitting the loan amount in tiny weekly installments. Doing business this way means a lot of work for the bank, but it makes it very convenient for the borrowers.

No Legal Instrument

There is no legal instrument between the lender and the borrower in the Grameen methodology. There is no stipulation that a client will be taken to the court of law to recover the loan, unlike in the conventional system. There is no provision in the methodology to enforce a contract by any external intervention.

Conventional banks go into 'punishment' mode when a borrower is taking more time in repaying the loan than it was agreed upon. They call these borrowers "defaulters". Grameen methodology allows such borrowers to reschedule their loans without making them feel that they have done anything wrong.

When a client gets into difficulty, conventional banks get worried about their money and make all efforts to recover the money, including taking over the collateral. Grameen system, in such cases, works extra hard to assist the borrower in difficulty, and makes all efforts to help her regain her strength and overcome her difficulties.

Interest Cannot Exceed Principal

In conventional banks charging interest does not stop when a borrower gets into trouble and cannot make the payments any more. (Sometimes exceptions are made only to some privileged loan defaulters.) As a result, interest charged on a loan can be a multiple of the principal, because the borrower has lost the capacity to repay the loan. In Grameen Bank this cannot happen. Charging interest will stop at a pre-determined maximum, if the borrower cannot pay back the loan. This maximum is equivalent to the principal amount of the loan. If the borrower has already paid it, no more interest will be charged. Interest on conventional bank loans are generally compounded quarterly, while all interests are simple interests in Grameen Bank.

Gives Scholarships and Student Loans

Conventional banks do not pay attention to what happens to the borrowers' families as results of taking loans from the banks. Grameen system pays a lot of attention to monitoring the education of the children (Grameen Bank routinely gives them scholarships and student loans), housing, sanitation, access to clean drinking water, and their coping capacity for meeting disasters and emergency situations. Grameen system helps the borrowers to build their own pension funds, and other types of savings.

In case of death of a borrower, Grameen system does not require the family of the deceased to pay back the loan. There is a built-in insurance programme which pays off the entire outstanding amount with interest. No liability is transferred to the family.

Lends to the Beggars

In Grameen Bank even a beggar gets special attention. A beggar comes under a campaign from Grameen Bank which is designed to persuade him/her to join Grameen programme. The bank explains to her how she can carry some merchandise with her when she goes out to beg from door to door and earn money, or she can display some merchandise by her side when she is begging in a fixed place. Grameen's idea is to graduate her to a dignified livelihood rather than continue with begging. To date, nearly 70,000 beggars have been reached. Such a programme would not be a part of a conventional bank's work.

Sixteen Decisions

Grameen system encourages the borrowers to adopt some goals in social, educational and health areas. These are known as "Sixteen Decisions" (no dowry, education for children, sanitary latrine, planting trees, eating vegetables to combat night-blindness among children, arranging clean drinking water, etc.). Conventional banks do not see this as their business.

Housing and Microenterprise

Grameen Bank introduced housing loan in 1984. It became a very attractive programme for the borrowers. Maximum amount given for housing loan is US \$ 249 to be repaid over a period of 5 years in weekly installments. Interest rate is 8 per cent. 627,058 houses have been constructed with the housing loans averaging US \$ 202. A total US \$ 127 million has been disbursed for housing loans.

Many borrowers are moving ahead in businesses faster than others for many favourable reasons, such as, proximity to the market, presence of experienced male members in the family, etc. Grameen Bank provides larger loans, called micro-enterprise

loans, for these fast moving members. There is no restriction on the loan size. So far 668,389 members took micro-enterprise loans. A total of US \$ 235.00 million has been disbursed under this category of loans for purchasing a truck which is operated by the husband of the borrower. Power-tiller, irrigation pump, transport vehicle, and river-craft for transportation and fishing are popular items for micro-enterprise loans.

Scholarships and Student Loans

Scholarships are given, every year, to the children of Grameen members, with priority on girl children, to encourage them to get better grades in schools. Each year, about 9,000 children, at various levels of school education, receive these scholarships.

Students who succeed in reaching the tertiary level of education are given higher education loans, covering tuition, maintenance, and other school expenses. By December 2005, 8,926 students received higher education loans, of them 8,294 students are studying at various universities; 99 are studying in medical schools, 211 are studying to become engineers, 322 are studying in other professional institutions.

Telephone-Ladies

To-date Grameen Bank has provided loans to 187,187 borrowers to buy mobile phones and offer telecommunication services in nearly half of the villages of Bangladesh where this service never existed before. Telephone-ladies run a very profitable business with these phones and play an important role in the telecommunication sector of the country, while generating revenue for Grameen Phone, the largest telephone company in the country.

Progress in Bangladesh

In the last 15 years, Bangladesh has made significant achievements in terms of human,

economic and social indicators. GDP growth has been over 5 per cent. Bangladesh birth rate has declined significantly. Fertility rate declined from 6.3 in 1975 to 3.3 in 1999 - 2000 reduced almost to half. Life expectancy of women in Bangladesh used to be lower than men, but is now higher.

Child and infant mortality have been falling at more than 5% a year, malnutrition among mothers has fallen from 52% in 1996 to 42% in 2002. In the past decade, Bangladesh reduced infant mortality by half — at a rate faster than any other developing country has done.

Primary school enrolment rates have reached 90%, up from 72% in 1990.

Enrolment in secondary education has been rising. Bangladesh has already eliminated gender disparity in primary and secondary school enrolment and has made remarkable progress in providing universal basic education.

Bangladesh has outstanding accomplishment in reducing child labour. According to UNICEF, percentage of child labour in Niger is the highest (66%). Bangladesh has one of the lowest percentages (7%). Nepal is 31%, India 13%.

Female labour force participation rate increased dramatically between 1983 and 2000, both for rural and urban, with sharper increase in rural, than in urban.

Bangladesh is cited as a success story in producing enough food to feed her people despite doubling the population in 35 years, remembered as the country which gave the world oral saline to combat diarrhea and internationally respectability by demonstrating her skill and efficiency in disaster management.

Not only is Bangladesh recognized as the birth-place of microcredit, it is also the home of the largest microcredit program as well as the country with the largest number of such program. Over 15 million poor borrowers are reached by microcredit in Bangladesh, representing about half of the country's population.

One of the reasons for this rapid expansion of microcredit in Bangladesh is due to the Palli Karma Shahayak Foundation (PKSF) which has financed microcredit programs throughout Bangladesh.

This progress has helped Bangladesh move steadily towards achieving Millennium Development Goals (MDG). According to data on current trends, Bangladesh has either met or is expected to meet most of the MDG targets. If right policies are pursued dedicatedly there is a good chance that Bangladesh will reduce poverty by half by 2015.

Microcredit Worldwide

Grameen philosophy and methodology have spread around the world. Microcredit Summit of 1997 set the goal to reach 100 million poorest families

with microcredit by 2005. Although we do not have the final figures, obvious from the trend that we have crossed that number by the end of 2005.

Two new goals have been set by the Summit Campaign for phase II to be achieved by 2015, coinciding with the year set to achieve the Millennium Development Goals. First goal is to ensure that 175 million of the world's poorest families, especially the women of those families, are receiving credit for self employment and other financial and business services by the end of 2015. With the average of five in a family, this would affect 875 million family members.

A second goal of the campaign is to ensure that 100 million of the world's poorest families move from below US\$ 1 a day to above US\$ 1 a day by the end of 2015. With an average of five per family, this would mean that 500 million people would have risen above US\$ 1 a day, nearly completing the Millennium Development Goal on halving absolute poverty.

Grameen Trust For Grameen Replication Worldwide

Many global initiatives have been established to spread microcredit. Grameen Trust (GT) is an international wholesale fund that was created in 1989 to provide support to start Grameen replications in other countries. Grameen Trust started providing start-up money for projects all around the world since 1991. Grameen Trust provided loan funds, operational funds, training, and technical assistance which enabled these projects to establish their programmes, build track records, and eventually source funds locally and internationally.

Funded by donors to-date, Grameen Trust has supported 137 programs in 37 countries in Asia and the Pacific, Africa, Latin America and Europe. GT has approved nearly US\$ 21 million as loans to these partner organizations, who in turn have disbursed US\$ 1.34 billion to more than 2.7 million poor borrowers, 99% of whom are women, in these countries. If we assume that each family has five members, then GT's support has impacted 13.5 million very poor people in these countries. Most of GT's partner organizations report near 100% repayment rates.

BOT Approach of Grameen Trust

In a different type of program, Grameen Trust also goes into a country to create a microcredit program directly on the ground with experienced staff from Grameen Bank, under a Build-Operate-Transfer (BOT) contract. Grameen Trust staff set up the program, recruiting and training local staff. This is a very efficient approach which shows good results very quickly. Lag time between a decision to start a program and implementation is minimal. Probability of success is also very high, as many risks and uncertainties can be bypassed under this arrangement. Donors and governments can try this arrangement whenever they are in doubt about the success of their microcredit program.

BOT approach can contribute to rapid expansion of microcredit in areas where it doesn't exist.

Grameen Trust set up successful BOT projects in Turkey, Myanmar, Kosovo and Zambia over the last nine years. This year it has embarked on such programs in Costa Rica and Guatemala. Negotiations on extending BOT programs in other countries in Latin America and Africa are currently underway.

Impact

Independent studies show that microcredit has a host of positive impacts on families that receive it. A World Bank study in 1998 reported that 5% of Grameen Bank, BRAC, and RD 12 of BRDB borrowers move out of poverty each year. A recent World Bank study by Shahid Khondkar (2003) shows that micro-credit programs operating in Bangladesh over a long period, have produced a greater impact on extreme poverty than on moderate poverty.

"The results of this study strongly support the view that microcredit not only affects the welfare of participants and non-participants but also the aggregate welfare at village level" Khondkar concluded.

Studies around the world have also shown that microcredit programs improve the coping mechanisms of the poor. This was demonstrated very clearly during times of disaster such as during the floods in Bangladesh in 1998. A large number of impact studies have been made on Grameen Bank from different perspectives. They all show significant impact on its members across wide range of economic and social indicators, including increased income, improved nutrition, better food intake, better consumption on clothing, better housing, lower child mortality, lower birth rate, higher adoption of family-planning practices, better

healthcare, better access to education for the children, empowerment of women, participation in social and political activities.

According to Grameen Bank's own internal survey, 56% of its borrower families have crossed the poverty line by 2005, judging this on the basis of ten indicators (size of loan, amount of savings, housing condition, furniture in the house, provision of pure drinking water, sanitation and warm clothing, education of the children, etc.) set by Grameen Bank to track impact of its program on the poor families that it serves.

How to Expand the Outreach

There is no doubt that microcredit can contribute in significant way to poverty reduction. Although the expansion of microcredit to the poor is encouraging, there is still a number of constraints which prevent microcredit spreading even more quickly.

Bangladesh is still the only country where microcredit outreach is over 75% of the poor families. In most of the countries it has not even reached 10% of the poor families. To reach the Summit's phase II goal of 175 million poor families by 2015, and to ensure that 100 million of those who were below US\$ 1 rise above it, each country must reach out to 50% of the poor families within that country. Therefore, there is a lot of catching up to do.

Two major issues are always discussed in connection with the institutionalisation of microcredit in Bangladesh and elsewhere. They are 1) financing of microcredit and 2) legal and regulatory framework for integrating microcredit with the national financial system. Both issues are inextricably connected with each other. If the issue of appropriate legal and regulatory framework for microcredit institutions is resolved, then the funding issue becomes much easier to address.

Enabling to Take Deposit is the Answer

Under the Grameen policies, branches are financed entirely with deposits mobilised within the locality served by the branch. A branch can mobilise more deposits than it needs to finance its loan operation, within the first month. A new branch becomes profitable within a year. Grameen Bank can mobilise deposits because it is a formal bank. NGOs cannot take deposits because NGO law does not support it. Microcredit can be funded locally at the village level, provided legal framework is created to allow microcredit programmes (MCP) to accept public deposits. If this legal framework is created, donor funding can be reserved for only start-ups, shoe-horning NGO-MCPs to graduate into microcredit banks (MCBs), training, research and development, other technical support. This will give donor money more leverage than it currently gets.

There are many NGO-MCPs with over 100,000 microcredit borrowers in Bangladesh and around the world. 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 all around them. They can easily get to it if only they are 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 enabling environment for the NGOs to convert themselves into microcredit banks will change the whole microcredit scenario.

I am strongly advocating that lawmakers pay serious attention to this issue in the context of reaching the Millennium Development Goal of reducing poverty by half by the year 2015. This is one enabling step the lawmakers must take.

Creating Microcredit Regulatory Commission

By now all policymakers do recognise that microcredit needs different kind of banking format than conventional banking. Creation of separate legal framework, and a separate Microcredit Regulatory Commission will be the result of that recognition. Some countries (for example Philippines, Venezuela, Uganda) have already passed laws to create microcredit banks. But they closely followed the law that already exists for the conventional banks. I argue that we need to have sharper departure from the existing banking laws.

I am not aware of any separate regulatory commission for microcredit that has been created by any country. It will be an important initial step towards institutionalisation of microcredit. India has created separate regulatory body for rural finance. I see no reason why a separate regulatory body cannot be created for microcredit which can develop into a dynamic financial sector in any country with appropriate policy support. Central bank of the country can play an important role within the microcredit commission. Selection of the first chairman of the commission will be very critical. He or she must have deep understanding of microcredit, and patience and skill for creating an entirely new financial sector.

Essential Elements in Legal Framework for a Microcredit Bank

The law for creating a microcredit bank should have two things in mind. First, it should allow and encourage NGOs to convert one or more units of their microcredit operations into MCBs to test out the formal financial world. The law and the microcredit commission should make sure that the NGOs like the new experience. If NGOs convert more and more of their units into MCBs, this will be a testimony to the success of the new law.

Second, the law should encourage creation of start-up MCBs, without going through the process of being born as an NGO-MCP as a first step, and then converting it into an MCB as a second step.

There should be a clear definition of an MCB so that the law is not misused. The law should state clearly that an MCB is a bank which primarily serves bottom 50 percent (or bottom 25 per cent, as the case may be), or people earning less than a dollar (or less than two dollars) a day. There should be clear mention that MCBs would give preference to poor women. The law should be flexible enough to allow a part (say, 40 per cent) of the business of MCBs to go outside of strictly microcredit type banking, such as, providing credit for small businesses with or without collateral. The law should allow poor microcredit borrower to grow into borrowing larger loans as her business grows. No microcredit borrower should be forced to leave a MCB because her loan size has grown bigger over time.

Deposit Mobilization

MCBs should be allowed to take deposits from borrowers as well as from the public. The restriction on the amount that it can mobilize as deposit can be related to the amount of loans outstanding of the MCB.

For example, the deposit mobilization may not exceed a maximum of twice the amount of the loans outstanding.

NGO MCPs and Deposit Mobilization

NGO MCPs that are not registered as MCBs should be allowed to mobilize deposits but only from their members and not from the general public. They may be allowed to take borrower deposits until the balance of deposits equals 75 per cent of their outstanding loans.

Deposit Insurance

It is necessary to protect the deposits of the poor against the risk of failure, fraud or mismanagement of MCBs. There should be some arrangement for deposit insurance for deposits mobilized by MCBs to protect the interest of the depositors.

Interest Rate

There should be no restrictive laws limiting the interest rate to be set for MCBs. MCBs may charge interest rate higher than the interest rate charged by commercial banks for their small loans. Microcredit interest rate should not be too far above the commercial bank interest rate.

As a thumb-rule I would say that an MCB should try to keep the interest rate within 5 to 10 percentage points above the commercial rate. If it goes above this limit, it would be entering money-lenders' world, leaving the microcredit world behind. In any case, there should be full disclosure to the borrowers and to the public, of the interest rates being charged and how it is calculated.

The Microcredit Commission should not rush to regulate and overregulate MCBs. As MCBs innovate and develop, they require a flexible and enabling regulatory environment. Keeping in mind that these programs are designed to help the poor, governments should not exert too much control which will discourage MCBs from expanding their operation.

Transforming NGO-MCPs into MCBs will be the only way for self-reliance for the MCPs. Creation of MCBs can strengthen the financial system of a country by filling in a vacuum left by the conventional banks, and give a boost to the emergence of a local level grass-root economy.

Conclusion

Next five years will be very critical in terms of making adequate institutional, financial, and policy preparations for reaching the MDG of 2015. We have less than ten years left for reaching the goal. If we fail to make appropriate preparations we'll fail to achieve the goal. Certainly we do not wish to accept the option of failure. Microcredit institutions, along with a whole generation of other social business enterprises, can play a vital role in attaining the MDG of halving extreme poverty by 2015. Issues raised in this paper needs to be seriously considered to get the world ready for successfully completing the most exciting task mankind ever embarked on. Let us not fail in this endeavour. ■