The Maturing of Grameen Bank

The Poor Always Pay Back: The Grameen II Story
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There is substantial interest across the world about Grameen.[1] With its founder Muhammad Yunus winning the Nobel Prize there is an enhanced interest in its operations. It has now become an icon in the targeting of financial services to the poor, drawing attention of development practitioners and venture capitalists alike. While much has been written about Grameen by scholars, this new book is a narrative from within. Dipal Barua is the deputy managing director of Grameen and Asif Dowla a former student of Yunus and an integral part of the initial Grameen team. Therefore readers' expectations from the book are not about a balanced critical view, but a narrative of the changes that have happened in the past few years.

This book is to be seen in conjunction with two other narratives from within – the autobiography of Yunus, *Banker to the Poor* and a set of case studies *Jorimon and Others*. Both narrate the early days of Grameen. While *Banker to the Poor* talks about the convictions and experimentations of Yunus in the evolution of Grameen, *Jorimon and Others* indicates the problems that Grameen would eventually face. Unfortunately, when a programme is successful, the proponents fail to read the sub-text of their own writings and will have to be woken up with a jolt. The jolt admittedly came. "After the devastating flood of 1998, when two-thirds of the country was under water for 11 weeks, the bank was facing repayment problems in certain areas. Although 80 per cent of the borrowers were repaying on time, 20 per cent became irregular in their repayment" (p xiii). While Grameen responded to this jolt, the contours of change were not widely known.

Another jolt came from an article in the *Wall Street Journal* by Daniel Pearl in November 2001. The article appeared from a place where Grameen had gained its legitimacy – the western world. It was a jolt because Grameen was on a high at that point after the Global Microcredit Summit in 1997. The summit put microcredit and Grameen on a global map, with the likes of Hillary Clinton and the queen of Spain lending their name and presence to endorse the microcredit movement. Pearl's article highlighted what the book now acknowledges – that there were significant bad loans and they were being rescheduled. However, the book surprisingly does not even make a passing reference to this article which triggered a hot debate on most of the development listserves and also called for the entire correspondence between Pearl and Yunus to be put on the Grameen website.

In *Banker to the Poor* Yunus talked about how they perfected the Grameen methodology. Starting from the initial experiments in the credit market by extending loans in Jobra village it was a long learning curve that Yunus and his friends went through. It is evident from the book that there were significant design flaws initially, and there was indeed uncertainty about the most effective procedure for loan recovery. Eventually, the essence of Grameen was distilled in two simple and essential elements of banking – the frequency of contact and discipline. Frequency of contact gave early warning signals about the state of borrowers and discipline took care of any possible default. Given that the formal credit system was in a mess in Bangladesh, it was quite natural that the antidote provided by Grameen was extreme. They went overboard on both these elements – contact established through weekly repayment meetings, and discipline established through a zero level tolerance even for a possible genuine default.

Changed Borrowers

That is why we find angst in the borrowers' voices even when it is recorded by insiders of Grameen. The angst is about starting income generating micro-enterprises to service and repay the loan. It is about the fear that one may not be able to live up to the exacting standards of discipline of Grameen. The stories of Sakhina or Fuljan in *Jorimon and Others* clearly echo the fear of inability to repay and thus wanting to be away from the clutches of Grameen. While the Indian self-help groups leverage intra-community trust as a surrogate for documentation and physical collateral – reducing transaction costs and increasing compliance – the Grameen system possibly used social collateral in a coercive manner.[2] Thus, symbolism of the Grameen had aspects that reinforced discipline, censure of people who deviated and in the recitation of pledges. Grameen turned out to be a credit treadmill that made it difficult for people to get off because you could never be a member of a group unless you were a borrower.

This system worked as long as the failures of the underlying micro-enterprises were isolated because the group as a whole was able to absorb the losses and move ahead. There was a critical mass of people who kept this treadmill going. However, the flood of 1998 changed the rules of the game significantly because a large part of the borrowing population suffered a collateral damage. The group mechanism was bound to crack and affected the credit treadmill significantly.

Grameen II was a response to the issues that the original design would have faced at some point in time. Grameen reacted to a situation while it could have proactively looked at its model, when there was widespread criticism about it operations from the outside world. But when they did respond they did so very creatively. This was only after the flood hit the books of Grameen. Grameen II as a model turns the original assumptions on its head and moves ahead towards a proper banking system.

While Grameen may like to claim that its borrowers have become sophisticated over time, their needs have grown, their absorptive capacity is better, all these calling for a change in the methodology, there is more to it than just the borrowers becoming better. Under Grameen most of the risk costs were transferred to the borrowing groups by having in-built mechanisms like compulsory savings and group tax. This took care of minor defaults and unforeseen blips in the borrowers' cash flows that put the repayment of an instalment to risk. It allowed Grameen to keep its books clean and show little default – though there could have been a larger default not captured due to the cushioning mechanism provided by the system. The Grameen loan products were all similar – having a pre-specified interest rate irrespective of the purpose, an equated weekly instalment and a fixed interest rate, thus taking the fungibility argument to the extreme. This helped Grameen to keep its systems simple, administer its programme efficiently and replicate it widely.

Grameen II is actually the story of the organisation itself maturing and moving ahead. It might be the result of some issues that they had to grapple with – the borrowers including the likes of Jorimon – becoming sophisticated over time. In such a situation the following questions are relevant:

– What does Grameen do with borrowers, who can no longer be classified as poor? Do they let them out of the system or grow with the customer and offer diversified and sophisticated financial services? Data indicates that 58.4 per cent of Grameen borrowers have moved out of poverty on the basis of their 10 indicators (p 43). Thus a majority of the borrowers are not "poor".

– What do they do when borrowers think that meeting once a week and undertaking the pledge is too transaction intensive and they no longer have the time-slack to attend such meetings?

– What do they do with increasing need for resources to cater to larger customer base – the traditional sources of donor money not designed to keep pace with a commercial level growth?

Adapting to the Market

Obviously Grameen had to attend to this issue on a priority basis. It was also clear that Grameen was becoming a significant player in the overall market and it had to adapt itself to the rules of the markets. If it did not, then it would be at the cost of always having entry level customers while those graduating from the Grameen would move on to the formal commercial institutions. Indeed this is an aspect captured brilliantly by Maheshwari[3] in her study on older self-help groups in Ajmer. She finds that members who have been entrepreneurially successful find that the group is unable to meet their requirements and form something called "companies" – self-liquidating groups that rotate savings and credit for an annual cycle with much larger amounts of payments than what an average SHG would do.

If Grameen adapts itself to the rules of the market, the only caveat then would be to ensure that it does not suffer from a mission drift and remains knitted to its original objective of servicing the fringes left out by the formal system. Grameen II is a brave attempt at trying to reorient and redesign towards the markets – by being almost like a mainstream bank, while continuing to focus on the poor. The book argues that while the key features of Grameen II are different in terms of design and delivery of products, the essence of Grameen is retained by its organisational structure where the borrowers continue to be shareholders and also have significant presence in the governance system of the bank.

In Grameen II we can see that the system of checks and balances are more sophisticated. The group concept has been abandoned. There is more of self-insurance through a compulsory savings account instead of group collateral. Unlike the group tax in the old model, where a good borrower possibly ended up compensating for the default of a bad borrower, in Grameen II the borrowers save for themselves. There is scope for withdrawal of personal savings accumulated, provided the borrower is not having a "bridge" or a "flexible" loan – a euphemism for default. There are checks and balances within the system that deals with each customer as an independent entity with their own transaction history. However, the importance of Grameen II is that it continues to look at the customer as an integrated unit rather than classify them as borrowers and depositors. This linkage on the lending side honours discipline in a sophisticated manner. The frequency of contact is still maintained through group meetings. However, the interesting aspect is the change in the seating pattern at the meetings. Earlier the seating pattern used to be like a file formation. Now it is in the shape of a horse-shoe more in the nature of how boardrooms are designed in large corporates. This indeed is a powerful symbol that indicates how things have emerged over a period of time and comments about the transition. There are other initiatives that address the loan risks – including a loan insurance that takes care of losses due to deaths. We see that as Grameen gets more sophisticated even their risks are being integrated with the larger demographics rather than being absorbed at the local level. These risk mitigation products are also offered for subscription on a voluntary basis rather than pushing it as a compulsory precondition.

Grameen II also represents the maturing of Grameen from a microcredit organisation to a microfinance organisation. Not only has Grameen introduced savings as a measure of loan risk mitigation, it has also taken care of capital build up of its borrowers. Thus one sees that there are newer products that aim at long-term capital build up including a pension scheme. The customers also have an opportunity to buy mutual fund units and thus participate in the capital markets.

The other paradigm shift in Grameen II is that they have also started accessing non-borrower deposits. This is the ultimate acknowledgement that the institution has indeed become a bank. This means Grameen would have to come in for a greater regulatory environment as public savings would be involved. However, this aspect actually almost completes the picture of an institution that would be providing well rounded financial services, with a focus on the poor and not just a micro-credit treadmill. This indicates that Grameen is on a steep learning curve on its second phase. With the Nobel in their kitty they have to remember that they would be watched even more closely – both by sceptics and admirers alike.

The story of Grameen II on how the transition was actually implemented is documented in detail in the book. Given the new global interest in microfinance this book would certainly be an important resource book is not only for curious academics interested in design of organisations and sub-systems, but also for the practitioners of microfinance to introspect and reflect on the second phase of the growth of microfinance movement in a "mature" market like Bangladesh. Possibly it is time for Grameen to rightfully use its name "Grameen Bank". EPW

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Notes

1 The term Grameen is used in literature to mean both the organisation – Grameen Bank as well as the methodology adopted by them. In this essay we use the term Grameen interchangeably to refer to the institution, the methodology and the philosophy, while we use the term Grameen II to represent the current model used by Grameen Bank.

2 M S Sriram, 'Information Asymmetry and Trust: A Framework for Studying Microfinance in India', *Vikalpa*, 30(4), pp 77-85, 2005.

3 Neelam Maheshwari, *Access to Credit: Determinants for an SHG Member*, PRADAN, New Delhi (mimeo), 2004.