

## Case Study

### MICRO FINANCE

#### THE NEW MANTRA OF RURAL FINANCE TO REDUCE POVERTY

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*“Micro-credit is something which is not going to disappear... because this is a need of the people, whatever name you give it, you have to have those financial facilities coming to them because it is totally unfair... to deny half the population of the world financial services”.*

– Dr. Muhammad Yunus, Founder – Bangladesh Grameen Bank, in March 2002 (<http://news.bbc.co.uk>)

*“Micro finance has tremendous potential as an instrument for poverty reduction”.*

– Shahid Khandker, Senior Economist, World Bank, in 1999 ([www.reliefweb.int](http://www.reliefweb.int))

**T**HE rural finance policy pursued in most developing countries beginning from 1950s was based on providing subsidized credit through state controlled or directed institutions to rural segments of population. The key problem areas visualized in rural financial markets includes- lack of credit in rural areas, absence of modern technology in agriculture, low savings capacity in rural areas and prevalence of usurious moneylenders. Emergence of micro credit in late 1970s and early 1980s in the backdrop of growing world attention on deficiencies of earlier approach in rural finance explains much of its dominant theoretical underpinnings.

Microfinance refers to providing loans and finance to poor people for self-employment. Generally, small amounts are disbursed as loans, and the timeframe for repayment of loans is longer compared to commercial banks. Together with providing financial services, many microfinance institutions work for social development in the areas in which they operate.

Microfinance institutions generally have the following characteristics:

- Providing small loans for the working capital requirements of the rural poor.
- Minimal appraisal of borrowers and investments as compared to commercial banks.
- No collateral demanded; however, these institutions impose compulsory savings and group guarantees.
- Based on the loan repayment history of the members, microfinance institutions extend larger loans to the members repeatedly.

Though microfinance institutions provide the necessary monetary support and try to increase social awareness among their members, their activities do not include providing training for basic skills

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required for doing business. They do not extend any marketing facilities nor undertake activities to improve the literacy rate and health conditions of members (<http://en.wikipedia.org>).

### **Micro Finance and Poverty Relief in India**

A significant amount of the underprivileged people in India is somehow able to tailor their financial resources in a way that they can realize their ambitions vis-à-vis their houses or other plans. However with the introduction of micro finance in India, the standard of living of the poor section of the population is expected to improve (Patil et al., 2008).

Micro finance services are designed to help the underprivileged to increase their earning, consolidate their properties and even gain a decent financial stability in life. The advantage of availing the micro finance credit over the more traditional means is the unwillingness of the later to serve the underprivileged people (Singh, 2008).

### **Grameen Bank – A Role Model in Microfinance**

Yet another monsoon season was approaching; but Joshuna Begum (Begum) unlike her neighbors was not worried about her house getting damaged during the monsoon. Her house now had a tin roof, mud walls and wooden windows, a luxury in rural Bangladesh. Earlier, Begum's house had a straw roof and bamboo walls, which used to get damaged in the monsoon season, forcing the whole family to live in the kitchen. She got her hut repaired with a loan from the Bangladesh Grameen Bank (Grameen Bank).

Begum wasn't the only one; there were thousands of people in rural Bangladesh who had improved their living conditions with the help of the microfinance programs of Grameen Bank, a pioneer in microfinance. Grameen Bank helped thousands of poor Bangladeshi women to improve their lives by extending loans to them to start their own enterprises. By 2003, it was reported that between 33-48% of Grameen Bank borrowers had moved above the poverty line. By 2003, with 1,170 branches across Bangladesh, Grameen Bank was seen as a role model for microfinance all over the world.

The Grameen Bank model was replicated across the world – not only in developing countries like India, Pakistan, and Vietnam, but even in developed countries such as Australia and the USA, where similar schemes were set up to improve the lives of the urban poor.

However, the Grameen Bank also attracted criticism from the media and economists all over world. Analysts pointed out that there was no proper monitoring of how the loans were utilized; it was reported that the loans availed of by women were used largely for consumption rather than for investment purposes. Analysts also pointed out that the accounting methods used by Grameen Bank were not in accordance with industry standards, and that the bank did not provide full details about its financial position and loan repayments position.

### **Background Note**

In the mid-1970s, Professor Muhammad Yunus (Yunus), then Head of the Rural Economics Program at the University of Chittagong, observed that banks did not extend their credit schemes to the rural poor as they were not considered creditworthy. In this situation, the rural poor were forced to approach moneylenders who charged exorbitant rates of interest. In 1976, Yunus launched The Grameen Bank Project, on an experimental basis to study the framework of banking services for the rural poor. The objectives of the Grameen Bank Project were:

- Providing banking services to the rural poor
- Eliminating exploitation of the rural poor by moneylenders

- Facilitating self-employment projects for unemployed rural people
- Making women self-reliant by providing them opportunities through Grameen Bank
- To reverse the vicious cycle of – low income, low saving & low investment, into a new cycle of “more credit, more investment, more income.”

To start with, Yunus took loans from commercial banks and extended the money to 42 needy women in Jobra village in Chittagong district. The project spread to surrounding villages between 1976 and 1979. However, bankers were skeptical about the project and argued that it was initially successful because Yunus implemented it around the university campus where he had a good reputation. In order to convince bankers about the project's long-term viability, Yunus took two years leave from the university and started working in the Tangail district. The Bangladesh Central Bank provided financial support for the Tangail project and Yunus was appointed as the Project Director.

The project was started in 1979. With the successful implementation of the Grameen Bank project in the Tangail district, it was extended to other districts in the country. By 1980, Grameen Bank had disbursed \$1.10 million as loans to the rural poor. In 1983, Grameen Bank was given the status of an independent bank by a special ordinance of the Bangladesh Government. Initially, government contributed around 60% of the bank's capital and bank members held the remaining 40%. However, by 2003, government held only 7% and members held a 93% stake in the bank.

Initially, Grameen Bank raised funds through bonds issued to the commercial banks and it also borrowed from Central Bank at subsidized interest rates. Grameen Bank also got funds from international agencies like the World Bank and the Ford Foundation. Foreign governments also provided funds for the Grameen Bank at subsidized rates.

In the late 1980s, Grameen Bank diversified into a number of different fields. It started leasing unutilized and underutilized fishing ponds and irrigation pumps. At the same time, it also started training and extending support to people from other developing countries to replicate the Grameen Bank model in their countries.

When it was successful in leasing fishing ponds to the poor, Grameen Bank started expanding its non-banking activities. The Grameen Fisheries Foundation and the Grameen Krishi Foundation were formed to oversee the leasing of fisheries and irrigation pumps. In 1989, the Grameen Trust was formed to provide training and support to people from other countries to start micro finance programs. By the mid-1990s, Grameen Bank had expanded its activities to areas such as venture capital, textile industry and Internet Service Provider (ISP). All the non-banking ventures of Grameen bank were grouped under the Grameen Family.

By 2002, Grameen Bank had 2.4 million borrowers (95% of them were women) and its activities were spread across 41,000 villages with over 1,100 branches. By August 2002, it had disbursed cumulative loans of \$3708.22 millions and the loan repayment rate was reported to be around 95%.

### **The Success Story of Grameen Bank**

The Grameen Bank model was one of the most widely researched microfinance models all over world. The Bank had four tiers, the lowest level being branch office and the highest level being the head office. The branch office supervised all the ground activities of the bank such as organizing target groups, supervising the credit process and sanctioning loans to members. For every 15-22 villages, a branch was set up with a manager and staff. An area office supervised around 10-15 branch offices. Program officers assisted the area office to supervise the utilization of loans and their recovery. All area offices

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were under the purview of a Zonal Office. Each zonal office supervised around 10-13 area offices and all zonal offices reported to the head office situated in Dhaka.

Grameen Bank operated on the principles of mutual trust, supervision, accountability and member participation. Unlike commercial banks, which granted credit on the basis of collateral security, Grameen Bank did not demand any security for extending credit. The interest charged by Grameen Bank was higher than that charged by commercial banks, but lower than the interest charged by moneylenders. The difference between the interest earned by the Grameen Bank and interests paid by it on the loans taken from commercial banks was used to cover the operational costs of the Bank.

When Grameen Bank started, many felt that it would soon fail; but on the contrary the bank expanded its operations very rapidly. From 15,000 borrowers in 1980, the membership increased to 100,000 in 1984; by 1991 it had 910,842 members, and by 2002, the number increased to 2.3 million. From a figure of US \$498 in 1976, the bank's total disbursements increased to US \$170.39 million in August 2002.

The loan repayment rate was reported to be 95%. The high repayment rate was probably a result of peer group pressure, and the Grameen Bank's rule – that for availing of fresh loans, earlier loans had to be repaid. Another important factor that led to high repayments of loans was social pressure. Creditors' knocking at the door for loan repayments was considered disgraceful among Bangladeshis. It is believed that the above factors led to the success of Grameen Bank, which also succeeded in improving the lives of its members.

Many research studies indicate that Grameen Bank brought positive changes in the lives of thousands of rural Bangladeshis. The landless poor benefited the most from the Grameen Bank movement. The landless poor, who earlier worked as agricultural laborers, acquired land for their own farming activities after becoming Grameen Bank members. According to a World Bank study conducted in 1994, Grameen Bank had improved the position of women in rural Bangladesh. Women members of Grameen Bank were more confident and socially aware than their non-Grameen Bank counterparts. Grameen Bank members even took active part in politics. In the 1997 local elections, more than 2,000 Grameen Bank women members were elected to local civic bodies.

Grameen Bank also encouraged the rural poor to get educated. It provided educational loans to its members to enable their children to go to school and college. According to reports, the rate of school-going girls among Grameen Bank member families was 57% higher than that in non-member families ([www.grameen-info.org](http://www.grameen-info.org), [en.wikipedia.org](http://en.wikipedia.org)).

## **Global Acceptance of Microfinance**

It is claimed that this new paradigm of unsecured small scale financial service provision helps poor people take advantage of economic opportunities, expand their income, smoothen their consumption requirement, reduce vulnerability and also empowers them. Former World Bank President James Wolfensohn said "Microfinance fits squarely into the Bank's overall strategy. As you know, the Bank's mission is to reduce poverty and improve living standards by promoting sustainable growth and investment in people through loans, technical assistance, and policy guidance. Microfinance contributes directly to this objective". The emphasis on microfinance is reflected in microfinance being a key feature in Poverty Reduction Strategy Papers (PRSPs).

## **Microfinance & MDG**

Micro credit Summit Campaign's 2005 report argues that the campaign offers much needed hope for achieving the Millennium Development Goals, especially relating to poverty reduction. Asian Development

Bank (ADB) in its theme chapter on microfinance cites access to financial services as critical for eliminating poverty and reaching MDGs (ABD, 2004). Food and Agriculture Organization (FAO) and the World Food Programme (WFP) declared that it will be possible to achieve the eight Millennium Development Goals (MDG's) by the established deadline of 2015 "if the developing and industrialized countries take action immediately" by implementing plans and projects, in which micro credit could play a major role (www.iran-daily.com).

### Questions for Discussion

1. According to analysts, Grameen Bank was successful because of its unique working model. Analyze the working model of Grameen Bank and discuss how it differs from the traditional commercial banking model?
2. Many analysts criticized Grameen Bank for its style of functioning. Analyze the drawbacks of the Grameen Bank model.
3. "Microfinance has tremendous potential as an instrument for poverty reduction (MDG1)". Comment upon the statement.
4. Do you suggest that the Grameen Bank model for poverty alleviation be emulated in other developing countries? Explain with reasons.

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