



STANFORD
GRADUATE SCHOOL OF BUSINESS

STANFORD SOCIAL INNOVATION *review*

Frontlines

Credit to the Poor

**Muhammad Yunus was getting nowhere in
Bangladesh – so he opened his own bank**

Stanford Social Innovation Review
Summer 2003

Copyright © 2004 by Leland Stanford Jr. University
All Rights Reserved

DO NOT COPY



STANFORD
GRADUATE SCHOOL OF BUSINESS

Stanford Social Innovation Review
518 Memorial Way, Stanford, CA 94305-5015
Ph: 650-725-5399. Fax: 650-723-0516
Email: info@ssireview.com, www.ssireview.com

Credit to the Poor

Muhammad Yunus was getting nowhere in Bangladesh – so he opened his own bank

The Grameen Bank is a pioneer in micro-credit, providing credit to the poor in rural Bangladesh. It has 2.4 million borrowers and 1,175 branches serving more than 60 percent of the villages in Bangladesh. Professor Muhammad Yunus, founder and managing director, comments on the creation of the bank:

The Grameen story began in 1976. When we began, I had no idea what I was setting out to do.

Usually people start with an idea, a blueprint, a road map, or a business plan. I had none of these. I didn't even have a name for the concept. My efforts came out of frustration: Frustration that we experience in many third world countries, where you hope that things will be different tomorrow, but you wake up to find that it is actually worse than it was yesterday.

I was teaching in Chittagong University in Bangladesh, and as a fresh Ph.D. from the United States, I was full of arrogance and was ready to tell the world that I knew everything. Then came 1974, when we were hit by a famine, and hundreds of thousands of people were dying of hunger. I felt strange teaching brilliant theories of economics when I saw that the situation outside my classroom was so different.

I saw repeatedly how much people suffered for tiny amounts of money.

People in need of small amounts of capital used loan sharks. I was shocked when I spoke with a woman and found that all of her income went to pay a loan shark. So I decided to make a list of such people in need of money in the village. When my list was completed, there were 42 names on it and the total amount they needed was \$27. That was the biggest shock for



Muhammad Yunus and William Fuller, 27 years later.

me. I was teaching the National Development Plan for Bangladesh, where the government planned to spend \$7 billion (U.S.) for development over five years in part to help the poor. Yet a few yards from my classroom, people were not waiting for millions of dollars, they were waiting for a few pennies and they didn't have it. So my first response was to give this money out of my own pocket, and that was the beginning.

If you can bring so much happiness

to so many people with such a small amount of money, I thought, why shouldn't you do more of it? The idea haunted me. I thought I could do it by persuading the local bank to lend money, small amounts of money, directly to the people, but it refused. The bank said it was a crazy idea to give money to poor people because they are not creditworthy, insisting that all the money would be lost because the poor had no collateral, but I did not agree. After several months, I finally I found a solution: I offered myself as a guarantor. "I'll sign the papers," I said. "You give me the money and the risk is on me." After several more months of negotiation, the banks agreed.

I took the money from the bank and gave it to the people. The bankers said it would not work. I said, "But look, it worked." They agreed that it may work in one village, but said it would not work in two. So I extended the model to a second village, and it worked. When I succeeded in over 100 villages, I wondered why I was still trying to convince the bankers. I knew that the people did pay back the loans without the need for collateral. This is when the idea of creating a bank first came to me. I gave up on conventional banks and decided to have a separate bank for the poor; unfortunately, I needed separate legislation to create this bank. It took two years to convince the government and get the legislation, but in 1983, the Grameen project finally became a bank.

International Expansion

At first, people said that Grameen could only work in Bangladesh, as it was an unusual country where all kinds of unusual things happen. And we didn't have any evidence that Grameen methodology would work

WILLIAM FULLER: A funder's perspective

Twenty-seven years ago, when Muhammad Yunus was creating the Grameen Bank, he talked about the idea with William Fuller, a Ford Foundation representative in Bangladesh. Fuller, now the president of the Asia Foundation, looks back:

My first contact with Yunus had nothing to do with the Grameen bank, but rather with an idea he had, and which we funded, for setting up a rural economic studies program at Chittagong University. A little later, Yunus and I talked about testing the notion of making small loans to landless borrowers. That idea was very different than the original rural studies program. It did not appear in the grant letter that was signed by me on behalf of the Ford Foundation, but there was something that was absolutely inspiring about him.

In philanthropy, you sometimes bet more on people than you do on institutions. Yunus had a compelling concept for putting resources in the hands of the poor and he was clearly committed to carrying out that dream, so we made the grant. I drew a number of lessons from the experience. First, that a small grant, at the right time, with the right person, can make a difference. Second, in the philanthropy business, you should never let yourself be trapped or blinded by your own goals or objectives, by your letters of agreement, or by the original benchmarks that you set up. The unexpected can be a terrific source of creativity and opportunity. Loaning to borrowers without collateral was outside the scope of the original grant, but luckily I had the flexibility to reallocate funds and respond to Yunus' creative idea.

Importance of sociopolitical environment

There were other lessons also. I was concerned about Grameen's interest rates – around 13 to 15 percent – on noncollateralized loans to landless borrowers. In microfinance, it was not uncommon to have rates of 25 to 30 percent to cover loan losses, reserves, and supervisory costs. Why couldn't Grameen increase its interest rates? What I missed was a very important political consideration – the Bangladesh government was providing highly subsidized agricultural credit with rates of 8 to 10 percent to farmers that already had an asset – land. It would have been politically untenable for Yunus to charge landless borrowers higher rates.

The power of leverage

As Grameen expanded further, it needed more funding and it appeared that the state commercial banks might be interested. Unfortunately, they didn't want to lend to poor people with no collateral. We knew we needed to offer some kind of incentive or measure to reduce the risks for the state commercial banks. Thus, the Ford Foundation arranged a loan guarantee that would cover in a specified period of time half of any losses incurred by state commercial banks up to a certain limit.

The loan guarantee attracted the state commercial banks and leveraged far more resources than the Ford Foundation could ever have provided in the form of a grant.

elsewhere. In 1982, an economics professor started the program in Malaysia, the first replication of the Grameen Bank model. Then came the Philippines, Vietnam, and Indonesia. And then we received a request from the United States. Bill Clinton, then governor of Arkansas, wanted to start a Grameen program there, and he did. The idea soon spread to Chicago, China, India, Latin America, and so on.

Halfway there ...

By the end of 2003, microcredit institutions should have collectively crossed the halfway mark of our goal – reaching 100 million of the poorest families by 2005. But there are still 50 million more to go. The goal could be met if funding was available; we need donors. At the same time, to make microcredit programs sustainable, we

need to mobilize local deposits.

The solution is for donors and philanthropic organizations to guarantee local deposits. Once microcredit organizations can take local deposits, they can raise money locally and there will be no need, or at least less need, to bring in money from the outside. If donors can communicate to the government or the Central Bank that they will guarantee the deposits in the microcredit organization, microcredit programs can raise money locally. There is plenty of money available locally to enable these programs to expand as far as they would wish.

Looking Ahead

Microcredit institutions are powerful because they are not about charity for the poor, but are based on business principles. They are able to cover costs

and so need not depend for too long on subsidy. This lets them scale up and reach large numbers of poor people.

With microcredit programs showing all over the world that the poor are very much creditworthy, banking will never be the same again. Credit should be accepted as a human right, because it is a starting point for economic life and economic life provides the basis for social and political life. The poor are capable of taking care of themselves provided we create an enabling environment. We can put poverty in the museum, where it belongs. □

From the 2nd Annual Global Philanthropy Forum Conference on Borderless Giving, co-sponsored by the World Affairs Council of Northern California and the Stanford Institute for International Studies. Full transcript available at www.philanthropyforum.org.