Grameen Microfinance: An Evaluation of the Successes and Limitations of the Grameen Bank

Ana Maria Moreno

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Abstract
The Grameen Bank has attracted worldwide attention by providing small loans to poor people across rural villages in Bangladesh. In 2006 the Nobel Committee awarded the Grameen Bank and its founder Professor Mohammad Yunus the Nobel Peace Prize for their, "efforts to create economic and social development from below."[1] The Nobel committee asserted that microfinance is "an important liberating force and an ever more important instrument in the struggle against poverty."[2] Since then, a global microfinance revolution has emerged and the Grameen Bank has been at the vanguard of this movement, showing the potential to alleviate poverty by providing credit to poor households so that they can generate new self-employment opportunities.

Today, while diverse approaches to microcredit exist many view the Grameen Bank’s microfinance model as a paradigmatic alternative to top–down government-sponsored and NGO development initiatives.[3] Despite the contemporary salience and the future promise of Grameen-like microfinance as a poverty-alleviating tool, however, criticisms and conflicting evidence have emerged against the Grameen Bank’s microfinance model and its operations. As more microfinance institutions replicate this model, billions of dollars continue to be invested and millions of borrowers become dependent on Grameen-like microfinance, therefore, it has become increasingly important to examine the successes and limitations of the Grameen Bank.

The goal of this paper will be to evaluate the Grameen Bank’s financial and social successes and limitations. Chapter 1 explores the origins of the Grameen Bank and the structure of its credit delivery system. Chapter 2 examines the Grameen Bank's financial successes, including its institutional, outreach and loan portfolio growth in recent years. Chapter 3 presents the financial limitations of the Grameen Bank, in particular the recent rise in delinquency, several possible explanations for this rise as well as its significance relative to its main competitors and other microfinance institutions around the world. Chapter 4 presents the Grameen Bank’s social successes and limitations and finally Chapter 5 evaluates whether the Grameen Bank has been financially and socially successful as an institution and as a leader in the global microfinance movement.


Disciplines
Asian Studies | Growth and Development | Income Distribution | Inequality and Stratification | International Economics | Other Economics | Political Economy | Regional Economics

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Senior Honors Thesis

Grameen Microfinance: An Evaluation of the Successes and Limitations of the Grameen Bank

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Submitted to the Philosophy, Politics and Economics Program at the University of Pennsylvania in Partial Fulfillment of the Requirements for Honors.

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Introduction

The Grameen Bank has attracted worldwide attention by providing small loans to poor people across rural villages in Bangladesh. In 2006 the Nobel Committee awarded the Grameen Bank and its founder Professor Mohammad Yunus the Nobel Peace Prize for their, “efforts to create economic and social development from below.” ¹ The Nobel committee asserted that microfinance is “an important liberating force and an ever more important instrument in the struggle against poverty.”² Since then, a global microfinance revolution has emerged and the Grameen Bank has been at the vanguard of this movement, showing the potential to alleviate poverty by providing credit to poor households so that they can generate new self-employment opportunities.

Today, while diverse approaches to microcredit exist many view the Grameen Bank’s microfinance model as a paradigmatic alternative to top–down government-sponsored and NGO development initiatives.³ Despite the contemporary salience and the future promise of Grameen-like microfinance as a poverty-alleviating tool, however, criticisms and conflicting evidence have emerged against the Grameen Bank’s microfinance model and its operations. As more microfinance institutions replicate this model, billions of dollars continue to be invested and millions of borrowers become dependent on Grameen-like microfinance, therefore, it has become increasingly important to examine the successes and limitations of the Grameen Bank.


The goal of this paper will be to evaluate the Grameen Bank’s financial and social successes and limitations. Chapter 1 explores the origins of the Grameen Bank and the structure of its credit delivery system. Chapter 2 examines the Grameen Bank’s financial successes, including its institutional, outreach and loan portfolio growth in recent years. Chapter 3 presents the financial limitations of the Grameen Bank, in particular the recent rise in delinquency, several possible explanations for this rise as well as its significance relative to its main competitors and other microfinance institutions around the world. Chapter 4 presents the Grameen Bank’s social successes and limitations and finally Chapter 5 evaluates whether the Grameen Bank has been financially and socially successful as an institution and as a leader in the global microfinance movement.
Chapter 1: The Origins of the Grameen Bank

The Grameen Bank and the Beginnings of Microfinance

Access to credit can significantly change the lives of the poor because it provides them with an opportunity to invest in self-employment activities and as a result increase their household incomes, build assets and reduce their vulnerability to crises. Furthermore, access to credit also has the potential to empower and equip the poor to make their own choices and build their way out of poverty in a sustained and self-determined way. Finally, it can also make women better able to confront gender inequities and ultimately allow them to plan for their future and to invest in their own and their families’ health and education.

Given the significant benefits that access to credit can have on the lives of the poor, before institutional credit for the poor was introduced in Bangladesh scarce access to credit inhibited the rural poor’s ability to escape the poverty cycle. Prior to the emergence of the Grameen Bank and microfinance, commercial banks and moneylenders were the primarily sources of credit available in rural Bangladesh, yet both perpetuated the poverty trap. On the one hand, commercial banks shunned the poor because they were unable to provide collateral, while on the other hand local money lenders engaged in extortionary practices, such as charging excessively high rates of interests that consumed nearly all of their profits.

In 1974 the impetus that led to the establishment of the Grameen Bank and its microfinance model aimed at providing credit to poor households so that they can generate self-employment opportunities emerged during a drought and famine, which killed 1.5 million people in

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Bangladesh. During the drought, Professor Muhammad Yunus visited the Bangladeshi rural village of Jobra and observed how the poor were struggling to escape the poverty trap due to their inability to obtain affordable credit. In particular, Yunus attributes the origin of his vision of microfinance to an encounter in Jobra with Sufia Begum, a 21-year-old woman who had borrowed about 25 cents from moneylenders charging interest rates of approximately 10% per day based on the current exchange rates. Ms. Begum used the money she borrowed to make bamboo stools that she was then forced to sell back to the moneylender at a price below market value for a profit of approximately 2 cents.

Growing increasingly frustrated at his inability to help the poor, Yunus pioneered the idea of microcredit by providing small loans to poor people in rural villages in Bangladesh. In 1976 he experimented by lending small amounts of money at reasonable interest rates to 42 people in Jobra. He lent a total of $27 (about 62 cents per borrower) and to his surprise the borrowers paid him back in full and on time. Then, with the financial assistance of the International Fund for Agricultural Development (IFAD) Yunus extended his lending project nationally and travelled from village to village, offering small loans. From his experience travelling around Bangladesh, Yunus realized that making institutional credit available to the poor could serve as a powerful poverty alleviation tool. Consequently, he approached traditional banks and proposed that they

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should make uncollateralized loans to poor people in rural villages. Despite Yunus’ conviction that the poor would repay their loans if given the opportunity, however, traditional banks were not interested in making small loans to them. They asserted that poor borrowers would “never sufficiently organize themselves to repay, that proceeds from such loans were too small to cover administrative costs, that female borrowers would simply hand over the funds to their husbands and that the poor were incapable of successfully managing an added burden of indebtedness.”

In 1976 Yunus responded to the challenges posed by conventional banks and rejecting the basic methodology of conventional banking, which excluded the poor by classifying them as “not creditworthy,” he established the Grameen Bank. Yunus developed a microfinance model using rules of lending that were tailored to the poor’s circumstances and extended access to credit to the rural poor using this model. Today, three decades later, the Grameen Bank’s microcredit model serves as an alternative approach to conventional poverty alleviation strategies and it is aimed at providing microcredit and organizational input to those who would otherwise be excluded from the formal financial system.

**Grameen’s Credit Delivery System**

According to Yunus the following are several distinctive features of the Grameen Bank:

- Targets the Poorest of the Poor and Focuses on Women
- Group, Collateral-free lending
- Rural Banking

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Target the Poorest of the Poor and Focuses on Women

According to Professor Yunus, the Grameen Bank targets the poorest of the poor, with a particular emphasis on women, who receive 95% of the bank’s loans. The explicit criterion for individuals to be eligible for Grameen microcredit loans is “landlessness.” For instance, borrowers are eligible to obtain loan if they come from households, “owning less than 0.5 acres of cultivable land” or from households in which “total assets do not exceed the value of one acre of medium quality, single-cropped land in that area.”

Group, Collateral-free Lending

Grameen Bank offers loans for creating self-employment for income-generating activities and housing for the poor, as opposed to consumption. It extends credit to the poor to invest in productive areas, such as processing and manufacturing, agriculture and forestry, livestock and fisheries, services and trade.

Furthermore, the following are other important features of the Grameen Bank’s lending practices:

- **Multiple Loans**: Borrowers can take out more than one loan simultaneously.
- **Loan Amounts**: Loans start at $35 and average $200, depending on the needs of the borrowers and their level of credit, which is determined by previous borrowing and their repayment record.
- **Repayment**: Borrowers pay back their loans in installments (weekly or bi-weekly) and pay interest depending on the loan type.

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**Interest Rates:** There are four interest rates for loans from Grameen Bank: 20% for income generating loans, 8% for housing loans, 5% for student loans, and 0% (interest-free) loans for Struggling Members (beggars).

**Collateral-Free Lending:** The Grameen Bank does not require any collateral against its microloans, but instead it provides credit to the poorest of the poor on group basis. Hence, it replaces conventional requirement of physical collateral with group responsibility where group performance determines continued access to credit.\(^{15}\)

**Group Lending:** The Grameen Bank has developed its own credit delivery system to overcome problems of asymmetric information and imperfect enforcement by having borrowers take out loans in self-selected groups of five rather than individually.\(^{16}\) The purpose of the group lending structure is so that the other borrowers monitor and guarantee each other’s debts to the extent that one member defaulting will deprive others of future loans. Hence, while there is no group liability in the sense that repayment responsibility rests solely on the individual borrowers, the group lending structure forces members to be socially and economically accountable to each other, thereby creating pressure among group members to monitor each other and screen out bad borrowers.\(^{17}\)

- Several advantages of the group-lending approach, therefore, are that it uses peer pressure to monitor and enforce contracts, it provides an incentive structure for the borrowers to repay and it helps screen good borrowers from bad ones.\(^{18}\)

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**Rural Banking**

Grameen operates in 81,355 villages across Bangladesh.\(^{19}\) Based on the principle that the bank should go to the people, it has developed a client-centered delivery system in which bank workers go to the poor to collect their weekly installments and disburse new loans.\(^{20}\) Furthermore, to facilitate the expansive provision of microfinance loans across rural Bangladesh, the Grameen Bank credit delivery system is decentralized and hierarchical. Its administrative structure consists of four tiers - the head office, the zonal offices, the area offices and the branches- with a distinctive set of functions for each.\(^{21}\)

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As illustrated by Figure 1.1 at the bottom of the hierarchical structure is the Loan Group consisting of five individual borrowers per group. The group system represents the first level of regulation since loan groups are overseen by a group chairperson who is responsible for maintaining group discipline in weekly meetings, conducting weekly transactions with the bank workers and proposing loans on behalf of other group members.\(^\text{22}\)

At the second level of regulation is the Loan Center. Six to eight loan groups form a Loan Center and each loan center is overseen by a loan center manager who “visits borrowers regularly to monitor loan payments and plays a large role in selecting borrowers, approving lending groups and supervising income-generating projects.”\(^\text{23}\)

Then, as an added risk-management measure, several loan centers are overseen at the Bank Branch level. The branch is “the most important unit in Grameen Bank operations since it is the field-level office with the most contact with its member-borrowers and the basic profit-making unit.”\(^\text{24}\) A typical branch supervises 50-60 centers located in villages within walking distance of the branch and it is responsible for group formation, member training and loan supervision.\(^\text{25}\) Furthermore, each of the Grameen Bank’s 2562 branches is run by a branch manager and several center managers.

Finally, several branch offices are supervised by an area manager and program officer at the area office and they have the ultimate authority to make decisions about individual loans.

\(^{22}\) Rahman, Aminur. Women and Microcredit in Rural Bangladesh.. p.5.

\(^{23}\) Rahman, Aminur. Women and Microcredit in Rural Bangladesh.. p.5.

\(^{24}\) Rahman, Aminur. Women and Microcredit in Rural Bangladesh.. p.5.

## FIGURE 1.2. Summary of Grameen Bank’s Strategy, Risk Management, Growth and Compensation

| Strategy | • Target a unique client base—largely rural women  
|          | • Integrate social and financial goals and create lasting partnerships with the microfinance community to grow the global base of microfinance  
|          | • Lobby governmental organizations to increase visibility of microfinance initiatives  
| Growth   | • No donor funds since 1995  
|          | • 90% of loans funded through income and deposits  
|          | • Started Grameen-branded businesses but limited its risk to small loan commitments; organizations are left to run as independent entities  
| Risk Management | • First line of risk management is the loan group of women from the same village  
|          | • Women put pressure on one another because default affects the ability of each member in the group to take loans  
|          | • This is the most important factor in keeping defaults low  
|          | • Next line of defense is surprise internal audits  
|          | • Quarterly monitoring and evaluation  
|          | • Surprise center visits by branch managers  
| Compensation | • Managed and operated by savers and borrowers  
|          | • 5-star rating system that motivates branches to compete with one another for profitability, excess of savings over loans, educational attainment of borrowers, poverty alleviation of the borrower community and repayment rates. The ratings only carry bragging rights but appear to motivate the branches to compete. |
Chapter 2: Financial Successes of the Grameen Bank

The Grameen Bank’s successes and limitations can be measured in terms of both social and financial standards. Financially, according to the Grameen Bank’s financial statements since 2002 the Grameen Bank has experienced significant institutional, outreach and loan disbursement growth.

Institutional Growth

As illustrated by Figures 2.1, 2.2 and 2.3 Grameen experienced high institutional growth since 2002. In particular, there has been a significant increase in the Grameen Bank’s number of employees, number of offices and total assets.
Figure 2.2 Source- Grameen Bank

Figure 2.3: Source- Grameen Bank
Outreach Growth

The Grameen Bank’s has also experienced significant outreach growth since 2002.\textsuperscript{26} As shown by Figure 2.4 there has been growth in the number of members, the number of active borrowers, the average loan balance per borrower and the percent of women members. As Figure 2.4 illustrates, as of 2009 the total borrowers of the bank were 7.97 million and 97\% of those are women. This indicates that the number of borrowers has more than doubled since 2002, when the bank had only 2.08 million members. Similar growth can also be observed in the number of branches since as of 2009 the bank had 2,562 branches, which is also almost twice the 1,178 branches it had in 2002.

\textbf{FIGURE 2.4 Grameen Bank’s Outreach Growth, 2002-2009}

\begin{center}
\begin{tabular}{|c|c|c|c|c|c|c|c|}
\hline
\hline
3 Number of branches & 1,178 & 1,195 & 1,358 & 1,735 & 2,319 & 2,481 & 2,539 & 2,562 \\
\hline
4 Number of members (In millions) & 2.48 & 3.12 & 4.06 & 5.58 & 6.91 & 7.41 & 7.67 & 7.97 \\
\hline
5 Number of active borrowers (In millions) & 2.08 & 2.87 & 3.70 & 5.05 & 5.96 & 6.16 & 6.21 & 6.43 \\
\hline
6 Number of active borrowers per branch (year-end) & 1,766 & 2,402 & 2,722 & 2,912 & 2,571 & 2,482 & 2,448 & 2,508 \\
\hline
7 Number of loan officers & 7,448 & 7,495 & 7,925 & 9,166 & 12,048 & 14,561 & 14,000 & 13,262 \\
\hline
8 Percent of women members & 95.20\% & 95.44\% & 95.66\% & 96.27\% & 96.70\% & 96.85\% & 96.88\% & 96.79\% \\
\hline
9 Average loan balance per borrower (Tk) & 6,134 & 5,622 & 5,444 & 5,563 & 5,578 & 5,901 & 7,147 & 8,514 \\
\hline
Average loan balance per borrower (USD) & 106 & 96 & 90 & 85 & 80 & 86 & 104 & 123 \\
\hline
\end{tabular}
\end{center}

\textit{Source- Grameen Bank}

Loan Portfolio Growth

Finally, since 2002 the Grameen Bank has also seen growth in its loan portfolio. According to Figure 2.5 below there has been growth in the principal amount of loans disbursed, the number of loans disbursed, the gross total of loan outstanding, the current performing loans and the portfolio growth rate.

**FIGURE 2.5 Grameen Bank’s Loan Portfolio Growth, 2002-2009**

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 Loans (Principal Amount) disbursed (in million Taka)</td>
<td>15,869</td>
<td>21,467</td>
<td>25,873</td>
<td>39,183</td>
<td>49,871</td>
<td>50,430</td>
<td>62,105</td>
<td>79,408</td>
</tr>
<tr>
<td>11 Number of loans disbursed (in millions)</td>
<td>2.13</td>
<td>3.19</td>
<td>3.81</td>
<td>5.09</td>
<td>6.45</td>
<td>6.37</td>
<td>7.18</td>
<td>8.25</td>
</tr>
<tr>
<td>12 Total loan outstanding (gross) (in million Taka)</td>
<td>12,759</td>
<td>16,138</td>
<td>20,127</td>
<td>28,109</td>
<td>33,259</td>
<td>36,337</td>
<td>44,412</td>
<td>54,718</td>
</tr>
<tr>
<td>13 Current (Performing) loans (in million Taka)</td>
<td>12,533</td>
<td>15,679</td>
<td>19,535</td>
<td>27,388</td>
<td>32,365</td>
<td>34,927</td>
<td>42,782</td>
<td>52,318</td>
</tr>
<tr>
<td>14 Overdue loans (in million Taka)</td>
<td>116</td>
<td>371</td>
<td>368</td>
<td>479</td>
<td>595</td>
<td>1,023</td>
<td>1,236</td>
<td>1,439</td>
</tr>
<tr>
<td>15 Portfolio growth rate</td>
<td>1.99%</td>
<td>26.48%</td>
<td>24.72%</td>
<td>39.66%</td>
<td>18.32%</td>
<td>9.26%</td>
<td>22.22%</td>
<td>23.20%</td>
</tr>
</tbody>
</table>

Source: Grameen Bank

The Grameen Bank’s institutional, outreach and loan portfolio growth since 2002 shows that it has been successful at creating more opportunities for the rural poor to borrow money across Bangladesh. By expanding the number of active borrowers, employees, branches, and loans disbursed, the Grameen Bank has been able to expand access to credit and to include millions
more poor people into the financial system. Maintaining such growth in an efficient and financially viable way, therefore, will be instrumental for supporting the Grameen Bank’s goal to expand the provision of microfinance across Bangladesh as a poverty alleviation strategy in the future.

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Chapter 3: Financial Limitations of the Grameen Bank

Decreasing Loan Recovery Rates and Increasing Delinquency

In addition to its high institutional, outreach and loan portfolio growth one of the most important financial successes of the Grameen Bank has been its high repayment rate of 98%. The Grameen Bank has long prided itself on maintaining repayment rates, which are considerably higher than those of mainstream lenders.

In recent years, however, the accuracy of these figures has been disputed and critics have argued that the bank’s repayment rate has been declining and is in fact lower than 98%. Pearl and Phillips, for instance, have criticized the Grameen Bank’s financial reporting procedures and suggested that recent repayment problems are being masked by non-standard accounting practices. Likewise, Associate Professor of Economics and Public Policy at New York University Jonathan J. Murdoch has also maintained that the percentage of the Grameen Bank’s current loan portfolio that is actually at risk is greater than has been reported. According to Murdoch, “Grameen’s repayment rates have never been as good as they have claimed…Because Grameen has been so well-known, nobody has wanted to risk undermining the reputation of the idea”

Despite such criticisms against the Grameen Bank’s loose accounting standards and slow disclosure, recent data posted by the Grameen Bank supports criticisms that there has been a trend towards deteriorating repayment rates and increasing delinquency.

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29 Pearl, Daniel, and Michael M. Phillips. "Grameen Bank, Which Pioneered Loans For the Poor, Has Hit a Repayment Snag."
According to the Grameen Bank’s financial data since 2002:

- The percentage of borrowers not repaying their loans on time has increased
- Loan collection rates have decreased in the short and long term
- Delinquency has increased

**Defaulting Borrowers**

Figure 3.1 shows an approximate 1.50% increase over the last seven years in the percentage of outstanding borrowers missing 5 to 9 consecutive loans (1-2 months of weekly installments) from 0.10% in June 2002 to 1.51% in December 2009.

![Figure 3.1: Source- Grameen Bank](image)

**Loan Collection Rate**

Similarly, as Figure 3.2 illustrates the Grameen Bank has been experiencing recurring difficulties in collecting its loans particularly since December 2003. According to the graph there has been a decline in the on-time loan collection rate (% of amounts due actually paid) from nearly 99% in 2003 to the current 96.83%, marking a decrease of 2.17%.
Short and Long Run Loan Collection Rates

Likewise, when considering longer term difficulties, such as total amounts owed by people who have not only missed 5-9 consecutive payments but missed 10 or more payments, similar trends towards declining on-time repayment are evident since 2002.
In Figure 3.3 the % of amounts due in a month not paid is a non-recovery rate or the inverse of the values of Figure 3.2 from a collection to a non-collection standpoint; therefore, it shows the same trend as Figure 3.2 shows of decreasing on-time collection rates since 2002. Likewise, the two added indicators of the % of amounts outstanding owed by those who have missed 5-9 consecutive payments and 10 or more consecutive payments also show a similar trend towards decreasing on-time collection rates for longer periods of time.  

Delinquency

Finally, although the definition of repayment rate varies widely over microfinance institutions, in the microfinance industry 30 days is a common breakpoint marking when a loan becomes delinquent; hence, Portfolio at Risk (PAR) 30 is considered to be a standard international measures of portfolio quality since it measures the portion of a portfolio which is deemed at risk because payments are more than 30 days past due.  

According to Figure 3.4 there has been a rise in delinquency for the Grameen Bank’s core credit product, the basic loan, and for its flexible loans since 2002 due to the fact that there has been a rise in its Portfolio at Risk/30 days (Par 30) levels.


Although there has been a rise in the Grameen’s PAR 30 levels since 2002, this increase in PAR30 does not necessarily signal that the Grameen Bank is in a serious repayment crisis. In fact, a microfinance institution is considered to be in a serious crisis when its PAR 30 is above 5 or 10%. This is supported by a study from 2003 to 2008 which shows that “a random MFI of over US$1 million in assets had a 1–5% chance of failing during a three-year period, an MFI that reported PAR30 >5% had a 6–10% chance of failure, while one with PAR30 >10% would fail

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10–15% of the time.”^{34} Hence, since the Grameen Bank’s PAR 30 levels have remained consistently below the 5% threshold, the recent increase in PAR 30 is currently only a red flag indicator that a repayment crisis could occur in the future if these levels are permitted to rise further.

In addition, comparative data also shows that, despite the recent increase in its PAR 30 levels, the Grameen Bank has also been performing well relative to its main competitors BRAC and ASA. As Figure 3.5 illustrates since 2004 the Grameen Bank’s PAR 30 levels have been relatively lower than those of BRAC and ASA.^{35}

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^{34} Reille, Xavier, Christoph Kneiding, Daniel Rozas, and Nick O’Donohoe. "All Eyes on Asset Quality: Microfinance Global Valuation Survey 2010."

Although the accuracy of this comparison is ultimately dependent on the accuracy with which each of these institutions have measured and reported their overdue portfolios, according to available data from the Grameen Bank and Mix Market, the Grameen Bank’s PAR 30 levels have remained low relative to its competitors since 2004.36

Finally, the Grameen Bank has also been performing comparably to Syminvest’s 50 major investible microfinance institutions. As Figure 3.6 shows, much like the Grameen Bank, the average PAR 30 of the SYM 50 investible microfinance institutions has also not significantly exceeded the 5% threshold in recent years.37

The Grameen Bank, therefore, is not currently in a serious repayment crisis since its PAR 30 levels are below 5%, they are relatively lower than its main competitors BRAC and ASA and

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they are comparable to the average PAR 30 of the SYM50 investible microfinance institutions. However, precautions should nevertheless be taken to avoid more serious financial problems in the future particularly since higher delinquency could make it impossible for the Grameen Bank to be financially sustainable in the long run.

**Possible Causes of the Decreasing Recovery Rates and Increasing Delinquency**

To prevent the decreasing recovery rates and increasing delinquency from leading to a serious repayment crisis in the future it is important to consider possible causes of the recent trends. Although there are numerous possible explanations, in the following section multiple borrowing, over borrowing, adverse selection and the economy will be examined in greater detail as possible contributing factors to the Grameen Bank’s decreasing recovery rates and increasing delinquency since 2002.

*Adverse Selection*

The problem of adverse selection arises in microfinance when microfinance institutions are unable to distinguish between ‘risky’ and ‘safe’ borrowers prior to providing the loans.\(^{38}\) In the contractual relationship between the Grameen Bank and potential borrowers, therefore, there is an adverse selection risk because the Grameen Bank is not able to defer to usual measures of risk assessment, such as collateral or credit ratings to determine whether borrowers are ‘risky’ or ‘safe.’\(^{39}\)

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The group lending structure of the Grameen Bank, however, has diminished the bank’s role in controlling for such adverse selection problems because it has “triggered a peer selection effect among borrowers who know each other and often have more information about their peers because they belong to the same small rural communities.”\textsuperscript{40} This is the case because since group lending creates joint liability, it also induces borrowers who have perfect information about each other to choose partners of the same type.\textsuperscript{41} Consequently, safe borrowers have formed groups with other safe borrowers, leaving the risky borrowers to form their own groups.\textsuperscript{42}

Although the Grameen Bank’s group lending structure has reduced the possibility of adverse selection problems, it is probable that these adverse selection problems have not been fully corrected as the Grameen Bank has continued to expand. For instance, it is probable that they have not been completely corrected by the Grameen Bank’s staff since rapid growth typically requires MFIs to assign staff more quickly into responsible positions, sometimes resulting in less care being taken in recruitment, training, and preparation.\textsuperscript{43} Likewise, it is also probable that Grameen’s adverse selection problems may not have been completely self-corrected by borrowers as the number of Grameen borrowers has increased since risky borrowers are more likely to have joined groups with other borrowers.

As a result, it is possible that while expanding the bank has attracted a greater number of inherently risky borrowers, such as borrowers who are less driven, more risk seeking, poorly disciplined, less entrepreneurial or have lower quality projects. This is supported by the fact that as Figures 3.2 and 2.4 illustrate since 2002 there has been an increase in the number of Grameen borrowers.

\textsuperscript{40}Borge, Tore, and Oscar Olsen. \textit{The Missing Link in Microfinance}. p.9.

\textsuperscript{41} Borge, Tore, and Oscar Olsen. \textit{The Missing Link in Microfinance}. p.9.

\textsuperscript{42}Borge, Tore, and Oscar Olsen. \textit{The Missing Link in Microfinance}. p.9.

\textsuperscript{43} Chen, Greg, Rasmussen Stephen, and Reille Xavier. \textit{Growth and Vulnerabilities in Microfinance}. 
members and employees at the same time that there has also been a decrease in the loan collection rate. Given this positive correlation, therefore, it is possible that the rise in delinquency could be related to the fact that the Grameen Bank has been providing loans to riskier borrowers since 2002.

*Concentrated Market Competition and Multiple Borrowing*

The rise in delinquency at the Grameen Bank could also be attributed to an increase in multiple borrowing. The likelihood that clients borrow from more than one MFI has increased due to the fact that currently over 650 microcreditors operate in Bangladesh.\textsuperscript{44} Furthermore, since there is no national identification system in Bangladesh, creditors have been unable to share information to track how much debt people are juggling, as creditors in developed countries do through credit bureaus.\textsuperscript{45} As a result of this rise in competition and lack of transparency in terms of disbursing credit, microfinance borrowers have been able to take loans from multiple sources to smooth their cashflows.

According to Pearl and Phillips, the increasing competition from other microcredit institutions has not only resulted in a problem with overlapping loans from multiple institutions, but it has also created pressure for borrowers to maintain greater self-discipline.\textsuperscript{46} Despite this pressure, however, they suggest that multiple borrowing has in fact resulted in an erosion of credit discipline over the past several years because borrowers that have taken multiple loans have strived to maintain their regular repayment schedule through a process of loan recycling and

\textsuperscript{44} Chen, Greg, Rasmussen Stephen, and Reille Xavier. *Growth and Vulnerabilities in Microfinance.*

\textsuperscript{45} "Grameen Bank, Which Pioneered Loans For the Poor, Has Hit a Repayment Snag."

\textsuperscript{46} "Grameen Bank, Which Pioneered Loans For the Poor, Has Hit a Repayment Snag."
cross-financing, despite not having the ability to repay their loans. Moreover, since borrowers have been able to raise their total borrowings from multiple sources, the Grameen Bank’s practice of gradually raising loan sizes to ensure borrowers remain within their repayment limits has become less useful as a risk management tool. Instead, by taking on debt from multiple sources, borrowers have increased their liability and the risk of becoming trapped in a cycle of debt. Moreover, the increased competition and multiple borrowing observed in recent years has also created pressure for the Grameen Bank to remain competitive and to impose effective discipline on borrowers. However, since borrowers have been able to access loans from several MFIs or alternate between loans, they have become less dependent on the Grameen Bank and thus less constrained by its loan repayment schedules. Consequently, they have been able to default and still retain their borrowing relationship with other MFIs and this has in turn diminished their incentive to repay and made late payments more likely.

Another possible explanation for the decreasing loan collection rate, therefore, could also be the fact that Bangladeshis are currently juggling loans from several microcreditors at once and/or borrowing more money than they can repay. If this is the case, in the future it will be critical to establish a credit bureau in order to improve credit risk management and prevent a more expansive erosion of credit discipline.

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47 "Grameen Bank, Which Pioneered Loans For the Poor, Has Hit a Repayment Snag."


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Over Borrowing

Similarly, it is also possible that the increasing delinquency and percentage of borrowers defaulting can be due to the fact that borrowers are currently borrowing larger total amounts from the Grameen Bank than they can repay. As illustrated by the Figure 4.2 the amount of outstanding credit per Grameen Bank member has increased from 5160 taka in 2002 to approximately 7300 taka in 2010, which is also the same time period during in which the rise in delinquency took place:

![Graph showing the increase in outstanding credit per Grameen Bank member from 2002 to 2010.](Figure 3.7: Source- Grameen Bank Which Pioneered Loans for the Poor Has Hit a Repayment Snag)

This increase in total amount borrowed therefore makes it more likely that some clients are borrowing amounts beyond their means.\(^{51}\) Given the fact that there is also a positive correlation between the rise in delinquency by Grameen borrowers and the increase in outstanding credit per

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Grameen Bank member, therefore, over borrowing could also be another possible explanation for the recent rise in delinquency and decline in repayment rates since 2002.

**Economy of Bangladesh**

Finally, it is also possible that the economy of Bangladesh and the effects of the global financial crisis have indirectly inhibited Grameen member’s ability to repay their loans since there was a peak in delinquency during 2008 and 2009. According to macroeconomic indicators for the fiscal years of 2008 and 2009, however, problems in the economy did not cause the rise in delinquency because macroeconomic data shows that the economy of Bangladesh weathered the global economic crisis well and that instead it has been growing during the past years. In fact, in FY09 annual GDP growth still reached a healthy 5.9% GDP growth because limited integration with the world economy helped shield Bangladesh from the negative effects of the global economic crisis.52

![Annual Real GDP Growth (%)](image)

*Figure 3.8: Source- Bangladesh Bureau of Statistics*

Furthermore, although annual GDP growth in FY09 decelerated slightly from the 6.2% growth in FY08, the 5.9% GDP growth in FY09 was nevertheless considerably higher than in FY02 when GDP growth was approximately 4%. This is important because it shows that there has been healthy economic growth in Bangladesh during 2002-2008, the same years that delinquency has increased at the Grameen Bank. Hence, it is likely that external macroeconomic factors did not directly contribute to the recent rise in delinquency and decline in repayment rates since 2002.

53 Bangladesh Economic Update September 2009.
Chapter 4: Social Successes and Limitations of the Grameen Bank

In terms of social standards the Grameen Bank has also had significant successes and limitations.

Sixteen Decisions

Beginning in 1984, the Sixteen Decisions was introduced by the Grameen Bank as a social development program “to imbue members with discipline, unity and hard work to improve their living standards.” The Grameen Bank developed the Sixteen Decisions in order to promote social and financial discipline among the rural poor. At every branch of Grameen Bank the borrowers recite the Sixteen Decisions and they pledge to follow them. As illustrated by Figure 4.1 these decisions include certain codes of conduct that members are encouraged to follow in their daily life, such as the production of fruits and vegetables in kitchen gardens, investment for improvement of housing and education of children, use of latrines and safe drinking water for better health, and rejection of dowry in marriages.

According to the Grameen Bank, the implementation of the Sixteen Decisions has been successful because it has encouraged Grameen borrowers to adopt positive social habits. For instance, the Grameen Bank states that since the Sixteen Decisions were implemented almost all Grameen borrowers have their school-age children enrolled in regular classes and this in turn has helped bring about social change and educate the next generation.

Figure 4.1 presents a list of the Grameen Bank’s Sixteen Decisions.

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56 Hossain, Mahabub. *Credit for the Alleviation of Rural Poverty: The Grameen Bank in Bangladesh*. 
Sixteen Decisions of the Grameen Bank

1. We shall follow and advance the four principles of Grameen Bank: Discipline, Unity, Courage and Hard work – in all walks of our lives.
2. Prosperity we shall bring to our families.
3. We shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest.
4. We shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus.
5. During the plantation seasons, we shall plant as many seedlings as possible.
6. We shall plan to keep our families small. We shall minimize our expenditures. We shall look after our health.
7. We shall educate our children and ensure that they can earn to pay for their education.
8. We shall always keep our children and the environment clean.
9. We shall build and use pit-latrines.
10. We shall drink water from tube wells. If it is not available, we shall boil water or use alum.
11. We shall not take any dowry at our sons' weddings; neither shall we give any dowry at our daughter's wedding. We shall keep our centre free from the curse of dowry. We shall not practice child marriage.
12. We shall not inflict any injustice on anyone; neither shall we allow anyone to do so.
13. We shall collectively undertake bigger investments for higher incomes.
14. We shall always be ready to help each other. If anyone is in difficulty, we shall all help him or her.
15. If we come to know of any breach of discipline in any centre, we shall all go there and help restore discipline.
16. We shall take part in all social activities collectively.

Figure 4.1: Source - Grameen Bank

Limitations

Despite claims by proponents about the benefits of the Sixteen Decisions, however, opponents of this policy claim that it forces families and borrowers to abide by the rules and regulations set forth by the bank. Furthermore, some have gone as far as to say that the mandatory changes in lifestyle that the Grameen Bank imposes through the Sixteen Decisions “are tantamount to a cult’s demands.”

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Lending to Women

Historically, women have been neglected by development projects and removed from the growth and development process. The Grameen Bank, however, has actively promoted their membership and deliberately targeted women, recognizing that “their participation in social development is necessary for economic development because of their primary role in providing health, education and nutrition to the family members.”

By providing women with access to credit the Grameen Bank has helped women to initiate income-earning activities, marking a significant step towards promoting equity between men and women and establishing gender justice. Moreover, as a consequence of their increased economic opportunities, women have been able to gain authority and respect from their spouses and communities. Lending to them, therefore, has not only had positive effects on their economic participation and earnings, but it has also had a positive effect on their marital decision-making power and their ability to no longer be financially powerless in their families and communities.

In addition, the Grameen Bank has also helped poor women acquire self-esteem by promoting entrepreneurialism. Their extra income has also brought about better living conditions for other family members, especially their children. In fact, women are now able to “take a more active role in their children’s futures by providing their children with better educational opportunities

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and conveying a positive image about women to their daughters.”

Hence, advocates of the Grameen Bank suggest that it has promoted social justice by redressing Bangladesh’s history of depriving women access to credit and empowering poor people who had previously been disfranchised.

**Limitations**

Contrary to claims about the role of the Grameen Bank in promoting social justice and empowerment, critics view the Grameen Bank’s policies and services as disempowering to women. They claim that since the Grameen Bank targets its loans to women, some husbands who have been excluded, have forced their wives to sign up for loans, only to appropriate the funds from them. They suggest that most women borrowers are not the direct benefactors of the credit extended to them, but instead they “are mediators between male household members and the bank.” Hence, they indicate that the provision of loans to women does not empower them because “the lending mechanism can operate under the prevailing patriarchal norms of the village society and the positional vulnerability of women.” Instead, they contend that rather than empowering women, the Grameen Bank has inaugurated, “new forms of domination over women in society.”

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Other Social Effects

Finally, according to numerous studies, the following are several other social effects that the Grameen Bank has had on its borrowers, their families and rural villages in Bangladesh.

• *Higher Incomes*- The incomes of Grameen members are approximately 43% higher than incomes of control groups in nonprogram villages and 28% higher than nonmembers in Grameen villages. Grameen members are also able to rely more on savings and their own funds to cope with crises rather than to borrow from moneylenders.70

• *Household consumption*- Female clients have increased household consumption by 18 takas for every 100 takas borrowed.71

• *Children Education*- The children of Grameen borrowers compared to children of non-members show higher levels of schooling. For instance, almost all girls in Grameen households have had some schooling, compared to 60% of girls in non-client households. Furthermore, the schooling rate is significantly higher for boys given that 81% of boys in client households have received some schooling, compared to 54% in non-client households.72

• *Contraception*- Grameen clients show a higher rate of contraceptive use (59%) than non-clients (43%). This has been attributed to clients’ increased awareness of contraceptive programs.73

70 Hossain, Mahabub. *Credit for the Alleviation of Rural Poverty: The Grameen Bank in Bangladesh.*


73 ““What Do We Know about the Impact of Microfinance?” CGAP.
• *Environment* - Grameen Shakti is a non-profit company, part of the Grameen family, which has distributed clean energy products in remote areas of Bangladesh. As of December 2006, it has installed 77,000 solar home systems and 500 biogas plants.\(^{74}\)

\(^{74}\) "What Do We Know about the Impact of Microfinance?" CGAP.
Conclusion: The Grameen Bank and the Microfinance Movement

Since the Grameen Bank was established in 1976 it has demonstrated the potential of microfinance as an important liberating force and instrument in the struggle against poverty. By expanding access to credit to poor households across rural Bangladesh, the Grameen Bank has rejected the basic methodology of conventional banking and developed a paradigm using rules of lending that are tailored to help the rural poor. Furthermore, despite its limitations, the Grameen Bank has defied its critic’s expectations and proven to be a financially and socially successful institution.

From a financial standpoint, the Grameen Bank has successfully experienced high institutional, outreach and loan portfolio growth since 2002. By expanding the number of active borrowers, employees, branches, and loans disbursed it has been able to increase access to credit across rural Bangladesh, to include millions more poor people into the financial system and to create more self-employment opportunities for them. Moreover, although there has been a decrease in the Grameen Bank’s recovery rates and increase in delinquency since 2002, according to its PAR 30 levels, the standard international measure of portfolio at risk, currently the Grameen Bank is not in a serious repayment crisis. Rather, it is performing comparably to the SYM50 investible microfinance institutions and relatively better than its main competitors BRAC and ASA.

From a social impact standpoint, the Grameen Bank has also been successful. Although criticisms have emerged that the bank’s growth has contributed to the recent rise in delinquency, even if this is the case the benefits of helping a larger number of poor borrowers have outweighed the costs of higher delinquency particularly since the bank’s provision of credit has had significant social benefits for its borrowers. For instance, by providing women with access to

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credit, the Grameen Bank has helped women initiate income-earning activities, become financially independent and gain authority and respect from their spouses and communities; thus marking a significant step towards establishing gender justice. In addition, by providing the rural poor with an opportunity to invest in self-employment microenterprise actives, it has also helped borrowers reduce their vulnerability to crises and become empowered. Likewise, other important social effects include higher incomes, higher household consumption, increased children education, greater contraception use, among others.

Finally, in addition to being socially and financially successful as an institution, the Grameen Bank has also been successful as a key figure that has led to the emergence and development of the microfinance movement. Although Grameen-like microfinance may not be a panacea for global poverty alleviation, given its limitations, the success of the Grameen Bank has nevertheless demonstrated that microfinance can be an effective development tool. As a result, in recent years microfinance has emerged as a new approach to poverty alleviation and social change, it has gained widespread international recognition and it has been incorporated into mainstream development agendas. Ultimately, therefore, the Grameen Bank’s success has not only extended to its work as an independent microfinance institution, but also as the founder of the microfinance movement, which has significantly improved the lives of millions of poor people over the past three decades and changed the development discourse around the world.
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