

Chapter 2

Microcredit, Inclusive Finance and Solidarity

Noriatsu Matsui and Hiromi Tsuboi

Abstract The Grameen Bank of Bangladesh is one of the largest and most successful microcredit organizations. Its success in poverty alleviation comes from the human and organizational principles based on the philosophy of its founder, Muhammad Yunus. These Principles are embodied in Grameen Bank's organizational structure, the emphasis of weekly Center meetings, and above all the people-centered Sixteen-decisions. The meetings have served as education, communication, information, and social training for the poor who have never had such opportunities. Social business has been advocated and promoted as the mechanism to generate IGAs for the poor to use the microcredit. Social business and microcredit have been shown to be effective for the economic independence of the poor. Microcredit organizations pioneered earlier have led the development in this area in increasing financial access to the poor of the world, and various other financial activities, such as saving accounts, deposit accounts, insurances, and pension plans. Recent development from microcredit has evolved into inclusive finance, responsible investment, and assistance to the variety of social business.

Keywords Microcredit · Microfinance · Grameen Bank · BRAC · Poverty alleviation · Social business · Inclusive finance · Responsible investment

2.1 Introduction

This chapter discusses principles and development of microcredit. Microcredit system has become well recognized among development scholars, practitioners, and policy makers as a tool that is effective for the purpose of poverty reduction in

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many developing countries. The system of microcredit has unique and significant relevance in development economics. It is unique in the sense that it is the only development mechanism which has originated in the developing world. It is significant because it is the system in which the wish and intents of the poor people are directly honored and utilized when it is successful (Smith and Thurman 2007; Ahmed and Hakim 2004).

Microcredit and micro-finance have been used interchangeably recently. When the term micro-finance is emphasized, it has been used to include more comprehensive financial activities than just giving credit to the poor. It includes savings accounts and other diverse financial activities beyond granting small loans to the poor. Deposit accounts, kinds of insurance, and housing and education loans for low income people are all included in microfinance activities (de Aghion and Morduch 2005).

It is estimated that there are 2.7 billion adults who do not have any access to banking services in the developing world. As mentioned above, microfinance recently has shown a remarkable track record as an important tool for fighting against poverty and has entered the financial mainstream the world over. Around 15–20 years ago there were very few microcredit organizations anywhere. The increase in the number of microfinance institutions in the world has been quite impressive. There are also so many wholesale institutions for microfinance that have sprung up that it is hard to imagine that Muhammad Yunus has been strongly advocating the necessity of establishing wholesale financial institutions for microcredit for poverty alleviation then (APO 2006; Mosley and Steel 2003).

In this chapter we will examine Grameen Bank of Bangladesh as a pioneer of microcredit for the poor in the developing world. Some of the characteristics in the operation of the Grameen Bank are explained in Sects. 2.2 and 2.3, after discussing a brief history of microcredit development. All the major factors and operational modes of microcredit are listed. Grameen Bank as the mother of social business for poverty elimination will be discussed as a form toward solidarity economy in Sect. 2.4. The next section, Sect. 2.5 surveys recent movements in this area of inclusive finance and various institutions' functions in providing a variety of financial services to the poor in the world. This chapter tries to capture the most influential and contributing elements and factors for the success of microcredit systems in the world today.

2.2 Development of Microcredit

The Grameen Bank of Bangladesh started to give credit to the poor in 1976. After significant struggle, it was established as a government-chartered bank in 1983. Today, the Grameen Bank services more than 8.5 million people in Bangladesh, loaning small amount of money to the poor with a repayment rate of over 98 %. The small amounts of credit are extended without any collateral to the poor who are normally refused access to formal banking opportunities. This method of

giving credit to the poor has been so successful that more than 60 countries the world over have adopted this system of providing group-based, small amount of credit without any mortgage for the purpose of helping the poor escape from the trap of poverty and establishing their independence and thus their self-esteem (Khandker 1998).

Microcredit for the purpose of poverty elimination is a means to give leverage to the poor. The poor traditionally has been refused complete access to the banking system. Microcredit is intended to be useful in expanding people's substantial freedom (Sen 1999, pp. 39, 201–203), which is the ultimate goal of “development” and also is the means to achieve the development.

In a practical sense, the empowerment of the poor also requires instilling self-determination of their own life, and ability to organize, and thus resulting in self-confidence and self respects. Microcredit system designed for poverty elimination explicitly recognizes those important aspects put into the system. The borrowers in the microcredit system are encouraged to unite, attain mental independence, and to become able to manage their own resources with their own will free of external control.

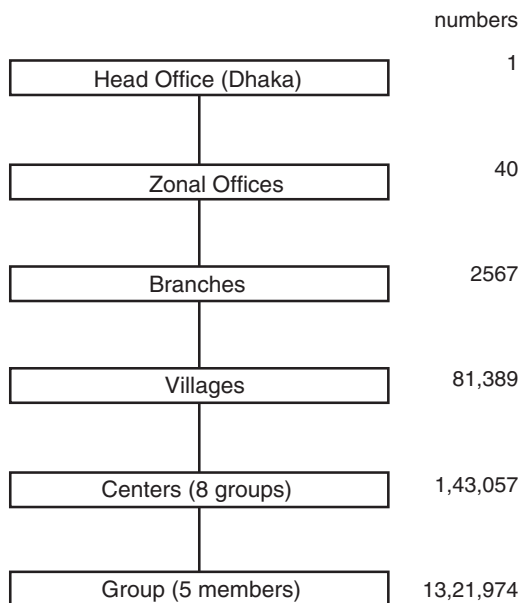
In order to borrow money from the Grameen Bank, one has to become a member of a group of five. To be a member one has to be poor, own less than half an acre of land, and be able to write one's name by hand. A regular loan is given to a member who has to pay back the loan in 50 weekly installments with interest. Payments in weekly installments are done at the Center meeting, where not only payback and recording but also certain group activities are carried out. The group activities are very important for the rural poor because they constitute rare opportunities to get information from a wider world than they regularly would get to know, and to become educated in social life. Thus, Center meetings can be understood as a unique opportunity of adult education for the rural poor women.

After paying back the loan fully in 50 weeks, a woman can then obtain a larger loan again for another 50 weeks. These loans are supposed to be used for some income generating activities (IGAs) such as milking cows or raising chickens, fish farming, starting a weaving business, or similar small business activities for the family. How and when a borrower uses the loaned money depends wholly on the borrower, not on the direction or control of the lender, Grameen Bank staff.

Grameen Bank now has saving accounts, deposit accounts, pension programs, life insurance, and other types of loans such as housing, and business, and education loans. The growth and success of Grameen Bank has been attributed by number of factors. The loan recovery rate of higher than 97 % and the 96 % participation rate of women must be noted as significant because Grameen Bank operates only in rural areas of Bangladesh, one of the poorest countries in the world, and deals with women who usually do not have voices of their own in families and communities.

The organizational structure is shown in the Fig. 2.1. It should be noted that there are groups of Grameen members who are more or less than 5. There are also non-members who have deposit accounts, insurance policies, or pension programs now.

Fig. 2.1 Organizational structure of Grameen Bank. Numbers at right are from www.grameen.com, as of January 2014



2.3 Effectiveness of Microcredit as Social System

The purpose of this section is to discuss the nature and characteristics of microcredit as a social organization that under certain conditions functions as an effective mechanism to help promote the realization and development of individual capability. The discussion demonstrates how contributing factors for the success of the microcredit mechanism are much in line with human nature.

2.3.1 *Grameen Bank*

The basic activity of Grameen Bank is to give small amounts of credit to the poor without any mortgage. The following will list some of the fundamental features of the Grameen Bank's operation (Yunus 2007, 2010).

1. Credit to the poor, in small amount: In order to qualify as a member, one has to be poor, defined as a landowner with less than one half of an acre, or who is landless. The amount of credit given to individuals is approximately \$100–\$200 (i.e., about Taka 10,000–20,000, or in Japanese Yen 10,000–20,000).
2. No collateral: There is no mortgage, and neither is credit insurance required.
3. Group (5 members) based lending: Five members in a group all must be the same sex, and only one person from the same household can join in Grameen Bank. A leader of the group has to form the group voluntarily, based on trust. The formation of groups plays an important role in joint responsibility, because

only one member at a time can get the loan after other members start to repay in weekly installment.

4. Weekly installments: Repayment usually begins right after one borrows the money at the weekly Center meeting, in 50 equal installments including interest payment. The interest rate for a Grameen loan is about the same as that of commercial banks in the market, 18–20 % per annum.
5. Weekly meeting at Center: Center consists of up to 8 groups, thus up to 40 members. Bank workers visit each Center meeting, 2 meetings in each morning. One bank worker usually visits and attends Center meetings up to 10 a week. Center leaders and group leaders, working with a Grameen Bank employee, take initiatives to conduct the Center meeting and help the Grameen Bank employee collect the money.
6. No restriction on the use of the loan: each individual borrower can use the loan for any IGAs. For example, raising chickens, selling eggs, fish pond farming, buying cows and selling milk, weaving and yarn, and making dresses and clothes for villagers.
7. Strict principles and flexible practices: There are 16 decisions that members of Grameen Bank developed over the years. Grameen Bank has changed its organization quite flexibly to adopt new realities in the economy.
8. After some difficult times following the flood of 1998, Grameen Bank changed the entire system of lending the loan, depositing it, and making repayment more flexible. This is called the “Grameen Generalized System (Grameen II)” which started in 2002.
9. In 2004, Grameen Bank started the “Struggling Member Programme,” which gives loans to street beggars.

Members of Grameen Bank at weekly Center meetings recite the 16 Decisions in order to remind themselves as a guideline for their daily lives. The *16 Decisions* of Grameen members are:

1. The four principles of Grameen Bank: Discipline, Unity, Courage, and Hardwork: we shall follow and advance in all walks of our lives.
2. We shall bring prosperity to our families.
3. We shall not live in dilapidated house. 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 planting 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 environment clean.
9. We shall build and use pit-latrines.
10. We shall drink water from tubewells. If it is not available, we shall boil water or use alum.

11. We shall not take any dowry at our son's weddings, neither shall we give any dowry at our daughter's weddings. We shall keep the 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.

Some of the Grameen Bank's principles are said to be that the right to get a credit is a human right, and that any human being has the willingness and ability to use the loan to improve their lives if the opportunity for a loan is given. These are based on the strong belief of Muhammad Yunus. Therefore, Grameen Bank goes to the people instead of the people going to the bank. Referring to the situation that the poor were not given access to the credit simply because they are poor, Muhammad Yunus says that it is not that the people are not credit-worthy, rather that the traditional banks are not people-worthy.

Grameen Bank has adopted 10 indicators by which members are judged to be poverty-free. These indicators were developed over time, and not by imposition from the top of the organization but rather from people's need to identify poverty. A member is considered to have moved out of poverty if her family fulfills the following criteria. They are:

1. The family lives in a house worth at least Tk. 25,000 (twenty five thousand) or a house with a tin roof, and each member of the family is able to sleep on the bed instead of on the floor.
2. Family members drink pure water of tube-wells, boiled water or water purified by using alum, arsenic-free, purifying tablets or pitcher filters.
3. All children in the family over six years of age are all going to school or finished primary school.
4. Minimum weekly loan installment of the borrower is Tk. 200 or more.
5. Family use sanitary latrine.
6. Family members have adequate clothing for every day use, warm clothing for winter, such as shawl, sweater, sheets, blankets, etc. and mosquito-nets to protect themselves from mosquitoes.
7. Family has sources of additional income, such as vegetable garden, fruit-bearing trees, etc., so that they are able to fall back on these sources of income when they need additional money.
8. The borrower maintains an average annual balance of Th. 5,000 in her savings accounts.
9. Family experiences no difficulty in having three square meals a day throughout the year, i.e., no member of the family goes hungry any time of the year.
10. Family can take care of the health. If any member of the family falls ill, family can afford to take all necessary steps to seek adequate health care (Fig. 2.2).



Fig. 2.2 A scene of a weekly center meeting of Grameen Bank, Noyonpur Village, August 2007

2.3.2 BRAC

BRAC (formerly Bangladesh Rural Advancement Committee) is another known microcredit organization based on a “credit plus” approach. It was established as a relief and rehabilitation organization in 1972 after the Bangladesh Liberation War. Over the years, BRAC has gradually evolved into a large and multifaceted development organization with the twin objectives of alleviation of poverty and empowerment of the poor (<http://microfinance.brac.net>).

It has been very successful in extending loans to the poor in the rural areas and repayment rate is 97.97 %. At the end of 2003, BRAC covers all of 64 districts of Bangladesh, 94 % of Upazilas (480 out of 507). The members (they call Village Organization Members) are more than 5.66 million with 99 % of who are women in 282,412 Village Organizations over the country. BRAC has also established 18 *Promises* for the members to recite at each VO meetings. They are;

1. We will not adopt corrupt or unlawful means.
2. We will work hard and improve our living conditions.
3. We will educate our children.
4. We will adopt family planning measures and have a small family.
5. We will keep ourselves, homes and surroundings clean.
6. We will always drink potable water.
7. We will always cover our food and wash our hands before eating.
8. We will build sanitary latrines & stop indiscriminate defecation.
9. We will cultivate vegetables around our homesteads and plant trees.
10. We will always help others.
11. We will fight against polygamy and violence towards women.
12. We will be loyal to our Village Organizations and obey its rules and regulations.

13. We will not sign anything without full understanding what is written.
14. We will attend the weekly and monthly meetings punctually.
15. We will obey the decisions of our Village Organizations.
16. We will deposit our weekly savings regularly.
17. We will repay all loans in time.
18. We will give equal opportunities to girls as well as boys.

2.3.3 Factors for Success

There are varieties of microcredit organizations not only in Bangladesh but also in many other developing countries. From many successful experiences, it is possible to extract the factors which have played critically important roles in microcredit systems that have served social organization for the cultivation and development of individual capability of the members of microcredit system.

First, there is an incentive mechanism to repay the loan fully. The rules of repayment and installment are simple to understand and easy to actually implement. Once fully paid back by a regular fixed number of installments, one becomes eligible to get a bigger amount of loan. A small group-based borrowing mechanism plays the role of mutual guarantee within the group. This mechanism is important because it works as the collateral which microcredit usually does not require, and because it prevents moral hazards from happening by requiring voluntary formation of the groups. Further evidence of the effectiveness of small groups is shown by higher default rates in the programs like the BRDB (Bangladesh Rural Development Board, a branch under the Ministry of Agriculture) microcredit program in which the number of group members is allowed to be 12–24. Having the number of group members near or more than 20 may often create free-riders and reduced incentive to repay regularly and ultimately even a borrow-and-run phenomena among the members.

Secondly, regular meeting attendance is mandatory not only for repayment but also for educating members and information dissemination. The role of education is quite significant in the sense that it gives the opportunity to raise awareness and literacy, to learn new things, to discipline punctuality, and also to train leadership in groups and among larger organization. Those who successfully show leadership qualities in small groups will be given further opportunities to become leaders in larger meetings. The role of information dissemination plays a significant role in order to widen the scope of knowledge on the side of the poor about family planning, nutrition, health care, housing, and children's education.

The third factor would be the fact that there is no specific requirement or specification imposed by the lender as to the use of the borrowed loan. This has often been one of the criticisms of Grameen Bank, suggesting that loans borrowed by women have been used up by husbands, that the loans can be used as means to repay other loans, and that there is no guarantee that the money is used for

income-generating activities. Based on trust, microcredit utilizes and is dependent on the willingness and ability on the side of the borrowers, the poor, in terms of their capability to improve their own lives, livelihood and the overall quality of life including their children. So far, the evidence shows that it is effective to trust people rather than distrust.

Year 2005 was the UN International Year of Microcredit in which targets of the microcredit were to reach millions of the poor in the world and through which the target of halving poverty in the UN Millenium Development Goals (MDGs) can be achieved. In order for the system of microcredit to be successful it is necessary that adopts three aspects mentioned above with careful consideration of local conditions.

2.4 Grameen Model of Social Business as Solidarity

One of the ideas of Muhammad Yunus behind the system of microcredit is the brief that the poor is a natural entrepreneur. In other words it says that anybody and everybody can have chance to become a successful entrepreneur. All that they need is a bit of success in what they do and a small initial amount of money. The Grameen Bank believes that by lending that small amount of initial money in the form of a loan the poor can realize great potential to be successful in their life and business.

Banerjee and Duflo (2011) point out that there are two reasons why the poor tends to find better chance to be successful. One relates to opportunity (2011, Chap. 9). The poor have a better chance to get fresher and newer ideas that no one has tried, to the extent that they have not been given opportunities so far. The second reason recognizes a new development. The market has neglected the BOP (Base of the Pyramid). Now, the new innovations to improve the life of the poor are in the hand of the poor themselves.

In order to make people acquire a long-term perspectives, not only income alone but also a sense of stability may play an important role. The sense of stability means the sense of affirmation of controlling power over one's future through the recognition that one can get a stream of income every month for sure.

Muhammad Yunus of Yunus Center (formerly the Managing Director of the Grameen Bank) has been persuading the youth in the world to create "social business" to tackle various social problems in each region and country. Social business has been proposed as a viable form of enterprise to pursue the social problems. It is recognized that those social problems are the kinds which neither government nor private organizations can continuously deal with to achieve the purpose of solving problems in society for longer and sustainable ways.

The definition of "social business" has been proposed in quite different ways by various agencies and organizations the world over. Social enterprise, social entrepreneurship, and other terms were frequently used. The forms of business organizations also differ in the areas and scope of goods and services they offer.

However, it seems that at least two conditions are clearly commonly mentioned for the qualification as “social business.” They are;

1. Solving one or more social problems must be the main purpose, therefore, even if profit or dividends are yielded, they will not be distributed to those who provided the capital.
2. The organizational management takes the form of business. This is so because it pursues the sustainability of the operation. Depending on donations, charity money, governmental subsidies, or even members’ fees do not guarantee to sustain the operation. Independent and self-sufficient operation of the enterprise is the basis for this.

Notes derived from the first condition are (1) that profit, surplus, or retained earnings must be used to expand the operation, (2) that these extras must be distributed to the workers in the operation, or (3) that these profits may be utilized for establishing new business entities for solving social problems, in the form of social business. The principle of non-distribution of extra profits to those who provided initial capitals can be relaxed only in the cases of transferring to a fund or funds for social business investment. It may be noted that this point may be controversial in the definition and functions of social business. It may also be mentioned that this controversy has been developing since the early times of discussions of social business and also it depends on actually who and what organization is arguing as to the requirements to be classified as social business.

Yunus (2007, 2010) clearly describes the fundamental philosophy of social business. His general ideas are shown in the following:

1. The concept of social business is based on a broad framework, including microcredit.
2. A social business is a cause-driven company.
3. Therefore, a social business is defined as that which is not a charity but a company designed to pursue specific social goals by using business methods.
4. Social business is categorized into two kinds. One is a non-loss and non-dividend company owned by owners and investors, and the profits are reinvested to expand the company’s reach and improve the product/service. The investors can only get back their original investment amount. This kind of company is called a Type I social business. Grameen Shakti (Energy), Grameen Danone Foods, and Grameen Veolia Water discussed in Chaps. 4–6 respectively come under this type. The other is a profit-making company owned by the poor directly or indirectly. Since all profits are plowed back into the poor, a company can alleviate poverty. Such a case is called a Type II social business. Grameen Bank, which is owned by the poor, is the only one example of this kind of social business, so far.

As for a Type I social business, Yunus presents his philosophy by the seven principles. They are:

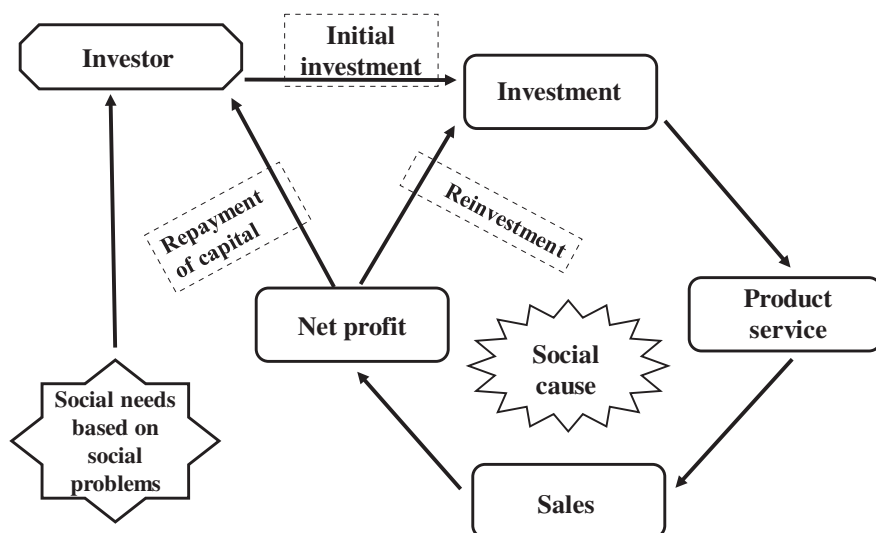


Fig. 2.3 Social business model of Type I

1. The business objective is to overcome poverty, or one more problems (such as education, health, technology access, and environment) that threaten people and society—not to maximize profit.
2. The company will attain financial and economic sustainability.
3. Investors get back only their investment amount. No dividend is given beyond the return of the original amount of investment.
4. When the investment amount is paid back, profit stays with the company for expansion and improvement.
5. The company will be environmentally conscious.
6. The workforce gets market wage with better than the standard working condition.
7. Do it with joy!!!

Figure 2.3 above summarizes the general ideas and seven principles, and illustrates Type I model of social business.

2.5 Credit, Inclusive Finance, and Recent Development

Recent development indicates that the microfinance instead of “microcredit” has been used quite frequently in order to capture the widening coverage of financial activities for the poor, and that inclusive finance is becoming a new key word for the changing trend in this area (Cull et al. 2013). The latter is most preferred as the

term to show and deal with access to banking and financial opportunities in many parts of the world, not just developing countries and the poor.

The use of 'credit' was adamantly adhered to by the Grameen Bank administration because the term connotes the people's mutual trust and help in supporting the system. It is believed that whichever terms "microcredit (MC)" or "microfinance (MF)" is used, the important features of the organizations are members' trust, people's initiatives, and willingness to make the mechanism to work.

Instituting the system of lending small loans to the poor in the mechanism in which these principles are equipped and people's sense of mutual trust is honored has been shown to be very critical for successful operation in the thirty years history of microcredit.

In the following, we discuss some international organizations and effort to provide microfinance to the poor in the world (Shariff and Wood 2001). IFC (International Finance Corporation, World Bank Group) is a wholesaler of microfinance that it reaches more than 100 microfinance institutions in over 60 countries. IFC has been working with mostly private financial sector development. It underscores the importance of sound development of financial markets particularly for small and medium size enterprises.

CGAP (Consultative Group to Assist the Poor) was established in 1995 and now housed in the World Bank building. It functions as a coordinating organization among microfinance institutions (MFIs) and recently has begun programs of human resource development for the microfinance field. Its role of networking extends to many MFIs.

UNCDF (United Nations Capital Development Fund) and UNPRI (United Nations Principles for Responsible Investment) are two organizations we mention here. The former has worked since 1975 mainly in Africa for funding infrastructure finance, but gradually its emphasis had moved more towards inclusive finance and local development funding in the developing world. The latter is an organization that promotes principles of responsibility in investment projects.

2.6 Further Considerations

- Consider a name and mechanism of an organization to lend money, assuming that you are assured some fund. What other banking, non-banking, and non-monetary activities would you like to offer to your borrowers?
- Consider to create a new business in your area, or in your country to attack a problem you are the most concerned about assuming you were to receive funding. What social problem, kind and type, do you like to see solved?

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