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The Ouster of Muhammad Yunus: Can Politics Destroy Grameen Bank?

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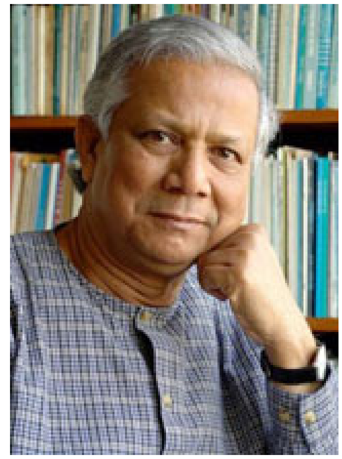

"Dismissed." A single word on April 4 from Bangladesh's highest court ended a bitter legal battle that has grabbed world attention. The loser in this case: Muhammad Yunus, Nobel Peace Prize laureate and founder of Grameen Bank, the groundbreaking Bangladeshi microfinance institution (MFI) he is no longer allowed to run. Upholding a previous ruling that Yunus, 70, illegally remained managing director of the MFI past the age limit of 60, the court sided with the government of Sheikh Hasina Wazed and the central bank. But as with many of the highs and lows of microfinance -- the industry that provides small loans and other financial services to the world's poor -- there is much more than meets the eye to this boardroom shakeout.

At a minimum, the recent Grameen saga is what Mary Ellen Iskenderian, president and CEO of non-profit Women's World Banking (WWB) in New York, calls "flash points" -- events over the past year that have shaken the collective confidence of the fast-growing, $60 billion (in assets) global microfinance industry. Once hailed for their promise of alleviating poverty by providing capital to the millions of "unbanked" poor around the world, MFIs from Morocco to Mexico have been accused of exploitation and profiting from aggressive sales tactics and the usurious double- or even triple-digit interest rates they charge customers.

Among the most dramatic turns were suicides reported in India last autumn. Struggling to pay back their loans, as many as 50 micro-borrowers allegedly took their lives in Andhra Pradesh (AP), the southeastern Indian state -- home to many of the country's burgeoning, and increasingly profitable, private micro-financiers. The tragedy underscored both the aggressive sales and collection tactics of MFIs and their uneasy relationship with governments. According to Iskenderian, the suicides gave the government of Andhra Pradesh, "which had been looking for a mechanism to meddle in the way microfinance has played out in AP for some time," a reason to impose severe regulations around it.

Next door in Bangladesh, tension between Yunus and the Bangladeshi government had been on the rise. That already tenuous relationship took a turn for the worse following the November airing of a documentary film that challenged the merits of microfinance and cited, among other things, the misuse of aid the Norwegian government gave to Grameen in the 1990s. Though officials in Norway quickly issued a statement saying that the aid case had been settled amicably long ago, the ball was rolling. Sheikh Hasina -- stoking a longstanding personal feud with Yunus -- weighed in. Using a press conference in February, she accused MFIs of "sucking blood from the poor." Her government has since launched various investigations into activities at Grameen Bank.

'An Accident of History'

Should the microfinance sector be worried? In many respects, Grameen Bank is not like other MFIs, nor is Yunus like other MFI executives. The industry does boast a number of equally charismatic pioneers, such as Shafiqual Haque Choudhury of ASA in Bangladesh. A respected leader in a related field is Ela Bhatt, founder of the India-based trade union SEWA (Self-Employed Women's Association). But few can match the high profile of Grameen's Nobel laureate, whose friends in high places include Barack Obama, Nelson Mandela and others who have rushed to voice their support for him.

As for Grameen, its special role as a microfinance institution under a government charter is what Stuart Rutherford, founder of SafeSave, a for-profit organization providing banking services to the poor in

Bangladesh, calls "an accident of history." Set up only a short while after Bangladesh's battle for independence from Pakistan 40 years ago, Grameen has been at the forefront of microcredit development in this densely populated country of 147 million. Grameen was enveloped into the central bank in the 1980s and given an unusual charter that has become both a blessing and a curse.

Though the Bangladeshi government owns a small percentage of capital in Grameen, holds three of its 12 board seats and has a say in the appointment of key executives, it has been a relatively passive stakeholder, reflecting its laissez-faire attitude toward MFIs in general. According to Rutherford, who is also an honorary fellow at the University of Manchester's Brooks World Poverty Institute in the U.K., while Bangladesh's short, violent history has vacillated between democracy and martial law, the country's microcredit providers were left alone, without much interference from governments or the business sector, including formal banking.

"Bangladesh got going early in microfinance for several reasons, some of which have to do with its particular situation," notes Rutherford. "The government there has always been weak compared to, say, India. For example, the Indian government tends to enforce rules, such as interest rate caps, much more effectively than in Bangladesh. So microfinance entrepreneurs like Yunus had more scope to experiment."

That has been a big benefit for Bangladesh's MFIs, agrees Asif Dowla, an economics professor at St. Mary's College in St. Mary's City, Md., and Grameen's first accountant. "Not being regulated is one of the reasons why MFIs have flourished in Bangladesh," he says. "The government didn't get in the way." It was only in 2006, in fact, that the government felt it needed to formally supervise the industry and set up the Microcredit Regulatory Authority (MRA). But the agency has struggled with its workload, having only licensed about 550 of the 1,000 MFIs on its radar, note experts. Grameen, meanwhile, does not fall under the MRA's purview because of its special charter.

With more than eight million customers, Grameen has indeed flourished. The bank has lent $10.3 billion since it began operations in 1976 and has a loan recovery rate of around 97%. It has doubled the number of its offices over the past 10 years to more than 2,900 and employees to some 23,000, including more than 13,000 loan officers, nearly all women. The average loan balance per borrower is $123, with the cost per borrower over the years hovering between $8 and $13 annually. As of 2009, Grameen had $1.5 billion of assets and a return on equity of 5.64%.

Slippery Times

But are Yunus -- and Grameen -- now paying a high price for that high-profile growth? Yes, says Tayyeb Shabbir, professor of finance at California State University in Dominguez Hills and an affiliated faculty member at Wharton. He echoes the widespread view that in Yunus's otherwise stellar career, he made one major miscalculation -- going briefly into politics in 2007. Though he quickly disbanded the political party he had set up then, politicians like Prime Minister Sheikh Hasina now view Yunus as unwelcome competition. "It is clear Yunus has dedicated his life to helping the poor, but if he had not decided to become a political animal, none of this might have happened," according to Shabbir. "If push comes to shove, [the prime minister] could make it difficult for Yunus. There's a reason why politics is called a dirty game."

Now Grameen has been put on a course that may be difficult to reverse, notes Wharton legal studies professor Nien-hê Hsieh "If people come to see Grameen Bank as subject to politics and political influence in this way, it [could] certainly be a problem for borrowers," he says. "Even if [Yunus's dismissal was] not politically motivated, just the perception that it is" could be damaging.

Wharton management professor Keith Weigelt agrees that Yunus's ouster appears to be politically motivated. It is also a reflection of the entire industry's "growing process" and the range of challenges MFIs are facing. While not new, those challenges are changing in intensity, he says, pointing to recent research results published by the Centre for the Study of Financial Innovation (CSFI), a New York-based non-profit think tank.

Based on a global survey polling more than 500 microfinance practitioners, investors and other professionals, the CSFI report titled, "Microfinance Banana Skins 2011," says "credit risk" is the top threat facing the industry, as it was in the previous survey in 2009. But "political interference" has moved from 10th place up to fifth place. Politics have indeed played a role in recent crises in India and elsewhere, particularly around election time, according to experts. That includes reports of politicians using microfinance networks to gain access to voters and promising payment holidays from MFI loans and other financial benefits if elected.

"Many politicians extract political mileage from the perpetuation of the cycle of poverty in which their constituents are trapped," says Ian MacMillan, a professor of management at Wharton. "If the media focus only on the few abuses and ignore the manifold benefits of microfinance, these politicians will cheer. They would love to see the microfinance movement fail."

Political interference is a big concern of microfinance practitioners for a number of reasons, according to Iskenderian of WWB, which works with a network of 39 MFIs around the world. Among WWB's network members in Bangladesh, she sees "a real sense of not wanting to stick their necks out very far because microfinance in Bangladesh, possibly much more than anywhere else in the world, has had such deep penetration. You can really trace the difference microfinance has made in millions of people's lives [in this country], and if there's a concern on the part of the government that this would represent a political threat, or a popular movement that would somehow be a rival politically, then the others in the sector are quite concerned."

Risk and Reputation

But politics is not the only growing threat in microfinance. Rising to second place from 17th place in CFSI's survey is reputation risk. According to the think tank's analysts, that "directly reflects the view that MFIs have brought credit risk upon themselves through their aggressive lending and their desire for growth," and has left "the good name of microfinance increasingly under attack."

MFIs seeking to alleviate poverty face "a balancing act around delivering financial services to the poor -- strong outreach is possible if costs are low and operations are profitable," says Katharine McKee, senior adviser at the Consultative Group to Assist the Poor (CGAP), an independent policy and research center housed within the World Bank. Her interviews with more than 50 MFI Board members, CEOs and others probe how governance structures are addressing the balancing act. "There can be both an opportunity and a pressure to grow quite fast. We see cases where some owners were seeking pretty high growth and returns in a relatively short time frame," she notes. "While attractive in the short run, this can create challenges for responsible lending and client service in the longer run."

As Wharton's Weigelt sees it, "Microfinance has proven to be a lucrative market so you see for-profit, commercial banks moving in now. It's not clear to me that we're keeping the 'triple bottom line'" of commitment to social development and the environment alongside profitability. "If you don't have the triple bottom line, it's basically subprime lending," he adds.

Grameen Bank is no stranger to the challenges of the balancing act that microfinance experts cite. Consider its savings products. Since a revamp in 2001, customers have piled into the organization's savings accounts, which continue to offer more attractive interest rates than elsewhere, according to Rutherford of SafeSave, noting that savings are now the equivalent to 150% of Grameen's loan portfolio. "This leads Grameen headquarters to put pressure on branch managers to step up lending, partly to earn enough ... to pay the interest on the savings," he says. "Branch managers privately acknowledge to me that this leads them to put pressure on clients to borrow -- a dangerous situation that might [result in] the kind of over-borrowing that has so damaged Indian microfinance recently."

One solution would be to lower the rate paid on savings. But Grameen "may understandably be reluctant to do this, as much of the money is in long-term, 10-year savings deals, and it may feel that it would be breaking an undertaking to its clients," notes Rutherford. "But somehow or other, this issue needs to be tackled before it leads to over-lending of poor-quality loans, which might [result in] poor repayment rates."

Who's Next?

That is just one of many pressing issues for Yunus's successor to address. In the days following the High Court's ruling, it was still unclear who would become Grameen's new managing director. According to a background report by CGAP, under Grameen Bank's Ordinance the managing director is selected by a committee of between three to five board members. The central bank must also give final clearance to the candidate. The government has significant influence over the board since it appoints the board chair and two other directors. The remaining nine board members are selected from among the bank's more than three million borrower-shareholders. These selection rules can also be changed over time, however.

"Can the government appoint someone of equal stature [as Yunus]? No," says Cal State's Shabbir. "But can they appoint another managing director? That should not be hard. A pro-government chairman has already been appointed," he says, referring to Muzammel Huq, a former Grameen veteran executive who had left the bank before returning recently.

Grameen's leadership vacuum raises a number of concerns. Beyond the prospect of greater political oversight, Grameen's leadership upheaval also shines the spotlight on governance, a notoriously weak area for many MFIs. "It's true that governance structures at many MFIs are lacking," notes Weigelt. "They're like startups. You have a founder, the founder has a vision and governance issues like succession planning take a back seat." In this year's CFSI survey, succession planning rose to fourth place from seventh place in the ranking of threats to the microfinance sector.

Grameen is no exception. In fact, Yunus has been criticized frequently for the lack of obvious succession candidates. True, it is a problem that even many shining stars in the private sector grapple with, including Apple and its CEO Steve Jobs, experts point out.

"But the question is, 'What is Grameen after Yunus?'" asks St. Mary's Dowla. "He always has said he wants a smooth transition. If it's not resolved properly, a lot of staff will leave -- they will be worth much more to other NGOs." Dowla also thinks borrowers might leave as well.

"The immediate need is to keep the confidence of Grameen's savers [since] the savings portfolio finances all the loans," adds Rutherford. "Given that poor households tend to equate Grameen with Yunus, this means finding some way to keep Yunus as a figurehead." Over the long term, Rutherford says, "I hope Grameen will keep its leadership role, coming up with product upgrades similar to the excellent Grameen Phase II changes brought in around 2001." But he concedes that change has never been very smooth at the bank. "So I expect some more near-misses," he notes.

Yunus has yet to announce publicly what his plans are now. Much might depend on what the government allows him to do. The *Financial Times* reported that he had cancelled a press conference that was scheduled after the ruling, and there have been no statements from the bank or related organizations set up by Yunus, including the Yunus Centre established a few years ago to develop social business. Two petitions filed by his supporters to challenge the latest ruling will be heard in early May, but observers do not expect those to get very far.

"The best that can be hoped for here is a face-saving resolution for all the interested parties, which may allow [them] to at least nominally declare victory," says Shabbir. "An honorific role -- possibly with some semblance of intrinsic powers thrown in for good measure -- for Yunus vis-à-vis Grameen Bank may achieve this goal. However, it does appear increasingly unlikely that any such resolution will involve a formal or full reinstatement of Yunus as the bank's managing director."

Some observers predict Yunus will divert his energy to bringing social business projects to fruition. In recent years, he had stepped back from the bank's day-to-day operations to develop social enterprises alongside ventures with various multinationals, with health-related projects in the works.

As for whether Yunus's fate is simply part of a bleaker future for microfinance overall, that remains to be seen. "The fact that we see a lot of mixed messages in terms of microfinance and poverty alleviation, and the fact that we see a backlash about microfinance being profitable, shows that part of the mission has lost its luster," according to Wharton's Hsieh. "But -- and I take it that this is what Yunus was into initially -- if the goal is to change people's mindset from thinking that the poorest of the poor [are] capable of nothing more than receiving donations and charity, to [thinking of them] as being capable of having a certain kind of control over their own lives, that part of the mission has succeeded and will continue."