

## **A Tale of Two Banks: Grameen Bank and SKS Microfinance**

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*This case makes a comparison between two banks involved in social banking using microfinance. Both banks aspire to enable people in poverty and small enterprises to obtain small loans. Both banks are committed to providing access to the money and credit for these individuals and their small enterprises. The case examines the similarities and differences of the banks and raises questions about the long term viability of their mission and for how long stockholders and contributors will be willing to forego satisfactory earnings to support the banks social missions and the future of social banking and both banks.*

### **INTRODUCTION**

Grameen Bank was founded in Bangladesh as a corporation under the Grameen Bank Ordinance in 1983. At its inception, authorized capital was 100 million Takas (equivalent to US \$1,436,162.50). Paid up capital was 30 million Takas (\$432,848.77). Presently Grameen's authorized capital is 3,500 million Takas (\$1,050 million). Borrowers hold 96.57 percent of the shares of stock.

The principal business of Grameen is lending without collateral to landless people for economic activities. The bank additionally takes deposits, excluding business in foreign exchange. Grameen offers the following loans: basic loans, housing loans, higher education loans, young entrepreneur loans and struggling members' loans.

While Grameen Bank does business in a number of countries, most of its activity is in Bangladesh. Bangladesh is a country located adjacent to India in Asia. (See description of Bangladesh in the following section).

SKS Microfinance is the largest lender to poor persons in India in terms of market share, outstanding loans and total borrowing. SKS (Swayan Krishi Sangathan) Society was founded in 1997 as a nonprofit organization. Its mission was to make small loans to poor individuals and to entrepreneurs. It operates primarily in India- the largest market of such people and businesses in the world. Since its transformation to a for-profit bank under the name of SKS Microfinance, it has been successful in making microfinance loans with a repayment rate of 99 percent. At the end of August 2010, its stock traded at 26.3 times estimated earnings.

In 2003, the founder of SKS, Mr. Vikram Akula, created five trusts. Each trust started with US \$500,000 in philanthropic contributions. In 2008 SKS Microfinance was set up as a separate for profit company and raised US \$75 million in equity to enable it to grow more rapidly in the microfinance area

in India with the help of commercial financing. The five trusts received some of the new bank's shares and have collectively become one of the biggest endowments in India- possible worth up to US \$175 million (New York Times, July 30, 2010, p.B6). SKS Society will continue as a charity to run poverty alleviation programs while SKS Microfinance will continue its work in microfinance as a for profit company. In 2008, SKS announced that it planned to raise up to US \$ 350,000,000 in additional equity. SKS leverages its equity to raise debt from public and private sectors and multinational banks to conduct its operations as a bank.

## THE TWO CEO'S

Former professor Muhammed Yunus founded and heads the Grameen Bank. While on a Fulbright Fellowship at Vanderbilt University in 1976, he conducted a research project. Its purpose was to determine the possibility of developing a system to extend credit and other banking services to rural poor in Asia. The result of his research was the inception of Grameen Bank. This bank became independent in October 1983 via legislation enacted by the Bangladesh government.

Mr. Yunus was awarded the Nobel Peace Prize on October 13, 2006 for developing his bank, which has the aim of alleviating poverty through the device of micro loans. Some of the loans are for as little as a few dollars to buy a pair of goats for an entrepreneur to start a business of raising goats to sell their milk and meat in a small village.

Mr. Vikram Akula initiated SKS after working in nonprofit organizations including contacts with Mr. Yunus at Grameen Bank to try to help the poor in India. He began SKS on his own with the help of some nonprofit investors to focus on the poor in India. Mr. Akula was born in India but grew up in Schenectady, New York and he graduated from Yale University. He retains his American citizenship but currently resides in India.

Mr. Akula has privately sold some of his shares of stock for almost US \$13 million and he holds options in SKS Microfinance potentially worth US \$55 million (New York Times, op cit). Mr. Akula was listed by Time Magazine in 2006 as one of the world's 100 most influential people.

Mr. Akula has also attracted controversy as he has been involved in a publicized custody fight over his son with his ex wife, a lawyer in Chicago.

## SOCIO-ECONOMIC ENVIRONMENT

Grameen Bank is domiciled in Bangladesh. Bangladesh is a country of 55,999 square miles. Bangladesh has a population of 162,221,000 people and is the seventh most populated country in the world. It is among the most densely populated countries in Asia. It borders India and was formerly part of Pakistan from which it achieved its independence in 1971. Bangladesh is a parliamentary democracy.

Per capita GDP has doubled in Bangladesh since 1975. GDP is relatively low at \$624 per person. The poverty rate has dropped 20 percent since the early 1990s. Growth has been propelled in urban centers led by the capital, Dhaka (formerly Dacca). The currency is the Taka with an exchange rate of 69.63 Takas to the US Dollar as of September 14, 2010.

Despite recent improvements, health and education levels remain low. The majority of the population lives on subsistence farming in rural villages. The literacy rate is about 53.7 percent with an 81.9 per cent rate among women.

The economy of India where SKS Microfinance functions is much more favorable. With a GDP of US \$1250 trillion, India stands eleventh in the world. GDP in India is almost double GDP in Bangladesh. Further, India is second only to China as the fastest growing economy in the world with an average annual growth rate of nearly 7 percent in recent years. The currency in India is the Rupee and the current exchange rate was 46.211 Rupees to the US Dollar on September 14, 2010.

Occupations in India are dominated by agriculture which employs 52 percent of the labor force of 500 million people out of a population of about 1.1 billion people. Agriculture is followed by services (34 percent) and industry (14percent). India's trade also has risen rapidly. Presently it amounts to 1.5 percent

of world trade. In 2006 India's total imports and exports were valued at above US \$ 440 billion versus \$253 billion in 2004. India's rapid growth is expected to continue. It is anticipated in some quarters that India's economy should surpass both France and Italy by 2020. Despite this progress, some rural areas of India have a lot of poverty similar to some rural areas of Bangladesh.

## **ORGANIZATION, GOVERNANCE AND RELATED MATTERS**

As stated earlier in this case, Grameen Bank is established as a corporation under the Bangladesh Grameen Bank Ordinance in 1983. Members (borrowers) hold 96.57 percent of the shares in the bank. The residual 3.43 percent of the bank shares are held by the Bangladesh government. The Board of the Bank is comprised of 13 people. They are: The Managing Director, three persons including the chairman of the corporation appointed by the Government, and nine members elected from the borrowers shareholders. Although the bank is technically a for profit business it is tax exempt in Bangladesh. However, the Bangladesh Government makes this status subject to transfer of all profits to a Rehabilitation Fund. The bank operates 2,562 branches. It was reported on December 30, 2009 that twenty percent of these branches were unprofitable.

Grameen Bank is a microfinance organization and community development bank. It is premised on the concept that the poor have underutilized skills and the potential to be successful if they have access to money and credit. A group based credit approach is used. This method relies on peer pressure within the group to ensure that loan agreements are followed and loans are repaid by all the members of each group of borrowers. The bank expects the consequences of this will be enhanced credit standing. The bank claims a payback rate of 98 percent on its loans and cites this as testimony to its success. The Wall Street Journal has reported that 20 percent of the loans were more than a year overdue in 2001. Later figures are not available.

Pursuant to its mission of enabling poor people (those living in poverty) to borrow money without using collateral, Grameen Bank's main activity is making these microfinance loans. Most of the loans are made to women. The bank also accepts deposits and provides some other bank services. It runs fabric, telephone and energy businesses as well (Wikipedia, downloaded July 9, 2010). Net profit for 2009 was 371,574,000 Takas or about \$ US 53 million using an exchange rate of 70 Takas to a Dollar.

SKS Microfinance is the world's fastest growing microfinance banking organization. It makes collateral free loans to the poor for creating income. Borrowers use their loans for such endeavors as vegetable production and selling, pottery, photography, and beauty parlors. The bank additionally makes interest free loans for emergencies, life insurance and loan insurance coverage. SKS stock recently has been selling at \$23.35 with a current price earnings ratio of 26.3. Its investors include such firms as Quantum Ltd., Sequoia Capital, Kismet capital, Unitas, Goldman Sachs and Morgan Stanley among other investors. India is now the largest microfinance market in the world with an estimated 150 million households without entrée to standard banking and financial services. To reach this market, SKS Microfinance has 2029 branches. As of March 2010, the bank had an estimated 6.8 million borrowers with loans thought to be about US\$ 624 million. SKS is currently one of the largest microfinance companies.

As explained earlier, SKS Microfinance's origin is embedded in the original SKS Society. Five trusts established by Mr. Akula bridged SKS Society (1997) and SKS Microfinance (founded to attract commercial financing). When SKS Microfinance was founded the trusts owned the company. As other investors invested in the company, the trusts share was gradually reduced to 15 percent. However, the trusts continued to dominate governance of SKS Microfinance because their stake was the largest. Attempts were made to develop an independent board principally to administer funds raised through independent public offerings. That structure has apparently dissolved after the first meeting as two influential members resigned from the board. There were reported differences with Mr. Akula over how to use the proceeds from the IPOs. Although not a member of the board at that time, Mr. Akula continued to influence strategy through control of the trusts.

Apparently the two board members who resigned wanted future proceeds of IPOs to be used to set up a grant making facility similar to a private foundation that could give money to existing social programs. Mr. Akula wanted the trusts to control disbursements and to support education, health and other programs to borrowers of SKS Microfinance via the nonprofit SKS Society.

## **STRATEGIC ISSUES AND CONCLUSION**

SKS Microfinance, buttressed by its affluent international investors, is contemplating a public stock offering which would raise up to US \$ 350 million. With loans as small as US \$ 20, the company under the leadership of Mr. Akula thinks it has shown that micro banking pays off. Mr. Akula has already privately sold shares worth approximately US \$13 million and has stock options that might be worth up to US\$35 million. Approval has been received from the Securities Exchange Board of India to offer the stock. Such an offering would be the first such IPO by a microfinance bank in India. In an interview, Mr. Akula stated, "The only place you can get the amount of money needed to help the poor is in capital markets" (Eric Bellman, The Wall Street Journal, C1, July 9, 2010).

Senior executives of Grameen Bank are watching this very carefully and wondering what strategy they should adopt. The recent financial reports they have seen are favorably disposed toward the proposed stock offering by SKS Microfinance. Grameen's management realizes that to remain competitive with SKS they must meet this challenge. Yet they also realize that Bangladesh is not a market of neither the extent nor the economic potential of India. Perhaps Grameen could rely more on a global market than the market in Bangladesh. The management of Grameen Bank realizes that it may not have the global visibility of SKS and may not have the financial resources to match SKS at this time.

Grameen Bank had net income of about US \$ 53 million in 2009. This income capped a decade of measurable growth. To continue the performance in the future Grameen Bank must be aggressive, gain greater visibility in the global capital market and must transcend the boundaries of Bangladesh for financial support.

Mr. Yunus has been critical of the proposed SKS public offering. He avers that this represents excessive emphasis on profit maximization, deemphasizes nonprofit dimensions and is inconsistent with the original mission of microfinance.

One of the investors in SKS Microfinance, is a nonprofit organization, Unitus, based in Seattle, USA holds stock in SKS that will be worth millions of dollars after a successful IPO. Unitus was created ten years ago with the specific charge of supporting the microfinance business. As recently as June 2010, the chief executive of Unitus held conversations with the Bill and Melinda Gates Foundation regarding new projects. In July 2010, the board of Unitus decided to lay off the staff and discontinue efforts to promote microfinance. The Unitus share in the proceeds from an IPO for SKS Microfinance would possibly be used for another charitable purpose.

Both Grameen Bank and SKS Microfinance must decide on future strategies. Both banks believe that they must continue to increase their capital to better serve the poor. Can social banking via microfinance be continued successfully by these organizations in the future? Is it necessary for Mr. Yunus to fully embrace the standard form of capitalism and for profit enterprise to succeed Mr. Akula or will the Grameen Bank model as supported by better model for long term success? What would you recommend to each of them for a future strategic plan?

## **CASE ANALYSIS NOTES**

### **OBJECTIVES AND USE**

This case is intended to serve several purposes. First, it aims to acquaint students with the concept of social banking and microfinance loans. Then it aims to illustrate the dilemma involved in meeting stockholders and donors likely expectation for greater earnings growth and stock price appreciation and at the same time meeting their commitment to its founding mission. Further, the case is intended to help

students become familiar with potential contradictions between social responsibility and business efficiency. The case also aspires to illuminate the almost inevitable conflict between personal goals and needs of the founders and those of succeeding management generations. Finally, it is intended to stimulate students to think about the long term sustainability of such banking and to do further research to explore the more general question of whether businesses giving preference to social concerns can grow and survive.

Understanding and analysis of this case requires some knowledge of finance, money and banking, relationships between business and society, management and governance. Accordingly, the use of this case is intended for graduate courses in management, business, government and society, money and banking, finance and business policy. It could be used productively in a senior level business policy course assuming a significant number of knowledgeable students.

It is also probable that graduate students will need to acquire knowledge in international banking and finance for their careers in the future. It is apparent that forces propelling development of global markets are strong and irreversible. It is perhaps essential that business students will need increased exposure to international finance and banking. To this end, this case may serve well in such graduate courses.

## **SOURCE NOTE**

Information germane to this case is available from a number of places. There is extensive data online from Wikipedia and under the names of both banks. Students can also type in social banking and microfinance. Both these captions will display useful references. Always helpful references are the Business Periodicals Index, The Readers Guide and the New York Times and Wall Street Journal Indices. The New York Times Index and the Wall Street Journal Index have extensive coverage of social banking activities and reports related to both banks. Cogent consideration of this case by the better students will mean they will do this kind of research.

## **Pedagogical Method**

Instructors will need to play an active role in teaching this case. The authors recommend that the instructor integrate a lecture addressing social banking into their course. Additionally, they should assign this case for a date subsequent to that lecture. Since students are unlikely to have much knowledge about Bangladesh, social banking in India, microfinance and either of the banks, they should be given ample time to prepare. The authors believe professors should welcome the opportunity to present independent views of matters in this case.

Lack of familiarity with the subjects of the case will probably preclude role playing. Emphasis should be on discussing the major issues in the case. Students might be asked to do research on some of the subjects of the case such as social banking and microfinance and on both India and Bangladesh.

## **DISCUSSION QUESTIONS**

1. Discuss the corporate structure of Grameen and governance of Grameen Bank.

Grameen Bank is a hybrid organization set up by legislation approved by the Government of Bangladesh. Like nonprofit organizations, it accepts donations from philanthropists and charitable foundations. Like a for profit organization it has shareholders. Unlike most banks almost all of the shares are held by borrowers from the bank with a small percent of shares held by the Government of Bangladesh. Governance also is unusual. The shareholders (borrowers) elect most members of the board of directors. Other directors are selected by the Government. Most officers are selected by the board of directors. The prospective use of profits is unclear as the government has the right to funnel profits to a government agency although this right has not been exercised as yet. Profits have in fact been used by the bank to fund more small loans to borrowers.

2. Is social banking compatible with a bank's need to be profitable and stockholders expectations of stock price appreciation and adequate return on equity?

Generally, the historical evidence makes it difficult to accept this proposition. Instances of for profit companies putting social responsibility ahead of an acceptable rate of return are not known to the authors. The usual experience has been for some companies to forego some level of profitability in favor of greater social commitment. Over the long term, for profit companies that have done this have not generally been in banking.

In the history of these two banks, the record is not yet clear. The contributions they have been able to attract from philanthropists, investment banks and institutional investors represent a very small part of their portfolios. Much of this has been given to encourage further lending to the poor. These contributions can be characterized as being charitable contributions which can perhaps be written off if they are not successful.

A great deal depends upon the donors to these banks. So long as these donors continue to be generous, the likely tension between social consciousness and the inevitable pressure for survival and growth can be suppressed. If at some future time supporters become dissatisfied and wish to put money elsewhere, the conflict between adherence between being effective and efficient will surface. The probability of this happening is high.

In banking, there seems to be no analogous situations in American financial history. Perhaps the closest are firms such as Household Finance Company and Beneficial Finance Company. Both of these firms have made loans to individuals who cannot obtain them from full service commercial banks. Both these firms have made loans ranging from \$1500.00 to \$10,000.00. Both of these firms have made larger loans as well.

3. Of the two banks in the case, which has better prospects for long time viability?

Probably SKS Microfinance does. It is operating in India which is a country that is experiencing rapid economic growth. An annual average growth in GDP in India has been about seven percent in recent years. India also has a much larger population than Bangladesh. The leadership of SKS is probably more aggressive than that of Grameen Bank. Regulation in India is also perhaps less strict. The Securities Exchange Board of India has already approved an IPO that could exceed US \$ 250,000,000. There is no restraint placed on SKS by the Government in India for disposition of profits.

Conversely, the Grameen Bank has a much smaller market in its home country, enjoys less apparent support from potential investors, and faces more restrictive government regulation in Bangladesh. Grameen Bank was tax exempt between 1997 and 2005 but was required to utilize profit as directed by the government. Only in recent years has it enjoyed tax exemption. It is likely that if Grameen Bank decides to use an IPO it will probably have the potential to raise up to about \$75 million.

Furthermore, because of the rapid economic growth in India and the loosening of the caste system, it is likely that the reduction in poverty will occur faster in India than in Bangladesh. This may permit SKS Microfinance to eventually trade up their loans sooner than Grameen Bank.

4. Suggest a future strategic plan for each bank.

Grameen Bank must examine its past record and decide whether it can continue to rely on capital from what are essentially nonprofit sources in order to continue growing in the future. Grameen may counter SKS's advantage in being located primarily in a much larger country by expanding further in more countries of the world so as to improve opportunities for growth. If Grameen Bank cannot get a large chunk of capital from nonprofit sources it could seek a change in its charter so it can gain funding in the private equity market so it can grow faster. Alternatively, it could encourage the founding of new

banks with a strong interest in social banking to further expand the concepts and model currently provided by Grameen Bank.

SKS can expand using capital provided by IPOs through the private equity market. It could expand in countries other than India by raising capital from countries where it hopes to grow. SKS could also reach out to Grameen Bank to see if there are some areas where the two banks could work together through joint ventures to expand. SKS could also consider trying to be acquired or merge with a larger commercial bank and continue as that bank's social banking division.

## UPDATES

The case was completed in mid 2010. This was a good time to end the case as many strategic decisions had to be made both by each of the two banks and by their government regulators. Students could look at the existing case without updating it to try to come up with solutions as discussed above in this Instructor's note.

Subsequent to the end of the case there have been significant events at both institutions. Instructors may wish to update the case or ask students to update the case on the internet to cover more recent events and developments and to aid in discussing the issues in the case.

In July 2010, SKS Microfinance completed a successful IPO that raised more than Rupees 1,650 crore for shares listed on the Bombay Stock Exchange. The stock was sold to investors at Rs.985 in the IPO and rose to Rs. 1,084 on the first day of listing. Several months after the IPO, Suresh Gurumani was terminated as CEO of the company by founder Vikram Akula and the board of the company after differences. Suresh received a settlement and left the board of the company. Income in the fourth quarter of the fiscal year ending in March 2011 reported a net loss of Rs 70 crore due to lower income from operations and high credit costs. The stock declined to 344.85 rupees per share after these results of operations for the quarter were disclosed. For the entire year ending in March 2011, the company's net profit declined 36 percent to Rs.111.63 crore, from Rs.170.93 crore in the previous fiscal year. (<http://articles.ecopnomicies.indiatimes.com/2011-05-06/nred/29517122>. (Note one crore in India equals 10 million rupees)

Twenty five percent of the microfinance business in India occurs in the Southern Indian state of Andhra Pradesh. Following a spate of suicides in Andhra Pradesh in 2010, the state government enacted regulations for the Microfinance industry called the Regulation of Money Lending Bill 2010. However, SKS is currently contesting the right of the state government to regulate this industry in the Supreme Court in India. It is uncertain at this time whether the regulations will be allowed by the court or whether only the national government of India can regulate this industry.

Grameen Bank also has faced regulatory problems in its home country of Bangladesh. The Minister of Finance has attempted to try to remove Mr. Yunis as CEO of Grameen Bank in 2011 on the grounds that at age 70, he was too old to run the bank. The Minister of Finance who attempted the removal was at that time 77 years old. Subsequent to the contested sacking of Mr. Yunis, the Minister of Finance announced plans in May 2011 to raise its stake in the Grameen Bank that would transform the bank into a state owned bank through a 14-point takeover plan. Some opponents of the plan for the government takeover have claimed that such a nationalization of the bank would have a chilling effect on foreign investment in Bangladesh. (See David Roodman's Microfiance Open Book Blog especially [http://blogs.cgdev.org/open\\_book/2011/05/14-point-grameen-bank-takeover-plan.php](http://blogs.cgdev.org/open_book/2011/05/14-point-grameen-bank-takeover-plan.php)). Mr. Roodman claims that this nationalization might even cause a run on the bank.