THE HAUSER CENTER
FOR NONPROFIT ORGANIZATIONS
at HARVARD UNIVERSITY

Early Ford Foundation Support for the Grameen Bank: Lessons in Philanthropic Accountability, Risk, and Impact

by
Steven Lawry

The Hauser Center for Nonprofit Organizations
Harvard University

October 2008
Working Paper No. 44

ABSTRACT

The paper uses a case study of a loan guarantee fund of $800,000 provided by the Ford Foundation to the Grameen Bank in 1981 as a framework for offering reflections on current debates within US philanthropy on accountability, support for innovation, risk taking and impact. Ford's loan guarantee fund leveraged commercial bank lending to Grameen Bank. The subsequent high rates of loan repayment by loan recipients convinced commercial bankers of the viability of Muhammad Yunus' model of lending to poor entrepreneurs unable to provide traditional loan collateral.

The paper develops the concept of "accountability regimes," and argues that foundations engaged in international poverty reduction are better able, institutionally, to bear risk in support of innovation than multilateral and bilateral aid organizations such as the World Bank and USAID. That said, recent interviews of a small sample of executives whose foundations fund poverty work abroad suggest ambivalent attitudes toward funding innovative and risky projects. This is attributed, in part, to high expectations on the part of foundation boards and top executives that foundation-funded programs show positive, early and measurable impact. The great diversity of the US philanthropic community, and the commitment of many foundations to important charitable activities that are not necessarily inviting of innovation, further explains a more modest investment by US philanthropy in the kind of innovative work that they are uniquely sanctioned to support.

Encouraging foundations to be more open to supporting innovative initiatives, the paper next offers three operational principles, drawn mainly from the Grameen case study, which foundations might observe in their poverty reduction initiatives. These are: the strongest ideas are likely to come from individuals and organizations outside of foundations working close to the problems; long-term impact assessments should focus on achievement of administrative and policy reforms in institutions that matter in the lives of poor people and; active and early engagement with governments, the private sector and publicly-funded donors will increase the chances that new ideas, once successfully tested, will bring about systemic change.

Early Ford Foundation Support for the Grameen Bank:
Lessons in Philanthropic Accountability, Risk, and Impact

In the 1970s, Muhammad Yunus had this now familiar idea that commercial banks could successfully lend money to poor people in Bangladesh who did not own the kinds of traditional assets, such as titled land and houses, typically needed to collateralize loans. By making loans to individuals through groups of peers and neighbors, a mix of mutual support and social pressure would ensure that individual loans were repaid. In 1981 Yunus, then an economics professor at Chittagong University, was preparing to test the new lending model on a large scale. As recounted in his autobiography, *Banker to the Poor*,[1] he approached commercial banks in Bangladesh and asked them to capitalize the Grameen Bank's five-year expansion plan, that aimed to open dozens of branch offices in five rural districts in addition to those in Jobra village and Tangail district, where Yunus had been testing group lending models since 1976 and 1979 respectively. Grameen was at the time a special project under the Bangladesh Bank, the central bank of Bangladesh, and the ability to raise funds on commercial terms was seen by Yunus as a key test of Grameen's viability as a banking model and essential to its expansion nationally.[2] The commercial banks declined Yunus' initial request for capital. Banks have complex accountability regimes (a concept I discuss further below) consisting of depositors, shareholders, and regulators that act to ensure deposits will be safe and the bank will remain solvent. In the absence of collateral, poor people were not seen by bank managers as credit-worthy customers.

Yunus came to understand the immediate problem as one of reducing the risks to commercial banks of investing in Grameen in the face of uncertainty as to how his new loan repayment model would work out. So he went to the Ford Foundation's office in Dhaka and asked for an $800,000 loan guarantee fund as security against commercial bank lending. After careful appraisal by senior staff, Ford agreed to the request and deposited the requested funds[3] in a Grameen account at a London bank. Bangladeshi banks in turn agreed to Grameen's request to capitalize the planned expansion of operations, on commercial terms. The new repayment model worked, the commercial banks got their money back with interest, and the rest, as it were, is history. Yunus had made good on his initial assurances to the foundation that he would never have to dip into the loan guarantee fund. "The fact that it is there" he told Ford staff, "will do the magic."[4]

I find the story of this partnership between Muhammad Yunus and the Ford Foundation compelling in a number of ways. Most importantly, it demonstrates how private foundations are able to take on risk on behalf of new approaches to poverty reduction in ways that other institutions, including financial institutions such as commercial banks and publicly-financed donors such the US Agency for International Development (USAID), often cannot. Once the new ideas and practices that foundations are willing to fund initially are proven, banks, governments and other kinds of donors are more likely to incorporate them into their own work and in ways that may have far-reaching impact on the lives of poor people.

Building on the case study of Muhammad Yunus and the Grameen Bank, this paper seeks to explain why foundations are better able to support risky but potentially ground-breaking new approaches to poverty reduction in ways that other kinds of institutions cannot. It is not clear that foundations for which poverty reduction is a priority take full advantage of their distinctive ability to support innovative work. As a result, opportunities to foster essential changes in the policies and practices of key institutions—including in government and the private sector—that very directly affect the lives of poor people may be lost. The paper concludes with recommendations on how foundations concerned with poverty reduction might make fuller use of their distinctive and important advantages.

Foundations can bear greater levels of risk than other kinds of institutions.

Various categories of organizations display different kinds of *accountability regimes.* An accountability regime is the mix of formal rules and informal protocols and conventions—public and private, external and internal, moral and ethical—that condition organizational decision making in the face of opportunity, uncertainty and risk.

The Grameen case suggests that the differences in accountability regimes faced by foundations and commercial banks have implications for their respective tolerances for certain kinds of risk. If Yunus' experiment had failed one might imagine the president of the Ford Foundation telling his board, "Well, we appraised this very carefully. It seemed like a good idea. And supporting ideas that have promise of giving poor people better access to opportunity is part of what we do. Taking on risk requires us to be prepared to accept a certain amount of failure." One might imagine a sadly different conversation in the bank's board room if the loan had failed and the manager had approved it in the absence of Ford's loan guarantee.

Comparing accountability regimes of for-profit organizations like banks with not-for-profit organizations such as foundations presents some interesting "apple-and-orange" analytical challenges. For private firms, accountability is directly connected to performance in competitive market environments. Survival, profitability and investment returns are among the precise and rigorous criteria against which the market and shareholders evaluate private firms and their executives and boards. The tax-exemption granted to foundations and other nonprofit organizations is not based on demonstrating measurable results, but upon pursuing a recognized charitable mission with the intention of providing social benefit.

Importantly, accountability regimes vary among different kinds of donors engaged in international development and poverty reduction. The World Bank is governed by a board consisting of 22 national governments, its loans are negotiated with beneficiary governments, and it raises much of its finance in global financial markets. World Bank policies and loans are subject to a particularly complex combination of political scrutiny and market discipline that favors the orthodox and tested approach over the innovative and risky.

The US Agency for International Development (USAID) is an entity of the US Department of State, and in addition to its important development work, serves a variety of US national and global political interests. Unlike foundations, USAID's funding is appropriated directly from the federal budget and its policy and programming decisions are subject to high levels of Congressional scrutiny. USAID's mission, goals and budget are subject to a great number of claims and pressures from a diverse community of constituency groups. USAID has numerous political detractors, often making administrators averse to taking on innovative and risky projects where they would have to explain before Congress the "waste" of taxpayers' dollars if they should fail. The World Bank, USAID and other large multilateral and bilateral donors have a mandate to fund major sector development programs, often involving large investments in agricultural, transportation, educational and health infrastructure, at levels of expenditure significantly beyond the budgets of foundations.

Philanthropic accountability regimes are, on the other hand, arguably simpler and less subject to close public supervision or market discipline.[5] Foundations are accountable through US tax law for assuring the public that tax-exempt foundation dollars are being used for bona fide tax-exempt purposes, such as for education, health care, research and charitable relief. In 1969, Congress passed legislation requiring foundations to pay out five percent of the value of their endowment annually on charitable works and management costs.[6] Foundations have an ethical responsibility not to spend lavish amounts of money on themselves, taking into account the need to employ and adequately reward professional staff to shape programs and manage and monitor grant portfolios. If particularly risky ventures should fail, they do not have to pay anyone back. These considerations have from time to time accommodated, I believe, a greater appetite for supporting innovative and risky work—such as the early development of microfinance—among philanthropic donors than institutions such as the World Bank and USAID.

In fact, where new ideas developed with philanthropic funding show promising results (in other words, are looking less risky), publicly-financed donors are often willing to provide funding support at levels that may enable the work to be brought to scale in ways that foundations, with their smaller budgets, cannot. Indeed, microfinance programs are today ubiquitous elements in the poverty-reduction strategies of the World Bank, USAID and a great number of other donors.

Do we see a greater proclivity on the part of foundations to support experimental and risky approaches to poverty reduction than say the World Bank or USAID? The data and even methodology needed to offer a conclusive answer to this question are lacking.[7] However, a recent unpublished study summarizing interviews with current or former executives of seven of the largest fifteen US foundations that fund poverty reduction in developing countries provides some useful insight. The study found that supporting innovative programs does not appear to be a central tenet of philanthropic strategy.[8] The study drew the following conclusions:

- Support for explicitly innovative approaches to poverty reduction is a small and probably decreasing part of what foundations do.

- High expectations on the part of foundation boards and top executives that foundation-funded programs show positive, early and measurable impact reduce tolerance for innovation and risk.

- While foundation leaders recognize the value of supporting local leaders and organizations, they are reluctant to fund non-US 501(c)3 organizations, especially when the granting foundation does not have an office in the country where the work is being carried out. US organizations perform reliably and to a high standard, but they are wedded to organization-wide policies and practices that may not be inviting of local innovation.

- Post-9/11 international compliance regulations and legal uncertainties are having a chilling effect on making grants to non-US organizations.

Although these findings are based on a small number of interviews, they are not surprising in light of the diversity of the US philanthropic community. In the words of Joel Fleishman, "Every foundation is sui generis, each reflecting the personalities, values, goals, and talents of the key people behind it."[9] Foundation program priorities may be quite firmly established by their founders, and may or may not encompass areas of endeavor where systemic social or institutional change is considered an ultimate measure of achievement.

Surely, trustees would imagine their stewardship responsibilities to extend to ensuring some discernable impact from the programs and grants they approve. US philanthropy provides the US and the world great service through its support for educational, health care and arts institutions that yield clear social benefits not dependent on achievement of systemic changes in governance or markets.

That said, it should also be clear that the kinds of systemic changes exemplified by Yunus' new model for bank lending are needed in greater number and in many places around the world if significant progress is to be made in reducing poverty.

Powerful ideas come from outside of foundations.

Good ideas have many sources of inspiration, but the powerful insights that Muhammad Yunus had about banks and their underserved but potentially viable clients in rural Bangladesh had very particular antecedents. Yunus lived and worked near to the community he wished to serve, he had an intimate knowledge of his country's social, economic and political institutions, and he applied what are clearly strong analytical skills and intuitive powers to the problems he encountered. He also demonstrated a talent for persuading leaders of key institutions—banks, government agencies, foundations and other donors—of the potential viability of his ideas. A person of thought and action, an insightful analyst and incisive leader, Yunus is a model of the kind of rare social innovator that foundations should be most receptive to supporting.

The example of Muhammad Yunus' partnership with the Ford Foundation suggests some lessons for the posture of foundations and the role of foundation program staff in relation to prospective grantees.

First, foundations should have their doors wide open to the potentially powerful ideas of people outside of philanthropy who are in a position to test and champion those ideas in the complex social, economic and political environments in which they live and work. That Yunus did not have to penetrate several layers of Ford Foundation bureaucracy is a testament to the Foundation's understanding that vital experience and knowledge is located throughout the societies in which Ford made grants, and not only in its offices in Dhaka and New York. Foundation program staff should be constantly in search of people distinguished for the sophistication and power of their ideas and their practical understanding of what it takes to bring about meaningful change in their societies.

Moreover, the Grameen Bank case illustrates the difference between general knowledge of markets and market institutions, such as commercial banks, and particularistic knowledge of the differing social and cultural environments in which banks may operate, and the importance of having command over both. It was an axiom of development economics that a constraint to the flow of commercial credit to poor people was their inability to marshal collateral. It required Yunus' particular knowledge of Bangladeshi rural society and cultural resources to fashion a socially-mediated set of protocols and incentives for assuring loan repayment.

Program staff should have strong conceptual and analytical skills and a considerable amount of general knowledge about the societies in which they work. Foundation staff should not be asked to shape highly detailed and specific program strategies within their fields of general responsibility. Narrow program frames may have the effect of prematurely rejecting consideration of potentially powerful ideas because they "don't fit my program." For instance, where a foundation makes a commitment to supporting microfinance institutions and staffs its poverty division with mainly microfinance specialists, it is increasing the possibility that unforeseen future breakthrough ideas for reducing poverty that are not related to microfinance get overlooked. Being alert to changes in the big picture is a vital staff capacity.

Board members can encourage the foundations they steward to be more open to the ideas of social innovators. By conveying a passion for innovation and an understanding that successful innovations typically emerge only after prolonged periods of trial and error, boards can sanction risk taking on the part of executives and staff. Board members surely must take account of organizational mission, founders' intent and their traditional fiduciary responsibilities, but observance of these responsibilities should in no way preclude openness to the powerful ideas of individuals and organizations working close to the problems.[10]

Efforts to better measure impact are a good thing, but they should not have an inadvertent chilling effect on innovation.

It is essential that current calls for greater foundation accountability not put the brakes to philanthropy's unique capacity to support innovation. Surely, certain improvements in accountability protocols are appropriate. Some foundations have clarified and tightened internal decision-making processes to reduce the danger of trustee conflicts of interest. Resources are being set aside to support evaluations and impact assessments. A number of foundations are making efforts to invite beneficiary communities and grantees into discussions about strategy and impact. These efforts may have the positive effect of giving the public greater overall confidence in foundation governance and management in ways that may come to increase the public's tolerance for foundation risk-taking.

The growing emphasis on quantitative measures of short-term impact can, however, shift the energies and attention of foundation program officers and grantees away from the hard work of fostering the kinds of systemic changes that are often needed to improve the lives of poor people. In a recent speech at Bates College, former Ford Foundation president Susan Berresford warned of the danger of "miniaturizing ambition" when foundations put too much pressure on themselves and on grantees to demonstrate short-term, measurable impacts. When your goal is social justice, the relevant indices can be amorphous and hard to define, but their long-term and systemic impacts can eventually be described. They may indeed speak to significant achievements.

Short-term performance indices alone have limited value in evaluating systemic change and are insufficient measures of its ultimate achievement. In my view, the kind of social entrepreneurism represented by Muhammad Yunus was concerned with fostering new ideas about how financial institutions could refashion their practices and programs in ways to better serve poor people. This view of social entrepreneurship, which focuses on the force of ideas rather than charismatic personalities alone, "moves the field toward defining entrepreneurship in a broader way that includes organizational and administrative reforms."[11] Actual achievement of essential reforms is the kind of practical measure of impact that evaluators concerned with systemic change should be following over time.

Achieving systemic change requires foundations and their grantees to work with governments, the private sector and publicly-funded donors early in the life-cycle of a promising idea.

For Muhammad Yunus, the essential goal was changing the lending policies of commercial banks in ways that gave poor people access to credit. Yunus told Adrienne Germain, the Ford Foundation representative in Dhaka in 1981, "I want to offer a guarantee to the commercial bankers who are supporting us so that they can't back out of the expansion because it is too risky."[12] Importantly, commercial banks were participants in the experiment from the outset, their participation facilitated by the Ford loan guarantee fund.

US philanthropies principally funded public institutions in the first thirty years of their engagement in developing countries, from the early 1950s to the early 1980s. For a number of reasons, the Ford and Rockefeller foundations began in the late 1970s and early 1980s to shift their funding away from government agencies, public universities and research institutes and quasi-independent development banks toward nonprofit organizations. Nonprofit organizations were seen to be less subject to the bureaucratic and political constraints of government and were often led by resourceful, dedicated and innovative new leaders. Significantly, large foundations that have begun funding internationally in recent years, such as Gates, Atlantic Philanthropies, Starr, Hewlett and Packard, have followed in the path forged by Ford and Rockefeller of principally funding nonprofit organizations.

Foundation funding has arguably proven decisive to the growth and independence of civil society in many countries around the world. But one of the consequences of the historic shift of foundation funding to the nonprofit sector is narrowed scope for direct engagement by foundations with governments on important public policy questions. This need not necessarily be a problem when the NGOs funded by foundations are engaging effectively with their governments on matters of shared interest. But problems do arise, in my view, where NGOs are not mixing it up with governments where current public policy is an impediment to the achievement of a program's goals, or where new government policies can bring considerable benefit. Governments, the private sector and large, traditional nonprofit institutions such as churches are vitally important institutions, and their policies toward the poor are often what foundations and civil society should be seeking to influence as a matter of priority.

We are not able to assess the record of transfer of promising new ideas from civil society to mainstream institutions in this paper. That record merits study. The lesson of Grameen is that when Yunus began to test the new lending model beyond the relatively controlled confines of his home district, he purposely engaged the institutions he understood he had to change—commercial banks—in the experiment from the outset. Yunus suffered considerable frustration as a result of his very early engagement with the Bangladesh Central Bank and a number of commercial banks. Officials of these institutions were endlessly skeptical of the viability of his plans. But his early encounters with state officials and commercial bankers deepened his understanding of the obstacles he had to overcome to change the banking system fundamentally.

The risks and rewards of philanthropic freedom.

Bearing risk on behalf of social and institutional changes that give poor people greater access to the benefits of markets, education, health care and political representation and human rights is philanthropy's great opportunity. I believe that foundations enjoy greater public sanction to carry risk on behalf of social innovation than many philanthropists and foundation executives appreciate. I also believe that, while the kind of insightful thinking and astute leadership qualities demonstrated by Muhammad Yunus are not commonplace, foundations can make no better contribution than to look outward and support people of comparable judgment and experience and the organizations and movements that they lead. I also believe that foundations have greater impact when they support efforts to change how governments, the private sector and other institutions that touch the lives of poor people respond to their circumstances and problems.

Poor people in developing countries live with uncertainty and bear risks on behalf of a better life that few of those who live in developed countries can imagine. Their prospects are made harder when key institutions, public and private, national and international, can't figure out how to bend and refashion their own purposes and policies in ways that give poor people access to the kinds of resources, benefits and protections those with greater wealth take for granted. This was Muhammad Yunus' great achievement. He saw in poor farmers and business people considerable entrepreneurial acumen stymied by lack of access to loan capital. Yunus fashioned an experiment using Ford Foundation risk capital that changed fundamentally how commercial banks in Bangladesh viewed the credit-worthiness of poor people. It was a marvelous partnership, and one that speaks to the great promise and potential of private philanthropy when it undertakes to bear risk on behalf of social innovation.

Steven Lawry *is senior research fellow at the Hauser Center for Nonprofit Organizations at Harvard University, where he co-leads a research program on transnational philanthropy and poverty reduction. He held a variety of positions at the Ford Foundation between 1992 and 2006, including representative for the Middle East and North Africa from 1997 to 2001. He was president of Antioch College from January 2006 to August 2007.*

The author is grateful to Ashley Berendt, graduate student at the Harvard Divinity School, for her research assistance. He wishes also to thank Charles Bailey, Susan Berresford, L. David Brown, James Honan, Jan Jaffe, Laura Johnston and Tony Pipa for their comments.

[1] Yunus, M. *Banker to the Poor* (New York: PublicAffairs, 2003).
[2] Ibid, 112.
[3] Ford Foundation records indicate that the exact amount of the loan guarantee fund was $770,000, consisting of a $154,000 recoverable grant to cover the first 2% of the value of possible loan defaults and $616,000 in the form of a Program Related Investment (PRI) to cover the subsequent 8% (Recommendation for Grant/Program Related Investment, The Ford Foundation, May 21, 1981). The unused funds were rolled over into a new grant to Grameen, in 1983, in support of research on small-scale enterprises and to provide loan guarantees to experimental group-owned enterprises. In assessing the experience of the initial grant and PRI, Ford staff recommending that the funds be rolled over into a new grant action noted, "The loan default rate that the banks feared never materialized and the recoverable grant was not used." (Recommendation for Grant Action and Program Related Investment, The Ford Foundation, May 31, 1983, p. 10)
[4] Yunus, M. *Banker to the Poor*, 113.
[5] Some critics of large philanthropies argue that the tax exemption granted expenditures on charitable activities justifies much greater public supervision of foundation activities than is currently the case. See

for example: Arnove, R. and Pinede, N. "Revisiting the Big Three," *Critical Sociology*, no. 33 (2007) 389-425.

[6] The Tax Reform Act of 1969 provides that foundations disburse 5 % of the average fair market value of their investment assets annually.

[7] The Hauser Center for Nonprofit Organizations seeks to assist in filling this gap with the research project: Philanthropy, Civil Society and Development Breakthroughs.

[8] Bastante, S. *The Strategic Role of US Private Foundations in Poverty Reduction in Development Countries: Are They Supporting Innovation?* (Cambridge, MA: Hauser Center for Nonprofit Organizations & Harvard Kennedy School, May 2008).

[9] Fleishman, J. *The Foundation* (New York: PublicAffairs, 2007) 28.

[10] A consultant commissioned by the Ford Foundation's Dhaka office in 1986 to review Ford's early grant support for Grameen noted in his report that "The Foundation's own contribution has been its flexible and timely support which proved critical in enabling Grameen Bank to keep up momentum and to maintain the supportive environment in which creative individuals like Dr. Yunus best flourish." (Ford Foundation Memorandum, "Close out of grants #810-0578 and #810-0579: Grameen Bank," March 30, 1986).

[11] Light, P.C. "Reshaping Social Entrepreneurship," *Stanford Social Innovation Review*, (Fall 2006) 50.

[12] Yunus, M. *Banker to the Poor*, 113.