**Finance and Banking in Alleviating Poverty:**

**Microcredit and Microfinance in an Age of Financial Crises**

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**Introduction**

This article, which forms part of the inaugural issue of the new ‘Journal of Social Business’, appears just 6 months after the highly successful day-long “Global Assembly” conference, organised by The Centre for Development (CfD) Scotland, at the University of Glasgow on the key theme – *Tackling Poverty for a Fairer World* to mark and honour the works of the 2006 Nobel Peace Prize winning *economist* Muhammad Yunus and the Grameen Bank which he established in 1976 to lift the poorest in Bangladesh out of poverty. The conference attracted a large audience and speakers from a broad spectrum of backgrounds; eg from major banks to the smallest providers of credit at a very local level, such as credit unions. This fact alone highlights the significance of the issues raised at the conference, especially the commonality of problems faced by quite distinct societies – both developing and developed - across the globe, while exploring alternative ways through banking and finance to help people out of poverty - what role that banks and credit institutions can play in this process? In the light of the recent global financial crisis, have existing forms of financial institutions failed because they have ignored the fundamental reason why banks exist, namely to facilitate credit to finance industry and trade? Instead of, as they have become, the *Masters of Industry* rather than *Servants to Industry.* Asa result of the crisis there has been growing demand, especially in the UK and the US, to split the retail functions of banks from their investment functions. In other words, to return to the traditional role of banks which is to provide finance for businesses. In that sense this article is timely, not just for what it suggests should be the role of finance and banking in the alleviation of poverty in a post-crisis age. It is also of interest to those economists who are re-examining the role and purpose of their discipline in the wider society. Does the recent financial crisis provide an opportunity for the profession to develop a ‘New Economics’ – *one that places people at the centre, not on the periphery*?

**Some History**

Throughout history, from the very early banking institutions created in Venice during the 12th century, banks were viewed as the handmaidens of industry and trade. They were means to an end; not ends in themselves. From the setting up of the first Joint Stock Bank onwards, the role of banks was *as servant not as master*. They provided the means of facilitating trade through the financial innovations of their day; everything from bills of exchange which played a key role in facilitating the expansion of trade with England in the 19th century, to the chequebooks and now the ATMs of today. Banks have always been in the business of financial innovation and financial intermediation- the matching of surplus lenders with potential borrowers. In one sense, the development of Microcredit institutions such as the Grameen Bank *known as village bank* in Bangladesh (and others such as Credit Unions in developed countries), are just one further step on the road of financial innovation. These are examples of modern day innovations no different from the much criticised Credit Default Swaps (CDS) and Credit Default Obligations (CDO) which played such a major role in the recent financial crisis. Perhaps the central message of this article is that modern financial systems have a role for all of the various types of institutions, from complex investment banks and hedge funds to credit unions and microcredit institutions. As long as each know their individual roles within the wider system. This message resonates with recently expressed views on the financial crisis, particularly the perceived need to isolate the retail banking aspects of finance, from the so-called investment or ‘casino’ form of banking. This will prevent the so-called ‘toxic’effects which occur when these types of banking activities are mixed together.

It is pertinent at this point to refer to Professor Yunus’s 2008 Adam Smith Lecture given at Glasgow University to mark the 250th anniversary of the publication of Smith’s *Theory of Moral Sentiments* (TMS). In his lecture[[1]](#footnote-2), Professor Yunus, points out, rightly, that the TMS should be viewed by economists as a counterbalance to Smith’s Wealth of Nations (WoN). That is, the TMS represents the other side of the market from the brute force of the *invisible hand* (some would say *invisible ‘fist’*) of the WoN. From the TMS we learn that there is a social consciousness within people. Perhaps this is where the Smithian concept of *enlightened self-interest* really comes from. Because people are multi dimensional, their selfish dimension is offset by their selfless dimension. The true role for the market then is to provide incentives in order that these two dimensions can more often be in harmony than in conflict. Quoting the TMS ... “how selfish so ever man may be supposed, there are evidently some principles in his nature, which may interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it”. The principles Smith has in mind included pity, compassion, empathy even sorrow at the fate of others. Even the ... “greatest ruffian, the most hardened violater of the laws of society, is not altogether without it”.

Actually even in the WoN, Smith deals with the “other side” of the market. What might be called the *acceptable face* of capitalism. In Chapter 2 of Book 2, Smith engages in a wide ranging discussion of the role of paper money and its bankers in society. He says with respect to the use that we can make of money (or in his day gold and silver) ... “if they employ it in purchasing goods in one foreign country in order to supply the consumption of another, or in what is called the carrying trade, whatever profit they make will be an addition to the neat revenue of their own country ...”. Here are the benefits derived from constructive and open trade. Whereas, Smith says, “if they employ it in purchasing foreign goods for home consumption, they may either, first, purchase such goods as are likely to be consumed by idle people who produce nothing, such as foreign wines, foreign skills etc; or secondly, they may purchase an additional stock of materials, tools and provisions, in order to maintain and employ an additional number of industrious people, who re-produce, with a profit, the value of their annual consumption”. He continues ... “in so far as it is employed in the first way, it promotes prodigality, increases expence and consumption without increasing production ... or establishing any permanent fund for supporting that expence, and is in every respect hurtful to the society ...”. Whereas ... “so far as it is employed in the second way, it promotes industry, and through it increases the consumption of the society, it provides a permanent fund for supporting that consumption, the people who consume re-producing, with a profit, the whole value of their annual consumption ... and ... the gross revenue of the society, the annual produce of their land and labour, is increase ...”.

Here Smith is warning us against conspicuous consumption which ultimately will be self-consuming. In relation to bankers themselves, Smith is forthright. He spoke of ...“the late multiplication of banking companies in both parts of the United Kingdom ... which ... obliges all of them to be more circumspect in their conduct, and, by not extending their currency beyond its due proportion to their cash, to guard themselves against any malicious runs, which the rivalship of so many competitors is always ready to bring upon them ... but at the same time ... this free competition too obliges all bankers to be more liberal in their dealings with their customers, lest their rivals should carry them away ...”.

So here is the true message of Smith: competition is good - in banking as in other endeavours - provided it is regulated and controlled. It should not be unfettered without a social dimension. In terms of the theme of this article, and indeed of this new Journal, the lesson to be learned from history, or at the very least from Adam Smith, is that banks and other types of credit institutions should be allowed to compete with each other freely; partly because competition is deemed to be good, *per se*, but also because providing alternative means of acquiring credit to different categories of borrowers is a good thing. Hence, the role of such alternative forms of credit as *collateral-free* ‘microcredit’ as in the Grameen Bank model which cater to those borrowers who might not otherwise be able to access credit (see Yunus 2007).

The Chinese have an expression - *let a thousand flowers bloom*, and this sentiment could easily be applied to the topic of this article. That is, there are numerous modes of finance and banking that can help to alleviate poverty in both developed and developing countries. Professor Yunus has himself said that the example of microcredit represented by the Grameen Bank may not be appropriate for all types of borrowers. There will continue to be a need for sources of finance at the top end of the market as well as at the bottom end of the market; the latter being well provided for in the various forms of microcredit arrangements that now exist in the world. In developed countries also there has been a long and distinguished history of banking and finance to those sections of the community to whom mainstream banks do not offer credit. For example, in the UK there are the Co-operative movement and the Credit Union movement which are both very strong. The latter, by 2006 had more than 170 million members across 97 countries, who are able to borrow on terms most similar to those offered under the Grameen Bank principle. There are also some specialist institutions such as the Triodos Bank which focuses exclusively on loans to social businesses and sustainable development projects. Even the large high street banks are now keen to portray themselves as engaged in some form of ethical banking in one form or another. This usually occurs through the sponsoring of charitable causes, sporting events, and the like, although they have also embraced, to some extent, *ethical* and “social” lending.

However, at the top end of the market the large international banks will still have a major role to play in; eg the huge loans provided through sovereign wealth funds; large infrastructural funding, much of it in developing countries; and the massive loans provided by syndicated banks, sometimes to sovereign governments. I suppose the question which follows from the example provided by the Grameen Bank is whether the potential exists for similar structures to prosper in developed countries on the scale of the Grameen Bank and not just in developing countries. One of the “unintended consequences” of the crisis might be that these alternative sources of finance will thrive. There are already signs of this happening, at least in the UK. Deposits have increased hugely in banks such as the Co-op Bank in the UK. New banks are emerging, for example - Virgin, Tesco and Metro Bank have all sprung up or are about to. Because of the *Too Big to Fail* problem - the notion that governments will always bail out the very large banks due to the fear of contagion - there is now increasing pressure on governments and regulators such as the UK Financial Services Authority (FSA) to break up the mega banks so as to avoid a repeat of the moral hazard that dominated at the time of the crisis.

Therefore, at present, there is a growing mood for increasing competition within banking. This will avoid the “Too Big to Fail**”** problem and will provide more opportunity for new and existing players to operate and thrive. If more banks emerge, as seems likely, not only the system as a whole will benefit, bank customers will also benefit because of the greater choice and security they will have in the wider range of banking services offered. This will also be good for the banks themselves as it will encourage stronger competition. This will be a competition based on price rather than, as heretofore, non-price aspects.

*When a market is dominated by monopolistic or oligopolistic structures, as in banking, non-price competition thrives at the expense of price competition. Banks are no different in this regard.*

A short anecdote is relevant at this point. During the depth of the financial crisis The Economist magazine ran an article on the case of the “Airdrie Savings Bank”. This is a small (indeed tiny) independent bank with just 7 branches located around the town of Airdrie, within a 25 miles radius of Glasgow, with total deposits (in 2007) of a mere £117million. It operates on very traditional lending criteria with minimal risk-taking and as a result weathered the financial crisis. Indeed, in one month (October 2008), it received an un-heard of boost to its deposits of £8.5 million, 7.4% of its then deposit base. This is a bank that originated in the savings bank movement led by Rev Henry Duncan in the poorer areas of Glasgow and Lanarkshire in the 19th century. In its November 13th issue of 2008, The Economist article described the bank ... “Boring, stolid, small and safe”. It had not only survived the crisis, it had actually “thrived” as a consequence of it. This was so, because this type of institution which can best be described as a “mutual” bank,became more popular than ever due to its low risk operations. Essentially just retail deposits, no dividends for shareholders, who do not exist in this form of ownership, and no lavish bonuses for bankers! Not only did its deposit base increase, quite soon afterwards it even announced the opening of an additional branch, again not far from Glasgow.

The continued success of the Airdrie Savings Bank, and other independent banks like it, is a testament to the need for banks, especially the retail banks, to go back to their roots and to serve their local communities. They should become as, Mervyn King - Governor of the Bank of England - said recently ...“more boring”. He also said if the view exists that “banks are too big to fail”, then perhaps some banks are in fact ...‘too big’! This example also harmonises with one of the key messages of this article, which is that banks and bankers should return to their antecedents at the time of Adam Smith and become once again the ‘servants’ not the ‘masters’of the economy. The link with the microcredit principles of the Grameen Bank model is clear. The next section of this article will examine in more detail these principles as they were first applied by Professor Yunus in Bangladesh in early days of microcredit movement, and are now being applied in many countries around the world. It will ask whether, especially in the light of the recent financial crisis, such principles might also be adopted in developed countries.

**Financing Social Business**

The essence of the microcredit phenomenon is the potential it has to stimulate *what Professor Yunus calls* ‘Social Business’ (Yunus 2007, 2010). The objectives of social business are to serve a social (and therefore also a business) need; to solve an identified problem; and to satisfy the collective benefit of others in society. The purpose of social business is *NOT* to make money for investors or shareholders. Yet a social business is *not in the business of NOT making profits* either. That is what charities are for. Rather, they are non-loss making but non-dividend companies. Investors (or members, as they may be called) can recoup their initial investment capital. Since surplus profits will be re-invested in the company, the company and its products should improve. They should become competitive with mainstream companies and ultimately just as efficient, or more efficient.

In reality, such social businesses exist across the world some of which have been stimulated by the Grameen bank concept. For example, the Grameen joint-venture with Danone, the French company well known for its yoghurts and similar products; and the tie up between Veolia, another French company, and Grameen in the area of safe drinking water, are just two examples. The key point is to start with the perceived social (and economic) need, whether it be to stimulate optimal levels of investment in renewable energy, healthcare for the poor, or to supply information technology to the poor. The *raison d’etre* of such a concept is that the businesses should primarily have a social purpose, which the market has not recognised or cannot provide the incentive structure to bring into existence. Rather than *supply creating its own demand,* these are businesses in which a*(social) demand creates its own supply.* Professor Yunus has identified a number of areas where the microcredit concept could thrive; eg technology for the poor; agricultural activities including agro-industry investments, where costs are often prohibitive; healthcare and health insurance; the environment and renewable energy; and education at all levels. In Bangladesh there have been remarkable improvements in many of these areas, thanks to the Grameen Bank.

In Professor Yunus’ opinion there would be nothing to stop the development of a ‘social stock market’ where the shares of social businesses are traded. This is a logical development from the concept of social business itself and could be a type of parallel equity exchange on the same lines as the Alternative Investment Market (AIM) within the London Stock Exchange. Ultimately it could go even further than this. Social businesses could impact on the process of globalisation itself, with the emergence of*‘*multinational social businesses’. Of course, all of this would also require the setting up of appropriate regulations, rating agencies, reporting and disclosure arrangements, as well as education to support these aspects. There already exist a number of university degree courses and MBA programmes around the globe which specialise on the theme of social business.

**From Microcredit to Microfinance:** From Individual Entrepreneurship to Collective Entrepreneurship

The above notwithstanding, how can the undoubted successes of the Grameen Bank be propelled to a higher stage. At one level, the provision of small “micro” loans to people who otherwise would not be able to access credit cannot be criticised. It must be good. And this author agrees. The difficulty arises when one attempts to move from that disaggregated level to an aggregated level. There are actually two aspects to this transition. The first is to devise mechanisms to allow the disaggregated components of “micro” credit to become aggregated, ie at a more “macro” level. In essence, this requires the very tools of finance that many have criticised as the cause of the recent financial crisis i.e. derivatives, securitisation, the bundling and unbundling of small sums into larger sums then back into smaller sums and so on. In effect, *secondary markets in microcredit*. This author’s view is that the use of such tools (or instruments) should not be discarded as inappropriate within the context of the microcredit sector. These tools are merely examples of financial innovation that can be either used or abused, depending on the underlying objective. In a sense, this suggests that microcredit has to become *microfinance* in the broader context. That is, it should embrace not just small individual loans to individuals, but also the packaging of larger loans to perhaps groups of borrowers eg at the village or even street level. It should also incorporate avenues for savings and insurance.

At a practical level, this requires the Grameen Bank to work with other mainstream banks, in the same way that it does already with the France’s largest retail bank Credit Agricole which has established a Grameen division. The same could be done in other countries. In the UK, the Co-op Bank might wish to cooperate in such a venture. Or the highly successful Credit Union movement. The reason for suggesting this is that the microfinance sector has to be self-sustaining. To be so, it has to foster the transition from individual entrepreneurship to collective entrepreneurship. Economists as far back as Schumpeter (and more recently Ha-Joon Chang, for example, in his 2010 book - *23 Things They Don’t Tell You About Capitalism*) have argued: successful economies require to make such a transition in order to be self-sustaining. It is not sufficient just to continue to finance individual examples of social business, laudable though that might be. The transition requires the creation of appropriate organisational and governance structures, whether it be in the form of cooperatives or community-owned businesses. Less developed countries have tried many examples of such arrangements, though they have often floundered because they have been dependent on state support and subsidy. Examples of such failures include *primary product Marketing Boards* and even the initially highly successful *Development Banks* that operated in many developing countries. The approach should be “bottom up” not “top down”.

At a theoretical level, there are two relevant concepts which help us to understand why such a transition is imperative. The first is what Chang refers to as the *fallacy of composition* problem. This is exemplified by the Grameen example of the so-called ‘telephone ladies’ in Bangladesh. This arose from a tie up between the Grameen Bank and Telenor, the Norwegian telephone company in 1997. This led to the financing of small loans for women to purchase mobile telephones and then to rent them out to their villagers. This was highly successful since the ladies made good initial profits between $750 and $1200, compared with an annual average income in Bangladesh of $350. However, the market became crowded and the ladies earnings fell. By 2005, their income was on average only $70 per year, whilst the average annual income in Bangladesh had risen to $450. Chang’s point is not that the mobile phone initiative was itself a bad idea. The point is that just because some people can succeed with a business, does not mean that everybody can. This is the fallacy of composition. Therefore, what is required is that such a success should then be used as a springboard to move up the value chain and not just to remain at the initial stage. In the mobile phone example, this is obviously difficult, given the technological costs and expertise involved. However, Chang’s point remains valid; namely that the danger of a successful process such as highlighted in this example is that it may get stuck at the initial stage and not become self-sustaining. There is also the possibility that the earnings made might be used for consumption purposes rather than for investment. The second relevant concept is “economies of scope”.

**From ‘Economies of Scale’ to ‘Economies of Scope’**

Economists have long referred to the advantages derived from size or scale namely; economies of scale. However, it is the concept of *economies of scope* that is perhaps most relevant to the case of microfinance. Economies of scope relate to the benefits derived from carrying on related activities. Specialised labour, technology and knowledge used in one activity can be used or transferred to a related activity. When there are multi-product firms, the benefits of increased economic activity often derive more from economies of scope than economies of scale. An economy of scope is made when ... *cost of (activity a plus activity b) < cost of activity a and cost of activity b separately*. Within microfinance there may be potential for such gains to be realised; eg through the pooling of loans to several individuals. In fact the spirit of microfinance, where individual borrowers are often borrowing not just for themselves but also for their village or neighbourhood, is conducive to such gains. When borrowing is done for multiple projects, this minimises transactions costs which is a type of economy of scope. But the concept also transcends to other realms. For example, if the knowledge or expertise gained in one successful project is transferred to another project. Also in terms of the credit status of borrowers there is also an economy of scope in the sharing of information about potential borrowers on aspects such as their default rate. This seems to operate anyway within the Grameen Bank system since repayment rates among borrowers are extremely high (average 98%); far higher than in mainstream banks. Perhaps the nature of the Grameen loan contract induces such an outcome where there is implicit, sometimes explicit, peer pressure exercised at the village or community levels. How else could some borrowers obtain credit without the usual collateral, as is the case in most microfinance loans offered under the Grameen Bank principle?

Achievement of these economies of scope whether it be in the loan agreements for borrowers, or the knowledge and expertise acquired in running a successful business which can be transferred to another business, should be easier within a Grameen Bank context. For one thing, the level of moral hazard will be lower because the lender and the borrower will tend to have mutual objectives rather than be in conflict with each other. This is also of course derived from the mutual status of the Bank in the sense that the borrowers are also the owners of the bank. The recent global financial crisis was partly due to the *multiple principal agent problems* which mainstream banks have to deal with. This is less likely within a Grameen Bank set up. Moreover, in the context of less developed countries, where there is no safety net in the form of a welfare system, the Grameen Bank system can also perform an equivalent role to that of the state in providing sources of funding for social goods such as health and education, at least at the village level. Some commentators such as Chang (ibid) and Bateman (2010) have criticised the microfinance sector because it might absolve governments of the responsibility to provide these services centrally. As long as the Grameen approach is not viewed in this way by governments, a level of cooperation and partnership can be developed between them. More than anything else, the main breakthrough achieved by Grameen is that it devolves decision-making to the lowest level. It also empowers people in ways that central government is incapable or unwilling to do. It is the essence of the self-help approach. John Maynard Keynes, the great economist, once said that governments should only do what the private market cannot do and not what the private market can do better and more efficiently. In the Grameen Bank model, we have the perfect exemplar of an intermediary - a financial intermediary - that can bridge such a gap.

**Financial Repression in Developing Countries and in Developed Countries**

It is a well-known fact that developing countries suffer from *Financial Repression*. This term is used to refer to a phenomenon first discussed by McKinnon and Shaw in the 1970’s, although the genesis of the idea goes back much further (McKinnon 1973; Shaw 1973). The basic concept is that, credit availability is often uncertain or erratic in developing countries. This is due to a combination of factors such as: government policies on interest rates (eg interest rate ceilings); controls on exchange rates (a preference for fixed exchange rates and a tendency for the currency to become overvalued); and an over-reliance on direct forms of controlling the money supply such as high reserve ratios. Together, according to McKinnon and Shaw, this leads to chronic disjunctions in the supply of credit, especially to those potential borrowers who have difficulty accessing credit, such as the poor, marginal groups in society and, for example, women. The resultant “feast and famine” of finance - at some periods credit is too easily available (feast), whilst at other times it is in short supply (famine) - leads to a *low quantity of savings and investment* and at the same time *low quality of investment.* This is why many developing countries fail to grow. In fact, the two effects are inter-connected. The result is that, rather than the market achieving optimal ‘credit rationing’ it is left to non-market processes to *clear* the market. These include: *rent-seeking behaviour* of one sort or another, influence and patronage, or less politely, corruption. For a review of the literature on the McKinnon - Shaw hypothesis, see Gemech and Struthers (2004).

The traditional neo-classical economist’ response to such a situation, is of course, to liberalise the various markets - credit markets, money markets, exchange rate markets, and even international capital markets. The solution merely lies in *getting the prices right*. This is what the so-called “trickle down” approach to development is based upon. The real insight of the microfinance and Grameen Bank model is that this approach is, in effect, replaced by a “trickle up”approach. As long as institutions can be established to ensure good governance, availability of finance may become less unreliable and erratic, smoother in fact. This, indeed, is why the microfinance concept was so intuitively appealing when it was first launched. It makes sense, not least because of the avoidance of the Principal-Agent problems referred to above (moral hazard and adverse selection), but also because it achieves several objectives at the same time. It empowers people, especially those of the very poorest in societies who need to be so empowered. It also embeds the replacement of a dependency culture with a self-help culture. Everybody gains, nobody loses. The outcome is more than a positive non-zero sum game.

**Spillover Benefits of Microfinance**

To be sustainable, microfinance initiatives have to develop spillover benefits, or what economists call *positive externalities*. This is required in order to have a long term impact on poverty. Examples of such spillovers include: other forms of capital such as *social capital*, *institutional capital* and *network capital*. In the absence of a stimulus such as that provided by microfinance, these forms of capital will lie dormant, though latent. The very fact that microfinance institutions harness their funding mechanisms through different forms of group intermediation (eg at the village level), helps to achieve these spillovers. The normal channels of financial intermediation through which economies of scale and scope are achieved (eg through the minimisation of search costs) is one way in which this can be brought about. Even within the domain of financial capital, spillovers are possible. For example, once people access loans from a microfinance institution and prove that they are a low risk of default, they can then progress on to other forms of financial investments such as longer term savings and insurance. Of course, when it comes to savings, people in poorer societies as well as poorer communities within richer societies, often save in very traditional and informal ways. This is partly attributable to their lack of access to mainstream banking services (eg this is very common in Africa). As a result, they often save in inefficient ways (eg hoarding of both money and physical goods including gold, as well as livestock).

The challenge, which the Grameen model has tried to grasp, is to harness these forms of savings in productive ways for the good of the community. This is no different from the Savings and Loans model in the US, or the building society, credit union and cooperative movements in the UK. There is a place for all of these models. Indeed, it could be argued that because cultures and attitudes vary across societies, it is important not to impose a *one size fits all* model everywhere. Whatever model works in each case should be adopted, although there is also great potential to ‘share best practice’ from all models. What is clear, and there is much evidence around the world to confirm this, is that if such models and forms of financial governance do not spring up, the vacuum that is left will be filled by unscrupulous forms of money lending. This happens also in developed economies.

**Institutions for Capacity Building**

Just as there are different models of finance that may alleviate poverty in different countries, so there are also different types of microfinance institutions. For example, there are “for profit” institutions, where the key objective is to make the financial sector more efficient. Here, the generation of profit is vital and the initial subsidy element within the small loans offered to borrowers is aimed at improving business start-ups and widening the social business network. A second type is the NGO model in which the objective is to alleviate poverty directly by providing essential services. This also depends on expanding the number of users or ‘clients’ of these services. A third type comes under the general heading of *cooperatives*. Here the key objective is to encourage affiliation or *affinity with a common ideal*, in the same way that many *faith-based organisations* function. The emphasis here is to recruit new members, expand the network, and provide ‘supportive services’ on a fair, equitable, and efficient basis. This third type is probably the closest to the Grameen model, and as suggested above, these have operated successfully in developing countries for many years. Indeed, on a local topic, 2013 will be the year to mark the anniversary of the great work undertaken by philanthropist and social reformer Robert Owen who established his famous model village in New Lanark, near Glasgow, and who is believed to be the founder of the Cooperative Movement. This was the social business of that age.

Ultimately, the challenge for all of these forms of financing poverty alleviation will be to ensure sustainability in funded microfinance businesses. And the Grameen Bank model is no different. In other words, it is necessary to avoid financing *easy-entry* micro-businesses, because easy-entry also means *easy-exit*. In a sense, this is one reason why microfinance loans should not be offered at excessively low rates of interest. Otherwise, this will encourage over-lending, often for unproductive activities (such as conspicuous consumption) with all the attendant problems of moral hazard and adverse selection which can arise. *A word of caution is appropriate.* Not all poor people wish to establish a business, social or otherwise. It is right for the Grameen model to aim, as it were to *democratise credit*. Some authors in this field have rightly suggested that while microfinance may be *necessary*, it cannot be *sufficient*to alleviate poverty. They refer to the need to emphasis what is called “livelihood finance” (note this is quite different from lifestyle finance). Livelihood finance suggests a holistic approach to finance - savings, short and long-term credit, insurance and re-insurance, infrastructure finance (eg shelter and roads), human capital formation (eg education), finance for agriculture, business development services (consultancy and advice), and once again, institutional development (capacity building and governance).

**Conclusions**

In this short article I have tried to encompass a range of considerations in order to assess the effectiveness of the microfinance revolution, and the Grameen Bank model in particular. Starting from a historical perspective which located the debate within the context of the early views of Adam Smith on the role of banks in his day, the article then considered the place for different types of financing models that may be applied in different countries, societies and situations. Obviously the recent global financial crisis, in particular the banking crisis, gives an added impetus to economists to explore new ways of facilitating credit to help poor people. This is a huge challenge for the profession and the *New Economics* approach is playing a central role in on-going debates. This is partly a theoretical challenge, since the old models are no longer “fit for purpose”. It is also a practical and pragmatic challenge not just for economists, but also for bankers and others who work in the world of finance. In this context, the microfinance revolution and the Grameen Bank are role models for this new approach. A simple philosophy may be appropriate here. The Grameen Bank approach has now been adopted in a large number of countries across different continents, and despite what some sceptics may argue, it is a remarkable success story. As for the potential for ‘social business’ to succeed in the modern world, this potential is enormous and should be harnessed. In a small way, the launch of this new Journal may help in that process.

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