

In Credit We Trust: Building Social Capital by
Grameen Bank in Bangladesh¹

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Abstract

In this paper we examine how a third-party--Grameen Bank in Bangladesh--created social capital that has been a boon to the explosive growth of Microfinance in Bangladesh and elsewhere. Using Putnam's definition, we show how Grameen Bank created social capital by forming horizontal and vertical networks, establishing new norms and fostering a new level of social trust to solve the collective action problems of poor people's access to capital. The fact that an MFI can create social capital has strong policy implications. Since social capital is a public good--non-excludable and non-rivalrous --the market will underprovide such good. This paper shows that Microfinance corrects another type of market failure--under provision of a public good, in addition to correcting the failure of the credit market. The social capital building aspects of an MFI need to be taken into account in the whole debate about the need for subsidy.

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I. Introduction

During the past several years, economists and other social scientists have created a resurgence of interest in the concept of social capital. Previously, researchers had recognized the importance of the concept; they just did not use the term social capital to identify it (Putnam 2000). That term gained widespread acceptance only with the publication of Robert Putnam's book *Making Democracy Work: Civic Traditions in Modern Italy* (1993). Social scientists in a variety of disciplines adopted the concept of social capital to analyze a variety of issues. For example, recent research in economics indicates that social capital improves the prospects for development. To follow up on this research result, the World Bank, through its *Social Capital Initiative* (Grootaer and van Bastelaer, 2002), has commissioned studies that examine the various means via which social capital helps development.

This research on the relationship between social capital and development points to an issue facing developing countries. If social capital is good for development, what can those countries do to create it? This question, however, does not have an easy answer. Researchers have contended that it may take centuries to build social capital and that the state cannot create it effectively. These contentions offer developing countries little solace, because they imply that those countries will have to wait a long time to benefit from social capital. The lack of social capital could constitute a significant impediment to development for those countries that cannot be easily overcome.

In this paper I will investigate whether or not the outlook for developing countries is so bleak. I want to explore if a third-party--a non-state institution ---can create social capital. As a case study, I will explore how Grameen Bank in Bangladesh created social

capital that has been a boon to the explosive growth of Microfinance in Bangladesh and elsewhere. Microfinance has been quite successful in reducing vulnerability and poverty in Bangladesh (Khandker, 1998) and elsewhere (Robinson, 2001). While researchers fully explored this success, with a few exceptions, they paid little attention to the social capital building aspects of Microfinance.

There are various reasons why study of Grameen Bank's social capital building aspect is important. First, it is a flagship organization with a track record of two decades. Even though Grameen Bank was established primarily for providing credit to the poor, it took up the responsibility of creating social capital to achieve its non-negotiable goal of alleviating poverty. Second, such a study allows examination of how an organization such as Grameen Bank that has survived various crises such as major natural disasters, labor unrest, borrowers protest, repayment crises and liquidity crises can still create and maintain social capital. A case study will provide a rich menu of how useful social capital was to withstand such crises as well as the role played by it in creating many of these crises. Third, the organization has gone through a full cycle of financing and capitalization beginning with grant based donor funds to soft loans and now to commercial and near-commercial sources of financing. We could explore if social capital played any role in this transition. Fourth, unlike many other Microfinance Institutions (MFIs) and credit-granting NGOs, members own Grameen Bank through mandatory share ownership. This provides an interesting case study of a unique corporate governance structure and we can explore the role played by such ownership structure in creating and enhancing social capital. Fifth, the cost aspects of Grameen Bank operation have been widely examined. Most studies that deal with benefits are

confined to mostly economic benefits and some non-economic benefits. Very few attempts have been made to articulate the social capital building aspects of an organization such as Grameen Bank. Lastly, in this study we will examine how a third party can create and maintain social capital and in the process improves the chance that developing countries can use social capital for development.

There is a burgeoning literature on social capital and more studies are being added on a regular basis. Social capital has been shown to be valuable for solving collective action problems such as forest management, distribution of irrigation water and reduction of crime in the neighborhood (Woolcock and Narayan, 2000). Providing a complete survey of the literature is beyond the scope of this paper. Interested readers can consult several excellent surveys that are part of this voluminous literature (Adler and Kwon, 1999; Harris, 1997; Woolcock, 1998b; Fine, 1999 and Paldam and Svendsen, 2000). Despite wide acceptance of its value in solving numerous problems there is no consensus as to what is a generally acceptable definition of social capital. In this paper we will use the definition of social capital used by Putnam, “features of social organization, such as trust, norms and networks that can improve the efficiency of society by facilitating coordinated actions” (Putnam, 1993, p. 167). In section II we will provide a very brief survey of papers that deal only with the social capital building aspects of microfinance in developing countries. Section III is the core section of the paper. In that section we will show how Grameen Bank created trust, norms and networks to solve collective action problems. We will conclude the paper in section IV.

II. Literature Review

As mentioned earlier there is a huge literature on social capital. Despite the success of Microfinance, with a few exceptions, the literature has ignored the social capital building aspects of Microfinance. That lack of attention is changing slowly. In recent years, several papers were written and projects were launched to explore the relationship between Microfinance and social capital¹. As part of the *Social Capital Initiative* of the World Bank, Thierry van Bastelaer (1999) examined how social capital reduces the cost of imperfect information that is congenital to microfinance. He argues that the main sources of social capital for Grameen Bank are the continuous relationship between staff and members and the patron-client relationship between loan officers and borrowers. Seibel (2000) studied the relationship between social capital and Microfinance in the Philippines. He evaluated the effectiveness of using Grameen type norms such as regular attendance in meetings, insistence on timely repayment, etc., among Grameen replications in the Philippines. The author concluded that the successful replicators use “hard core social capital of the original Grameen approach”--high moral commitments of leaders based on values enforced through training, peer selection and peer enforcement, and credit discipline (Seibel 2000, p.16-17). However, he suggests that to be successful, Microfinance Institutions (MFIs) in countries outside of Bangladesh need to cultivate additional and localized dimensions of social capital. Using data collected from FINCA-Peru, Karlan (2001) finds that social capital generates higher repayment and higher savings. In addition, social capital helps members distinguish between willful defaults and defaults due to true negative personal shocks.

III. Creation of Social Capital by Grameen Bank

The history of the creation of Grameen Bank is now well known. However, very few of these accounts are able to articulate the early struggle the Bank faced to establish its legitimacy. To provide the right context, it will be useful to revisit a bit of the early part of the history of Grameen Bank as well as the history of state intervention in the provision of credit in Bangladesh.

The British Colonial Government got involved in dispensing credit in rural areas in the nineteenth century. This was in response to its belief that indebtedness caused by the oppressive informal credit market was the cause of periodic famines. The Strachey Famine Commission of 1880 recommended that the Government of British India should advance loans to the rural poor and subsequently the Government enacted the Land Improvement Loans Act of 1883 and the Agricultural Loans Act of 1884 (Roy and Rafiquddin, 1994). These Acts enabled the government to advance loans to the rural poor. The Famine Commission of 1901 recommended the establishment of mutual credit associations to provide agricultural credit. This led to the enactment of the Co-operative Societies Act of 1904 and later the Bengal Co-operative Societies Act of 1940 in order to satisfy the credit demands of rural people. After partition, The East Pakistan Provincial Co-operative Bank Ltd. was established in 1948. Later the Government of Pakistan set up the Agricultural Development Finance Corporation in 1952 and the Agricultural Bank of Pakistan in 1957. Following the 1959 recommendation of the Credit Inquiry Commission, these two institutions were merged to form the Agricultural Development Bank of Pakistan (ADBP) in 1961.

After Bangladesh gained independence in 1971, ADBP was renamed Bangladesh Krishi Bank (BKB). In 1986, Rajshahi Krishi Unnayan Bank (RAKUB) was created with the BKB branches of Rajshahi Division assigned to meet credit demands in northern rural areas of the country. Commercial banks were nationalized in 1971 and the Government directed them to open more rural branches to supply credit to the priority sectors such as agriculture and industry. As of March 31, 1994, out of 5,762 total bank branches, over two-thirds were located in rural areas. The special agricultural credit program initiated by the government in 1977, under which banks were required to open two rural branches for every new urban branch, was responsible for such rapid expansion of nationalized commercial banks (NCBs) in rural areas. This ultimately resulted in unplanned proliferation and sub-optimal geographical coverage by rural branches and most of these branches were hardly making any profit. In 1982-83, BKB was asked to take over more than one hundred loss making branches of some NCBs. In 1994 more than 70 percent of BKB branches incurred losses.

Grameen Bank started as an action research project by Muhammad Yunus, a Bangladeshi economist in Chittagong in 1976. The objective of the project was to test whether the poor are creditworthy and if credit can be supplied without any collateral. Later with the help from some Nationalized Commercial Banks (NCBs), Professor Yunus was able to provide a formal structure to his experiment essentially serving as an intermediary lender, by lending bank funds to the rural landless, collecting repayments and depositing them with the NCBs. Soon the bank became a project of the central bank and it supported this work by facilitating funding from the International Fund for Agricultural Development (IFAD). After seven years of experimentation, in 1983,

Grameen Bank was established as a specialized bank with its own charter to work exclusively with the poor, defined as individuals owning less than half an acre of land.

IIIa. Creation of Trust

As the previous historical review shows, rural Bangladesh was littered with failed attempts by government intervention in the credit market. It is in this backdrop that one has to evaluate Grameen Bank's trust creation endeavors.

One of the first tasks Professor Yunus had to face was convincing skeptical commercial bankers that the poor are credit worthy. The commercial bankers questioned his every attempt to convince them, and to earn their trust, he had to take a leave of absence from his teaching job to start Grameen Bank in the District of Tangail, north of the capital, Dhaka. The bankers thought his initial success in Chittagong was due to his teaching assignment's proximity to the area and because he was a charismatic native of the city. When a supportive finance minister proposed a separate bank to expand the Grameen experiment, the commercial bankers put up all possible hurdles (Yunus, 1999, p. 118-119.).

It was also difficult to earn the trust of the Central Bank and the Ministry of Finance despite cooperation from some senior officials of both of these organizations. When the bank first attempted to introduce housing loans, the Central Bank resisted, arguing that the bank can provide credit only for production purposes and that housing loans are tantamount to consumption loans, as the house would not generate any income. Grameen Bank countered by suggesting that a house is like a factory building where all household based production occurs and as such owning a house is an important input of production in addition to being a consumption.² On one occasion the bank received a

terse letter asking it to justify why the majority of the borrowers of the bank were women. Professor Yunus retorted that the central bank itself ought to justify why the majority of the borrowers of commercial banks in Bangladesh were men. When Professor Yunus started Grameen Bank in Tangail, it was a hotbed of clandestine operations by various Marxist groups. In fact many of the staff recruited in the early days were former members of “The People’s Army”—an armed wing of a dissident Marxist movement. In addition, the bank faced opposition from the religious leaders who were and still are opposed to giving credit to women and having women deal with male bank workers³. The clerics threatened that if they joined Grameen Bank they would not be given a proper Islamic burial (Yunus 1999, p.107). Despite their size and enormous influence Grameen Bank and the NGOs are still threatened by the clerics (The Economist, 2001).⁴ The bank had to earn the trust of these diverse groups and convince them that providing credit to the poor, and mostly landless women, is a worthy venture.

However, the biggest challenge Grameen faced was to earn the trust of the very group that it was trying to help in the first place—the poor men and women. As mentioned earlier, all government initiatives to provide credit to the poor were usurped by the rich and the powerful, and poor rural women rarely received any credit at all. When Grameen arrived on the scene the poor could not believe that a government sponsored bank could be seriously interested in their welfare and would provide credit especially to poor women who did not have traditional forms of collateral. Yunus (1999) recalled how he had to struggle to convince the eligible women to accept credit. First of all, they would not go in from of him because of the *purdah* norm, so he ended up talking with them with a screen between them. Moreover, they were reluctant to accept credit

because they didn't know what to do with it and they had been taught that money is something that should be handled by men only. Bornstein (1996) noted the story of one GB member in Patuakhali District. When the Bank manager arrived at his village, rumors of his evil design have started to take a life of their own. "Some said the bank was run by Christian missionaries; some said it was a socialist plot. Others warned that if you borrowed money and failed to repay it, the manager would confiscate your possessions and send you to jail...Aleya recalled exactly how her husband reacted when she told him she wanted to join. He laughed at me. He just said, 'Oh, you think you're going to get money? Even men can't get money from a bank without land certificates. So how are you housewives going to get money?'" (Bornstein, 1996, p. 78-79).

Building the poor's trust was a long and an arduous process. The bank management and the staff worked very hard to attain the borrowers' trust in the early days. This trust building aspect of the bank is reflected in many of the management aspects of the bank. To ensure trust, the staff at the branch level is allowed flexibility in making decisions without the approval of their superiors. Even the recruitment of staff entails hiring the type of people that will be trustworthy. The staff are hired after a thorough process that entails interviews and tests. The newly recruited candidates are dispatched for training in a program run by the bank. The training program is extremely rigorous so much so that there is a 26% turnover within the first three months of the training and almost 50% never make it to the end of the program. "Every effort is made to weed out those ill-suited to the task during the six-month training period, but having survived this, it is rare for a Grameen employee to be dismissed: once part of the 'Grameen family,' every effort is made to retain them," (Woolcock, 1998a, p. 146). The

staff that are finally employed in the bank are imbued with a sense of pride and a genuine concern for the poor. Woolcock (1998a) notes that in the course of a single day the manager is “likely to find himself assuming the roles of marriage counselor, conflict negotiator, training officer, civic leader, and bank manager. From 6am until 10pm, a day in the life of this young rural banker at times seems more demanding and intense than that of an emergency room doctor” (p. 120).⁵

Trust is accentuated whenever a staff visits a borrower house, queries about the members’ children’s welfare and is the first one after a natural disaster to show up on the member’s doorstep. “Trust is based on reputation and that reputation has ultimately to be acquired through behavior over time in well-understood circumstances” (Dasgupta, 1988, p. 53). The most interesting example of trust building occurs during natural disasters such as floods and cyclones that are a regular occurrence in Bangladesh. During the time of such natural disasters, Grameen Bank staff are required to check up on the borrowers’ status, save them from rising water and provide them with necessary rations (Bornstein, 1996, p. 270-271).⁶ This suggests to the poor that the bank is genuinely interested in the well being of the members. These constant and regular attempts to build trust cause the accumulation of trust over time. Hirschman (1984) labeled trust as “moral resources” and argued that their supply does not remain intact if unused but may well increase through use (p. 93).

These earlier experiences with natural disasters are now codified into a formal disaster plan. As part of the disaster plan, managers at the local level are allowed to suspend repayments and allow access to a group fund. This convinces members that the bank is interested in their overall welfare rather than stellar repayment statistics. The

staff are instructed to participate in relief efforts such as providing ORS (Oral Rehydration Salts) packets, alums and water purification tablets to members as well as non-members and hiring local doctors to form medical teams to meet the immediate health needs of the members. During the devastating flood of 1998 Grameen paid a high price for this. The flood affected 71% of its branches, 58% of Centers and 52% of members. The bank declared 42% of its Centers as “Disaster Centers” where the bank suspended its normal activities, such as collection of repayments, and allowed the members to run down their group fund in many cases up to 100% (Barua, 1998). This led to a liquidity crisis. To replenish the reserve, the bank had to borrow money from the central bank at the commercial rate of interest (Chazan, 1998). Grameen is willing to sacrifice financial capital for the sake of maintaining social capital. Grameen Bank is currently struggling to improve the repayment rate and is going through a fundamental restructuring of the whole bank (Pearl and Phillips, 2001).

The constant attempt to attain and maintain the trust of borrowers was necessary given the fact that Grameen Bank was presenting itself as an alternative to traditional sources of credit. “This is an important lesson for all development interventions targeting the rural poor; if an organization is going to present itself as an alternative in some ways to traditional patrons, it must be credible. In Bangladesh, neither the banks nor short-term donor sponsored development projects have been credible in this respect.... if anything the banks have tended to push the rural poor back into the hands of their traditional patrons.” (McGregor, 1994, p. 25).

Despite their presence in rural Bangladesh for approximately the last 20 years, some of the well-known MFIs still labor to attain the confidence of their members.

Rutherford, Hossain and Wright (1996) recount how there was a run on savings deposit accounts of Grameen, BRAC and BURO-Tangail once withdrawal was allowed. This is because the members did not trust their organization and thought the change in policy was temporary. BURO-Tangail is a pioneering institution that created flexible savings services for its members from the start. Even it faced a run on the savings after the flood of 1998. However, savings collections have improved recently. Once members realized that the policy allowing withdrawal of savings would be permanent, they began redepositing their savings. Even after two decades of MFI existence, and with one of the highest densities of MFIs, rural Bangladeshis still question the intentions of these institutions. Rutherford (1999) reports that the possibility that there may be a run on the deposits discouraged large MFIs from allowing open access to members' savings. Yakub (1995) argues that acquisition of greater skills, resources, confidence and social position through repeated micro-credit borrowing might reduce the effectiveness of the mechanism that promotes repayment. The only way to reduce this incentive is to constantly invest in building trust. He suggests that Grameen Bank's attempts to make members 'stakeholders' in the bank by selling shares might bring forth their long-term commitment to the bank.

Grameen Bank proved that the poor can be trusted and, with proper incentives and institutional structures they will take advantage of the assistance. The Bank's trust in its members has created a realization among them that they have to reciprocate by repaying the loans on time. The mere fact that the bank has placed its trust in the poor makes them feel obligated, and this makes it harder for them to betray that trust. A respondent of the World Bank's *Voices of the Poor Study* repeats the same sentiments about the NGO

that supplies microcredit when she notes, “We trust Yuyasan IBU Hindun because it trusts us” (Narayan et al. 2000). Stuart Rutherford noted similar examples of bilateral trust between members and MFIs in his ‘financial diaries’ project in Bangladesh, “... when we asked them their views on the MFIs, many respondents remarked that MFIs are generally consistent and reliable in their behavior, relative to other partners. This was matched by consistent behavior towards the MFIs on the part of the MFIs members, many of whom made their weekly MFI payments regularly (or at least tried (sic) hard to do so) while at the same making excuses to other financial partners” (Rutherford, 2001a: 7).

The trust in poor people’s ability to repay loans constituted a collective capital that others providing credit could use as well. Arrow (1974) argues that the presence of trust will lessen the need to use costly safeguards and monitoring that would be necessary to conclude most transactions. Since its inception, Grameen Bank and its founder publicized the high repayment rate of its members. The high repayment rate was in sharp contrast to the low repayment rate of commercial sector. These high rates created a reputation for trustworthiness of the poor. Once Grameen Bank established the trust in poor people’s ability to repay, others could benefit from this generalized trust—a public good. Others were able to free-ride on this trust building without making the necessary investment in building trust. In the absence of Grameen Bank’s success, it is questionable whether Bangladesh would have become the showcase for the microfinance movement.

Dasgupta argues, “the creation of trust gives rise to externalities, but they too are local externalities. Moreover, the externalities are not anonymous, they are personalized”

(Dasgupta, 99:11). However, Grameen Bank created a generalized trust in poor people's ability to repay and their credit worthiness.

The task Professor Yunus set himself was to show a skeptical world that a formally constituted organization can lend to the poor and expect to get repaid, with interest, and on time. The highly disciplined system he devised therefore paid more attention to guaranteeing the recovery of loan and cutting down on delivery costs than to the banking needs and preferences of his customers. His outstanding success in showing that a very basic loan service can be delivered to the poor has allowed the current generation of critics and practitioners to move on to search for ways to increase the range and quality of banking services to the poor (Rutherford, 1995, p. 132-133).

Once Grameen Bank established the trust in the poor people's ability to repay, it led to emergence of NGOs that extended credit to the poor and encouraged others to bundle credit with other services. Rutherford (1995) recounts how ASA, the fastest growing NGO that was formed in the 1980s with the original intention of changing the social structure as a means to alleviate poverty, switched to providing credit in the early 1990s. He further notes that when ASA finally made up its mind to provide credit, it expressed its objective using words that are close to the ones enunciated by Professor Yunus in his pamphlet *Grameen Bank Project in Bangladesh* published in 1982 (Rutherford, 1995, p. 86 and p. 130). Many could argue that the general rush to supply credit was counter productive since it came at the expense of other more effective instruments such as education, infrastructure, etc. as a poverty alleviation tool. Moreover, not all NGOs were successful and many of them failed. However, the failure did not put a damper on the fundamental trust in the poor people's ability to repay. New and innovative credit granting NGOs are cropping up in Bangladesh on a regular basis and NGOs that were involved with social programs only are coming up with inventive

methods of bundling credit with their traditional services such as family planning, informal education and dissemination of agricultural technology.

Creating trust in the ability of the poor to repay loans was monumental in the context of the history of agricultural credit in Bangladesh. Historically, society as a whole had a condescending view of the poor and in particular their ability to repay loans. In addition, government sponsored credit programs created a legacy that suggests that it is morally wrong to insist that the poor repay loans. Prior to Grameen Bank there wasn't a bank that would lend money without any collateral and especially to poor, illiterate, landless women. There were formal sector institutions that mainly catered to the needs of the small and medium farmers and required collateral. The poor always had to depend on friends and relatives or on moneylenders to meet their credit needs. Grameen's other contribution was the creation of trust in institutions that deal with the poor people's money.

Rural Bangladesh is replete with failed attempts to provide credit to the poor. As is true in most of the government and donor sponsored credit schemes, the rich and powerful and their clients usurped the credit (McGregor, 1994). Most of these attempts were biased towards medium and small farmers. Since more than half of the rural population is landless, the focus on agriculture led to financial exclusion of the poorest of the poor. Even when program such as the Special Agricultural Credit Program (SACP) were launched in 1977 with the specific aim of increasing the supply of credit to small and landless sharecroppers by simplifying application procedures and easing collateral requirements, the program failed miserably in achieving its stated goal. Most of the loans

went to the larger farmers with political connections and had a high default rate of 56% (McGregor 1994, p. 9).

Mutual trust building between Grameen Bank and its borrowers had a positive spillover effect on other institutions. Other MFIs also had to invest in trust building. These vertical and bilateral trusts building between the bank and its borrowers lead to multilateral and vertical trust building in the rural society of Bangladesh.

IIIb. Creation of Norms

Grameen Bank's trust in poor borrowers and the reciprocal trust of the borrowers in the Bank were instrumental in changing credit relation norms in rural Bangladesh. Once norms such as transparency in financial transactions and credit discipline with absolute insistence on timely repayment were established, they became part of the preferences of the borrowers. This created a positive externality in that others benefited from these established norms. Other institutions that followed Grameen Bank did not have to invest much energy in impressing upon their members the importance of repaying on time. For example, ASA has switched to individual lending methodology recently. It is questionable if this would have been possible if Grameen Bank had not established the norm of repayment. A further benefit of such norms is exhibited in the repayment statistics of credit-granting NGOs in Bangladesh and especially when one compares these with the repayment statistics of government owned banks and other financial institutions (Khandker, 1998, Table 6.2 and 6.3).

Grameen Bank also helped to create the norm of credit discipline. It believed that nothing should be given for free to the poor. In the face of tremendous pressure, Grameen never forgave any loan. This was extremely difficult given the low recovery

rate and frequent write offs of agricultural loans by the Government. The biggest threat to Grameen's existence came in 1991. That year the newly elected Government decided to forgive all loans from government banks that were under 5,000 Taka (about \$ 125).

“Though the policy may sound as though it would benefit the poor, in reality almost 100 percent of these loans made by government banks went to land-owning, wealthier members of the population. But because most of our loans were also under 5,000 taka, many Grameen borrowers thought that their loans had been forgiven. It was extremely difficult to explain to our borrowers why the rich people in their village were getting their loans written off but they were not” (Yunus, 1999:197). So, the bank had to get on with the arduous task of convincing borrowers to repay their loans. So strong is the norm against default, especially among female members, that they will borrow from informal markets at a higher interest rate to keep their credit record clean (Sinha and Matin, 1998) or default with other financial partners and divert funds to repay the MFIs (Rutherford, 2001a).

Initially, to change the norm and convince a skeptical audience, Grameen Bank touted its high recovery rate as evidence of success. The 98% recovery rate became the gold seal of approval. It was probably necessary at that time to convince policymakers and skeptical commercial bankers. However, it became a burden. Any MFI with less than 98% recovery was considered a failure. It forced the institutions to panic once their recovery rates were less than the ideal, even though the rate for commercial banks in Bangladesh was a lot less and the recovery rate for government sponsored agricultural loans was less than 20% (Khandkar, 1998). The borrowers of nationalized commercial banks face a much more favorable environment—they are better educated, can access

funds with much lower interest rates, can take advantage of better infrastructures and can access better business networks. The poor's business ventures are more risky and more competitive, and they can't use the improved infrastructure available to better off borrowers. This suggests that the poor should have a low willingness and ability to repay. We find, however, that the poor outperform the better off borrowers by a multiple of two to three.

Grameen has created the norm of group lending. The groups consist of five people and initially the loan is extended to two members and based on their repayment performance, two more members get the loan. The chairperson of the group, however, is the last one to receive the loan. The main motive behind organizing the borrowers into groups is to use peer pressure or "social collateral" to guarantee repayment, since all members are jointly liable for the loan. In addition, the group was supposed to be a support mechanism for the members in need.

Moreover, members view group formation and using the group for disbursement and collection as a reflection of accountability and permanence (Matin, 2000). The Press in Bangladesh regularly reports cases of fly by night organizations showing up to collect savings on the promise of giving loans later in the rural areas. Once they have collected enough savings these organizations vanish in the air. An identifying characteristic of these institutions is that they rarely organize their victims into groups. Group lending and the associated connotation of permanency enhanced the trust in the institutions such as Grameen and others that use group lending; they do not face runs on their membership by the behavior of fake institutions that ran away with member's savings. Betty Wilkinson (2000) reports other benefit of group lending based on her informal survey of members of

MFI's around the world. Respondents in China report that group lending enables development of social relations/cohesion. In Zambia, membership in groups makes borrowers more rigorous in their business efforts and enables them to get advice from successful group members. Members from Papua New Guinea report that group meetings ensure that the credit officers stay honest because they keep a watchful eye.

The norms of group liability, regular attendance, staggered and accelerated lending appears to be replicable in most cultures with the exception of atomistic societies such as the United States. Researchers have attributed the lack of success in the United States to weak social capital of the poor and the poor's unenforced loan discipline compared to Bangladesh (Light and Gold, 2000). When the Grameen model was replicated in other countries such as the Philippines and Malaysia without adherence to the strict principle of the Grameen model, it failed miserably. Rehabilitation entailed returning to the essential principle of Grameen. Seibel (2000) describes the case of a Grameen replicator, ASHI, in the Philippines. When the repayment rate dropped to 58%, rehabilitation entailed strict adherence to the essential principles of the Grameen model: regular attendance of weekly meetings, punctuality, pledge, seating arrangements and absolute insistence on on-time payment. AIM, another replicator in Malaysia had to do the similar things as part of the rehabilitation strategy. However, research by Jain (1996) and others suggests that joint liability is rarely enforced in Bangladesh. Matin (1999) reports that joint liability is enforced mainly via staff pressure and infrequently by completely reversing the contract—members with good repayment records are rewarded instead of those with bad records being penalized to counter the demonstration effect of becoming irregular.

Grameen Bank also established the norm that credit is not charity. During the flood of 1987 that affected the northern part of the country, aid organizations asked the Bank to help distribute relief to flood victims. To inculcate the norm that it is not charity, the bank started a revolving disaster fund. The fund was capitalized by selling the food supplied by the aid agencies at cost with the condition that the borrowers would replenish the fund when the situation improves.

By holding center meetings in public the bank has created the norm of transparency in financial transactions. In these meetings a group chairperson, a position that regularly rotates to prevent distrust, collects repayment from members and hands them over to the bank worker who makes the entry in the ledger book. The bank worker disburses credit in center meeting. This precludes the possibility of misappropriation of funds by the staff and bestows a sense of ownership to the members. Given the amount of money handled by the staff, the incidence of embezzlement of funds by them is quite rare. In recent years many staff were attacked and physically assaulted on their way to the branch office after holding center meetings to collect funds. In many cases the staff tried to safeguard the funds at the cost of serious physical injury to them.

So far, we have explored creation of norms at the micro level. The bank has also created norm that pertains to the macro level. Currently each Grameen member owns one share of the bank. By virtue of this ownership, the borrowers own 93% of the shares of the bank and the borrowers elect nine out of twelve members of the Board. These nine members of the Board are elected via direct election by all the borrowers of the bank. From its inception the bank insisted on borrower's ownership of the bank. When it first received the charter in 1983 the borrowers owned only 40% of the shares. Through

cooperation from some senior level bureaucrats in successive governments, the bank persuaded the government to give up the majority ownership in the bank. This form of governance, where the borrowers own the bank and have their representations in making all major decisions of the bank is an absolutely new norm of corporate governance for Bangladesh.

Recent studies have questioned whether having illiterate women on the Board of Directors really make any difference at all. Rahman (1999) suggests that the presence of such women in the Board is another manifestation of dominant patriarchal norms; these women can be hoodwinked into accepting decisions made by dominant males. Still, it should be noted that not many banks in Bangladesh-- indeed even banks in the USA-- can claim to have 9 out of 12 female board members. Granted these women may not understand the intricacies of modern finance, but they are smart and savvy enough to understand the ramifications of policy changes at the field level. Putting women on the board will not change the country's historical norm of male domination overnight, but it is a symbolic change and a very good beginning at that. In fact, one could argue that electing female borrowers to the Board is more than symbolic, since they led the way on changing how the group fund works, not to mention many other important policy changes (Dowla, 2000). Since Grameen Bank does not pay dividends on share ownership, many have argued that such ownership is sort of an initiation fee rather than an example of ownership by the stakeholders. But many growth companies don't pay dividends so that their shareholders can take advantage of the capital gains. Besides, the decision not to pay dividends was made by the Board of Directors where borrowers have majority representation. Recently the Bank has started paying dividends of 8.5%, the same rate on

its savings deposits. Plans are underway that will entail swapping Grameen's shares for the shares of publicly traded companies of the Grameen Family such as Grameen Phone (Burr 2000).

The borrowers have established their own set of norms known as the *Sixteen Decisions*. Grameen Bank holds an workshop for center chiefs of each branch every year⁷. In these workshops the leaders share their achievements, review the problems they each face and examine ways of finding solutions to social and economic challenges. Because of the success of such workshops, Grameen Management decided to hold a national workshop in 1980 where the first four of these decisions were accepted. By 1984 the total number of decisions added up to sixteen. Some major decisions are the promise to keep the size of family small, send the children to school, grow and eat vegetables all year round, drink water from the tube wells, not accept and pay dowry and use pit latrines. In addition to the members, the greater community benefited from their adoption of these norms.

Research by the World Bank and others (Amin et al., 1994; Khandker and Latif, 1996; and Schular et al., 1994 and 1997) suggests that Grameen Bank's presence affects contraceptive use. However, Pitt and Khandker (1996) and Khandker (1998), using a different econometric methodology, find mixed statistical evidence on current contraceptive use and recent fertility. They find that lending to women reduces use of contraceptives while increasing men's contraceptive use. The difference in result can be explained by examining the mechanisms through which credit affect fertility. First, there is the "substitution effect of credit": increasing the opportunity cost of childbearing by increasing the economic returns on women's time. Second, since credit is likely to

increase income and assuming children to be normal goods can increase their demand via the “income effect” (Steele et al. 2001). Hence access to credit can increase or decrease fertility depending on whether income effect or substitution effect dominates.

Male and female credit from Grameen Bank increased boys schooling and female credit from the bank increased girls schooling as well. Grameen Bank’s credit to women led to improvements in the nutritional well-being of both male and female children (Khandker, 1998).

One could question why the members did not come up with these norms of behavior spontaneously. It is probably true that many of members value these norms and accept and adopt these in their everyday life. Why was there a need for this reaffirmation? Why was it necessary to have the tutelage of a third party to develop these codes of behavior? One could raise the same type of question about the formation of groups. Woolcock (1998) answers these questions succinctly by noting that “even if they wanted to form groups of their own accord, villagers struggle to engage in collective action of any sort because they do not have the organizational skills to do so, have a short radius of trust, and are so poor that they can afford to take few risks (i.e., they prefer strategies that defend what little they have over higher-risk ventures that might increase their income). An external agent is therefore needed to instill these skills and to provide a credible selection and enforcement mechanism, in order that the costs of banking with the poor might be lowered” (p. 132).

Anthropological research (Rahman, 1999) suggests that members are not abiding by these norms. Despite their public pronouncement, very few of them abide by the pledge to not pay and receive dowry. Members don’t use their pit latrines and in many

cases they have more than one pit latrine. In the bank's defense one could argue that it is the borrowers who came up with Sixteen Decisions, and the bank requires only that new borrowers memorize them. Encouragement and support for implementing them is given, but ultimate choice is left to borrowers. However, Rahman (1999) and his respondents noted that the staff neglects social development initiatives in regular center meetings. Non-compliance of these norms by the members may be their way of protesting against the bank's attention to loan collection only and its neglect of social intermediation.

Larance (1998) suggests that Grameen Bank created center meeting norms. These norms were adopted by other credit and non-credit granting NGOs in Bangladesh and in many other countries. The norms include "walking across the village to attend the center meeting, sitting in conversation at the center with a diverse group of women, handling money for the group, and receiving personal address from the GB employee" during the center meeting (Larance, p. 24). Further, she reports that the center meeting norm of personal address creates positive feelings among members. First, the female members like hearing their first name; it gives them self-identity in contrast to using only possessive terms denoting their relationship to the family's male members: such as someone's daughter, or wife or mother. Second, it was important to them because it indicated an educated person, the male bank worker, was showing them respect. Third, public pronouncement leads to others knowing their first names as well. This was valued because the respondents argued that prior to membership in the bank "no one knew the names of poor women. Now they do."

Larance (1998) further argues that the social capital formed among center members has also benefited non-members thus making it "social" in the true sense of the

word. Community members and the resident family planning worker in her study village suggested that establishment of the center and weekly meetings have reduced conflict among village members now that they know each other and their extended families. The village's NGO health worker vouched that the center has increased monitoring of children in the village also. Village elders noted that the center has increased exchange among people in the village and the members are included in better off social and economic circles.

Another aspect of center meeting norms, however, not discussed by Larance (98), is the norm of signing one's name to receive credit. Historically, the poor feared signing or putting fingerprints on any piece of paper as moneylenders, rich and powerful people swindled many poor illiterate people by tricking them to sign their name or putting fingerprints in paper. Grameen Bank members worked hard to learn how to sign their names. Rahman (99) reported that some of his respondents changed their names, as they were long and complicated. However, he notes, "Whether the names are given or arranged, the informants' ability to write their name is a source of pride and encouragement for literacy for the poor women in Bangladesh" (p. 90).

In addition to the above, the most important center norms created by Grameen are the norms of regular and timely attendance at the meetings and regular and timely saving and repayment of loan installments. It is interesting to note that whenever the bank faced localized repayment crisis in centers, the most important element of the rehabilitation strategy was to enforce the center norms. We already mentioned how Grameen replicators in Philippines and Malaysia rehabilitated themselves by strictly enforcing center meeting norms of seating arrangements, regular attendance and timely repayments

(Siebel 2000). When BURO Tangail, an innovative MFI well known for its flexible savings products in Bangladesh faced repayment crisis in 1999, the first thing it did was to try to reform the centers by enforcing the key norms. (Rutherford 2001b).

Grameen Bank created the norm of asset ownership by women. Women can own property in Bangladesh and Islamic law ensures such rights. However, such rights are not operative in practice, and access to property is limited by social traditions and customs (Subramanian, 1998). For example, a widow's inheritance is often claimed and used by her sons. By law, a daughter inherits half of her brother's shares when the father dies, however, very rarely would a woman actually put a claim to that right and the right is relinquished in practice (Subramanian 1998 and Quisumbing and de la Briere 2000). "By giving up the right of inheritance, the daughter keeps access to the parental home open in case of marital crisis, a time during which she might need her brother's help, and on occasion might have to move back to her father's family home, especially following a divorce" (Subramanian, 98, p. 10). To increase asset ownership by the women, loans for housing and leasing of cellular phones have specified pre-conditions that the assets have to be registered in the name of the women. This is to protect them in case of divorce and to improve their "fallback" position in the intra-household bargaining. A woman working for wage employment is against the social norm of labor. Grameen Bank's loan for asset ownership, such as a cellular phone, allows them to be self-employed and somewhat neutralizes the ill effects of not being employed for wage. Owning land improves the social status of women also, since in an agrarian society social class is predominantly determined by land ownership.

By providing female members access to cellular phones, Grameen Bank has created the norm of access to information technology. The phones are financed by a leasing loan from the Grameen Bank and the phones are provided by Grameen Telecom, a non-profit sister company of Grameen Bank that also owns Grameen Phone, the for-profit company. To be a village phone provider, the female members must have a good repayment record of Grameen Bank loans, must have an electrical connection so that batteries can be recharged and their residence has to be located near the center of their village (Bayes, von Braun and Akhter 1999). At present, there are close to 5,000 phones in the villages and Grameen Telecom plans to install 40,000 village phones by the end of year 2002.

Bangladesh has one of the lowest telephone densities in the world with only .26 lines per 100 people. Moreover, the waiting time for a landline phone connection is more than 2 years and a new installation cost \$450—one of the highest in the world. Most of these phones exists in the cities and are owned by men. Cellular phones were introduced in Bangladesh in early 1990s with a monopoly provider selling each set at a cost of \$2000. Owning a cellular phone was a status symbol and only the very rich could own a set. Once the Government decided to open up the sector for competition, Grameen Phone, a for-profit company was awarded a license for GSM cellular phones. Grameen Phone is a joint venture with four partners, however, the majority shares of the company are owned by Grameen Telecom, a non-profit company. Grameen Telecom provides cellular phone services in the rural areas. The phone and the accessories cost an estimated \$420.

Lack of information perpetuates poverty in that it gives the well-connected undue advantage in business and social transactions. However, technology that enhances

information flow alone would not eliminate a sense of powerlessness unless the problem of ownership of technology is resolved. The first Grameen bank phone owner made her maiden phone call to the Prime Minister who herself was a woman, and the image was flashed throughout the country. Giving women ownership of one of the most sophisticated information technology tools is invaluable for the self-esteem of these women and confers them higher social status. Moreover, it has a dramatic impact on the rest of society and challenges the norm that suggests that poor women cannot own and use technology.

Most of the phone calls (40%) are used to facilitate remittance payments for Bangladeshis living abroad. Phone ownership is empowering women in other ways; proximity to phone users provides the phone owner with knowledge of the exchange rate of currencies such as Dollar, Yen and Saudi Riyal that she can use to help other women to convert their remittances correctly. Since women are the link between the caller and the receiver, they are now privy to medical knowledge and current market prices of major cash crops in the urban areas. Phone ownership also allowed the technology to leapfrog from the elites to the most oppressed group in the society—the women.

It is clear that many of the norms created by Grameen are new to the local culture. However, some of the norms were already in existence and Grameen only activated these values and made them more salient (Uphoff, 2000). An important question is why some norms such as timely repayment got incorporated in the local culture whereas the pledge not to pay and receive dowry and use pit latrines was not adopted. Norms are incorporated either through internalization where individuals impose self sanctions for violating norms or through social sanctions against norm violations (Coleman, 1990).

Inefficient norms such as paying dowry were not adopted because of a lack of social sanction against violating this norm. Besides, pre-existing norms of buying happiness for the off-springs by paying dowry trumps the new norm of not paying. On the other hand, norm such as repayment on time was accepted because of the social sanctions against not paying on time because non-payment will be a public affair. Moreover, non-payment will be penalized by denial of future and larger credit by the Bank.

IIIc. Creation of Networks

Networks can be horizontal, connecting agents of the same status and power as well as vertical, connecting unequal agents in uneven relations of hierarchy and dependence (Putnam, 1993). Putnam (1993) noted a critical difference between horizontal and vertical networks: “A vertical network, no matter how dense and no matter how important to its participants, cannot sustain social trust and cooperation. Vertical flows of information are often less reliable than horizontal flows, in part because the subordinate husbands information as a hedge against exploitation” (p.174). Dasgupta (1999) mentions another reason for the difference; information about new economic opportunities is more likely to be shared among members of horizontal networks.

Grameen Bank has allowed its members to transcend the traditional patron-client (vertical) relationship and form productive horizontal relationships with other members and non-members. This does not mean that the patrons accepted this without a fight and that Grameen has replaced the vertical networks altogether. Grameen’s experience is replete with examples where the patrons reacted vigorously against the bank when they thought or perceived that their traditional patron-client relationship will be eroded by the

presence of Grameen Bank. Evidence suggests that despite being members of the bank for more than ten years, many still cling to traditional patron-client relationships.⁸

Larance's (1998) work provides the most interesting and exhaustive evidence of how membership in Grameen Bank expands borrowers' network. Her work aptly illustrates how the center meetings are used to expand networks beyond immediate family and kinship groups—weak horizontal ties. Many of her respondents reported that center meetings enabled them to expand their social and information networks that were used to facilitate economic and non-economic transactions. She cites the example of a respondent who, because of her new networks, learned of and enrolled in the government's mass education program that enabled her to learn how to read. Another member used the network to collect nutrient rich rice water to feed her cow that she bought with a loan from the bank. Seventy-four percent of her respondents reported that the networks were used to make up for shortfalls on loans. The members also used the networks to expand social exchanges. Members could now borrow clothes and jewelry from each other to wear in social occasions and use the network to meet social obligations in the village. The networks eased mobility restrictions for women who were secluded within their neighborhoods (*bari*) where they interacted almost exclusively with their husband's kin. Such mobility outside of their *bari* to visit others and travel to a "public" place in the village is a challenge to the well-established norm of *purdah*. The network was especially beneficial to women who were married patrilocally. Now instead of going to their natal village for help, they could use the local network to seek assistance.

Todd (1996) provides further evidence of expanding networks made possible by membership in Grameen Bank. She shows how access to regular supply of credit allows women to take advantage of existing networks consisting of her and the husband's kin ("bonding capital"), invest in new networks and reputation building outside of the kinship group ("bridging capital"). She mentions the case of Hibibah who combined her Grameen Bank capital and kinship group to lease, sharecrop and purchase land. Using the same network she was able to pursue her paddy stocking and money lending business. She developed clients for her business by giving interest free loans to center members as well as the village elites. She even became a patron herself, creating a group of followers by giving employment (p. 76). Not all Grameen members are as exceptional as Hibibah, but they all use their membership to expand their networks. As she notes

"Grameen Bank women used these kin networks specifically to advance their Grameen Bank projects, for borrowing and lending and for physical help when they were busy. In turn, they used their capital and growing prosperity to oil these networks, through gifts and small loans, through having Taka to buy livestock and lease land from others in their *gusti*, and through offering the kind of ceremonial feasts and contributions that signal their full membership of the social and religious life of the village. For the most successful Grameen families, this process has advanced to the point where they have become patrons rather than clients" (p.76).

The bank organizes annual meetings of group chairperson in each branch. In these meetings the members share marketing information as well as best practices regarding cow fattening, livestock rearing, poultry farming, fish farming. Later the center chiefs share these experiences with members in the center. This is another means of expanding horizontal networks.

Members who own cellular phones are able to strengthen their kinship networks. They are able to stay in touch with relatives living outside the village—the phone

ownership has reduced the cost of maintaining the networks. Non members are also able to expand their networks through the use of the phone. As mentioned earlier, a majority of the phone calls are used to facilitate remittance payments. Remittance money is used to purchase food and livestock, fix houses and buy land for the family left behind.

Because the male members are overseas the families end up using help of the kinship group for these purposes. Moreover, remittance payments constituted an informal financial network. Through the use of the phone, the senders are able to assist in the safe transfer of the remittance money and ensure that the recipients receive a higher final value. “Typically the phone call is made from the Gulf States to the village telling when the payment will arrive, with whom, and in what amount. When the cash arrives, the phones are then used to call Dhaka for information on currency exchange so that the money can be converted at an accurate and profitable exchange rate” (Burr, 2000, p.10).

Membership in the bank is allowing the borrowers to expand their networks vertically as well, whereby they can now have goods provided by the different levels of government at their doorsteps. The poor in general are excluded from essential services provided by the government. It is highly unlikely for a poor person to get services from government offices in rural Bangladesh. Even if they get the service, the transaction costs in terms of filling out the paper work, the waiting period and the cost of bribing the officials will be high. Publicly provided goods are distributed via the local elites and elected officials who usually allot it to their clients and kinship groups. Centers and the brand name of Grameen Bank are used as leverage to get essential services from various branches of the government such as advice from agricultural extension worker and immunization of children and livestock.⁹

Because of the enhanced self-confidence and expanded networks due to membership in the bank, female members find it easier to participate in the political process. Even though none of Larance's (1998) respondents contested the union level election, many regretted not running for positions. In the 1997 local level elections, the government encouraged women to run for office in the local union council election by reserving seats for women. However, many women participated in the open seats as well. Out of total seats of 4298, seven Grameen Bank members and 39 members of their families were elected to the post of Chairman. However, no women were elected as Chairman. In the election for membership in the union council, out of 51,396 seats, 261 male and 1,343 female Grameen members were elected by contest and 34 members were elected uncontested. In addition, 1,073 family members were elected as members of the union council.

Moore and Putzel (1999) suggest that empowerment should involve increasing the political capabilities of the poor. "It is the political capabilities of the poor that will determine whether they can employ social capital (the shared networks, norms and values created through social interaction) constructively or create social capital where it is lacking." (p. 14). They further argue that "the most important role for external agencies may not be directly to support the mobilization of the poor, but to create an enabling environment—an environment in which poor have an incentive to mobilize" (p. 18). By creating an enabling environment, Grameen Bank has enhanced the political participation of the poor. Even though the bank discourages discussion of political issues in center meetings, it encourages the members to vote and to go to the voting centers as one unit.

The provision of credit by Grameen Bank accentuates an existing source of social capital—the family. The use of the credit becomes a joint family enterprise. Grameen Bank is aware of this and is devising a new product that can take advantage of pooling of resource in the family enterprise such as a larger leasing loan, and a medium term loan for family members. One of the preconditions for these loans is that the family must have an additional source of income. Grameen’s female members are unable to use larger loans because of societal restriction on women’s mobility. In such cases the borrowers are accepting the help of the male members of the family to expand their businesses. The male members of the family can bank on the network of the members to upscale their operation. Todd (1996) suggests that members use husbands and sons as a surrogate for their hands and feet to circumvent the societal restrictions. She further notes that many of the female borrowers were using loan money to acquire land to turn their husbands from daily laborer working for others into small farmers working for the family. Critics (Rahman, 1999) argue that men utilizing women’s loans thwart the effort to empower women. Critics, however, are failing to recognize that credit of the women is used as an input in the household enterprises. Recent advances in bargaining theory suggest that women who bring financial resources to the households can improve their bargaining position.

In rural Bangladesh the poor trust each other within a “narrow radius of trust”—friends, family and *gusti* (kinship group). This is because trust in this case is enforceable by the threat of retaliation. Membership in Grameen Bank enhanced the “radius of trust” as it allowed people, who are not related to one another, to cooperate to achieve a common goal—access to credit in the current period and the future.

Borrowing from each other is not uncommon in rural Bangladesh. Many of these transactions are confined within kinship groups and family members. Some of these transactions are part of the patron-client relationship. Since a majority of the people are poor, they have very little surplus funds to share with each other. So, most of the funds are used as consumption loans to tide over minor emergencies and to withstand seasonal deprivation. These transactions are not large enough to be used in income earning ventures. Moreover, during the seasonal lean periods (in between harvests) most of them want to borrow and very few are willing to lend. This forces them to use negative coping strategies such as distress sale of assets, e.g., roof of the house, beds, and forward sale their own labor and their children's labor. Grameen Bank provided a permanent and better source of finance that goes beyond the consumption loan, and evidence shows that after a few cycles of loans with the bank, members are able to build enough asset bases to use positive strategies at the time of crisis.

In addition to credit, members also exchange gifts and swap labor and childcare services. These transactions are nothing new. There is an arrangement know as *badli* whereby during peak agricultural seasons families would get together and helped one another with the work (Siddiqui, 2000).¹⁰ What the members did was to leverage their Grameen Bank capital to expand the networks horizontally—to others who are not members of the kinship group and only brought together via the membership in the bank.¹¹

Many argue that the bank should take the next logical step—expand the network even further by acting as an intermediary between borrowers with good and long credit history and other means of income generation. There is a debate about graduating

successful members. The idea is that once a member has achieved success, she/he should leave and create room for others in the community. Grameen Bank's argument is that they should keep these borrowers to maintain the financial health of the institution as it allows them to cross-subsidize and capture the economies of scale in operation. Besides, the successful borrowers act as role models and show others that good things will happen to them if they stay with the bank for a long time and repay on time. However, from a social capital perspective, it makes sense to create linkages with other financial institutions. For example, Grameen Bank can be a guarantor for successful borrowers to create linkages with commercial banks. However, the bank believes that it should take on the responsibility of providing all financial services at all levels to all its members.

IV. Conclusion

In this paper we have shown how a third-party can enable creation of social capital using the case study of Grameen Bank in Bangladesh. It is true that creation of social capital was not the prime goal of Grameen Bank. However, in the process of providing credit to mostly poor women, the bank realized that such transactions have to be embedded in the social context. In other words, to ensure that credit delivery ultimately leads to qualitative changes in the lives of the members, the bank had to create and cultivate social capital. Our paper shows that deliberate attempts to create trust, norms and networks have fundamentally changed the lives of the members. However, the bank is showing signs of "growing pains." Because of the pressure to attain sustainability, the workload of the staff has increased enormously. The staff can barely keep up with collecting the installments and negotiating problems that arise from missed payments by a few borrowers. They have less time to explain the policies and procedures

and to provide social intermediation, i.e. giving advice on loan use, etc. Many members feel that the bank has lost sight of its mission and has become a bank of loan collection only (Rahman, 1999). This is quite unfortunate because the bank is losing the trust of some of the members that it has worked so hard to attain.

The fact that an MFI can create social capital has strong policy implications. Traditional measures of the benefits of Microfinance have looked at mostly economic and some non-economic aspects. Very few studies have discussed or tried to measure the extent of social capital created by a MFI. Since social capital is a public good--non-excludable and non-rivalrous--the market will underprovide such good. Microfinance is a means to correct market failure in the credit market. This paper shows that Microfinance corrects another type of market failure—under provision of a public good. In case of Grameen Bank, the public good provided is a “global public good”, since the model is being used all over the world. The social capital building aspects of an MFI need to be taken into account in the whole debate about the need for subsidy by the Government of Bangladesh.

In this paper we have relied mostly on ‘analytical descriptions’ of the means by which a third-party can create social capital. In future, the plan is to quantify precisely how the bank created trust, norms and networks and what effect these had on the productivity of the members. Moreover, we have only discussed the benefit of social capital. It is well known that social capital has a dark side too. For example, it is well-known that long-term borrowers of Grameen have lower repayment rates. This is an example of negative social capital; the members have leveraged their social capital for economic improvements and that reduced the threat of sanctions that enforce the

repayment norm. In future research, we plan to incorporate the negative aspects of social capital and illustrate how the dark side of social capital diminishes its full potential.

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Notes

¹ For the sake of brevity, we will confine our survey to papers and projects that deals with developing countries only. For evidences on the relationship between credit and social capital in the USA, see, Servon, 1999 and Anthony 1997.

² When the housing design received Aga Khan International award for Architecture design the jury had to be convinced that the design was not by professional architects and reflects the dreams and aspiration of the poor people. The project also received an award from Habitat for Humanity.

³ Every now and then the Press report incidences where local religious leaders issued a *Fatwa (religious dictate)* banning supply of credit to women. The clerics were against women owning cellular phone (Burr, 2000). Religious groups have been accused of physical assault on bank and the workers of the NGOs (The Economist, 2001).

⁴ Lisa Larance reported that members were continually threatened if they spoke to her during her field visits (personal communication).

⁵ For a list if tasks performed by a typical bank worker on a typical day, see Yunus, 1999, p. 104-105.

⁶“I had the privilege of going to Bangladesh in 1989 to see the Grameen Bank. I was there shortly after a major flood. My hosts showed me the high water line, waa-aay up on telephone poles and trees, and clients talked about how the Grameen Bank agents had come around in canoes to bring them food and water, while they sat stranded for days on the roofs of their houses. I asked what effect the floods had had on repayment, and the answer boiled down to, serious short term problem, but not a long term one. I understood then why the Grameen Bank has unusually loyal clients, and why it has developed non-standard ways of reporting on arrears.” Paul Rippey <paul@mtds.com> Posting on the listserv DEVFIN, September 7, 1998.

⁷ Woolcock (1998) notes that such workshops are becoming rare for established branches.

⁸ It is fair to point out that vertical network does not have to be exploitative. The poor may have to forge alliance with people in positions of power to reduce their sense of powerlessness and exclusion.

⁹ Warner (1999) notes that “In communities characterized by horizontal social capital, positive synergy may exist between community coalitions and local government” (p. 383). By establishing the horizontal networks in Centers, Grameen enabled government agencies to take advantage of positive synergy.

¹⁰ Siddiqui (2000) reports, in his study village, the incidence of such work sharing has declined in two decades from the level of 1977. However, he notes that *badli* is still observed amongst first time farmers and in emergency situations.

¹¹ The World Bank has collected numerical data on these exchanges between members in a new survey.