Sustainability of Microfinance and Bottom of the Pyramid

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ABSTRACT

Micro-entrepreneurship is an increasingly common way of fighting poverty. The Microfinance and Bottom of the Pyramid (BoP) concepts both use micro-entrepreneurship, but organize it in a different way. The question is which of both concepts has the best change of surviving in the long-term, i.e. which is the most sustainable. The structure of both concepts is judged using a case study where the incentives of the management of two companies that use the Microfinance and BoP concept are analyzed. The Microfinance approach is represented by Grameen, the BoP approach by Shakti. The analysis was conducted using the sustainability framework of Labuschagne, Brent & Erck (2005), with the modification that incentives for management are assessed, instead of business outcomes. Both Microfinance and BoP score high on their incentives for economic sustainability. The performance on social sustainability differs, with BoP scoring higher than Microfinance. The conclusion is that the BoP concept is more sustainable than the Microfinance concept.

Chapter 1 Introduction

§ 1.1 Motivation thesis

> *Most of the recent success stories [of poverty reduction] are countries that did not get a lot of foreign aid and did not spend a lot of time in IMF programs.*
> Easterly concludes from econometric research that some solutions intended to end poverty did not achieve their goal. (Easterly, 2006, pp. 303)

In *The White Man's Burden* (2006), William Easterly provocatively demonstrates that the countries that are helped most by NGOs or engaged in IMF programs did not escape poverty. He argues that what the poor really need is homegrown, bottom-up development, because such private initiatives meet the interests of the poor better.

It is increasingly popular to incorporate micro-entrepreneurship within development strategies. Micro-entrepreneurship follows the very principles of homegrown, bottom-up development. Numerous small enterprises try to meet the demand of (poor) customers day by day and provide themselves an income with that.

There are two distinct currents that promote micro-entrepreneurship. The first current is the somewhat older Microfinance movement, which has a particular social notion in its operations. The second and newer current is the group of multinational corporations that started business targeted on the poor (*bottom of the pyramid marketing*) the last decade. In these operations the poor are often employed to sell the products or services. The idea that micro-entrepreneurship can contribute to the decline of the poverty in the world is the starting point of this thesis.

Ending poverty by micro-entrepreneurship is only credible if a long-term vision is used, because poverty problems are often persistent and complex. It is for this reason that concepts for poverty fighting and sustainability are inextricably linked. A non-sustainable approach of micro-entrepreneurship is no solution to poverty at all. In addition, micro-entrepreneurship without attention to social aspects misses the goal of living a life with dignity. This thesis therefore uses the following definition of sustainability:

> *'For the business enterprise, sustainable development means adopting business strategies and activities that meet the needs of the enterprise and its stakeholders today while protecting, sustaining and enhancing the human and natural resources that will be needed in the future'*
>
> Deloitte & Touche's definition of sustainable development that captures both the needs of the enterprise and its stakeholders (Deloitte & Touche, 1992, pp. 1).

The goal of this thesis is to investigate which approach is the most sustainable; Microfinance or Bottom of the Pyramid.

§ 1.2 Goal and key-question

§ 1.2.1 Two visions in question

The Microfinance movement consists of many Micro Financial Institutions (MFIs) that provide financial services to the poor. The Microfinance movement promotes micro-entrepreneurship by providing small loans to people that were considered 'unbankable' by conventional banks. There are few barriers to borrowing and micro-entrepreneurs get the freedom to organize their enterprise at their discretion. Most MFIs work from a philanthropic motivation. Well-known MFIs are Grameen and the Bangladesh Rural Advancement Committee (BRAC) from Bangladesh, BancoSol from Bolivia and Bank Rakyat Indonesia from Indonesia.

The Bottom of the Pyramid (BoP) movement consists of multinationals active in developing countries trying to reach poor people to sell them their products or services. The BoP marketing concept approaches the poor not as victims but as possible customers of products or services. Turning the poor into consumers does not only provide revenue for companies, but also has positive impacts on the welfare of the poor (Prahalad, 2005). A company partners with local people to create a distribution network. Salespeople are thoroughly screened and trained before they can open a selling point for the company's products. Entrepreneurs who sell products of BoP businesses often have to meet guidelines, so that the company's brands remain under control of the firm. Examples of multinationals that work with the BoP concept are personal care and food producer Unilever in India, mobile telecommunications company Vodafone in Kenya, and consumer electronics producer Philips in India.

A full discussion of the two movements is not within the scope of this thesis. To focus the research, a case study, comparing two representatives of the respective currents, will be done. For the Microfinance current that is Grameen; Shakti represents the BoP current.

Grameen

Grameen Bank was founded in 1984 by Muhammad Yunus and is considered to be the starting point of the current Microfinance movement. Yunus' idea was to fight poverty in Bangladesh, not through charity but through promoting self-employment, by supplying microcredit.

Grameen has changed its way of doing business several times, continuously searching to optimally reach the company's two equally important goals. The first is nonzero profit, or economic independence of the company from donor money (the economic goal). The second is to provide positive changes in the life of their borrowers (the social goal).

For the results of this approach Grameen received much praise, especially the last decade. The year 2005 was even declared *Year of Microcredit* by the United Nations. In 2006 Grameen Bank founder Muhammed Yunus and the Grameen Bank itself received the Nobel Peace Prize for their *'efforts to create economic and social development'* (Nobelprize, 2006).

Shakti

Multinational Unilever is active in India for over 100 years. India's strong economic growth in the late 1980s and early 1990s brought international competitor Procter & Gamble (P&G) to the country to tap this market as well. A fierce competition for market share started in the cities where the wealthiest Indians were living.

The large rural market, where 80% of the Indians lived, was virtually left to Indian entrepreneurs. Unilever launched the Shakti project in 2001 in order to become the first large detergent player in that market. The challenge was finding a profitable way to sell detergents to the rural poor. Unilever presented a marketing innovation by recruiting women from the poor rural population and inviting them to become local entrepreneur for Unilever products. Shakti has grown tremendously the last decade and reached over 600 million consumers in 2010.

Shakti thus has a commercial objective, but also aims to realize social spillover effects. For Unilever however, the goal of reaching the rural markets of

India with its products is clearly superior to the positive spillover effect of declining poverty. This strong commercial focus contributes, according to Unilever, in fact to the social achievements. Unilever states:

> *'What this project has shown is that so much more can be achieved by looking at social and commercial challenges through the same lens, rather than seeing them as distinct and separate activities.'*
>
> Shakti statement about the possibility to combine social and commercial goals. (Neath and Sharma, 2008)

In this thesis the meaning of *'so much more can be achieved'* will be investigated. In a more controversial way one can translate this sentence from Shakti as a critique of the older Microfinance movement that has achieved too little in the last 30 years.

§ 1.2.2 Key-question

The aim of this thesis is to clarify which of the two visions of stimulating micro-entrepreneurship is the most sustainable one. The tension is whether the new BoP vision is an improvement on the older Microfinance movement. The main question of this thesis therefore is:

> *Is the Bottom of the Pyramid approach more sustainable than the Microfinance approach?*

Since this thesis mainly deals with a case study of Grameen and Shakti, the results of the analysis will primarily apply to these two companies, but where possible, they will be generalized to their respective currents.

§ 1.2.3 Thesis set-up

The remainder of this thesis is organized as follows: Chapter 2 describes methodology and the research design. Chapter 3 zooms in at Grameen and chapter 4 at Shakti. Chapter 5 compares the Microfinance and BoP approach and their representatives. Chapter 6 concludes and discusses the possibilities for future research.

Chapter 2 Methodology and research design

§ 2.1 Sustainability concept for evaluation

A framework is needed to make a sustainability comparison between Microfinance and BoP. The ideal analysis would be a comparison of the performance of Grameen and Shakti in the same market, as to minimize external factors. A Shakti equivalent exists under the name Joyeeta in Bangladesh, so Grameen and Shakti are both active in the same market. If there was enough information about both projects, the ideal evaluation could be carried out. Little is known, however, about Joyeeta, which makes such a comparison impossible. The scarcity of information about Joyeeta stems from the fact that Unilever itself does not publish information, nor is it available from external parties like the goverment or academic literature. As a result, two projects in different countries will have to be compared.

This paragraph explains the two most used sustainability concepts. These are the concepts of Brundtlandt (1987) and Elkington (1994). At the end a motivation is provided as to why the sustainability concept of Labuschagne et al. (2005) will be employed in this thesis.

Brundtlandt report and PPP-concept

Sustainable development has been put on the agenda by the Brundtland report in 1987 and has remained current since then. The report describes sustainable developments as:

> *'meeting the needs of the present without compromising the ability of future generations to meet their own needs'*
> (United Nations, 1987, p. 1)

This general formulation has been specified in three pillars; people, planet and profit (Elkington, 1994). The three Ps, also know as the Triple Bottom Line, are widely used for sustainability accounting. Every 'p' pays attention to one dimension of sustainable development. The classification of Elkington does not perfectly match with the terms most used in the more recent literature. To match recent literature the newer classifications will be used in this work. 'People' covers all that is needed for a balanced social structure in a society, in which all people have opportunities for development. In what follows, the term 'social sustainability' will be used instead of 'people'. 'Planet' means that the earth is used in a manner that will also be viable in the future. For 'planet' the term 'environmental sustainability' will be used. With 'profit' is meant the current and future economic stability of the subject under research. Instead of 'profit', recent literature prefers 'economic sustainability'.

While the Triple Bottom Line is well known, it certainly has its limitations. The author himself signals the lack of attention to economic and social sustainability, due to a strong focus on the environmental pillar (Elkington, 2004). Other criticism focuses on the difficult applicability of the Triple Bottom Line to real business situations (Brown *et al.*, 2006). Concepts based on the Brundtlandt definition (Hass *et al.*, 2002; United Nations Commission on Sustainable Development, 2001) are problematic because they are designed for sustainability at the national level, and are therefore difficult to apply to specific business projects as well.

Analyzing sustainability in developing countries

This thesis adopts the concept of Labuschagne et al. (2005). The concept provides a comprehensive framework in which the three pillars are split in different criteria.

The concept of Labuschagne et al. (2005) fits perfectly with the definition of Deloitte & Touche that is used in § 1.1. In this definition the focus is on business strategies and activities. The term 'business strategies and activities' can be interpreted in the broad and narrow sense, i.e. from complete corporations to small temporary business projects. In order to apply the Deloitte & Touche definition to specific business activities, the framework has to be broken down into clear criteria. This is the very advantage of Labuschagne et al. (2005) as it provides a detailed framework.

The second useful feature for the purpose of this thesis is that Labuschagne *et al.* (2005) is specifically designed for companies (or their projects) active in developing countries. Since both Microfinance and BoP are located in developing countries, this is an indispensable feature.

The framework measures sustainability, split in three categories: social, environmental and economic. Each of these categories is subdivided in so-called criteria, covering various aspects of sustainability. Each criterion is scored based on a number of questions which concretely measures sustainability, relative to other projects or firms. Paragraphs 2.2 and 2.3 elaborate on the Labuschagne framework, and introduce the specific criteria and questions.

§ 2.2 Justification of research composition

For the purpose of this thesis, the Labuschagne et al. (2005) framework is applied with some modifications, which will be justified here. Firstly, the environment criterion is excluded. Secondly, data analysis is replaced by incentive analysis and, finally, the focus is strictly on the core business of both business concepts.

§ 2.2.1 Exclusion of environmental sustainability

Both Grameen and Shakti enable entrepreneurs to do business, but both organizations do not employ people directly (perhaps for administrative purposes). The activities of Grameen and Shakti have a direct economic impact and social impact (they create business, and therewith jobs), but the environmental effects are only secondary, and in the hands of the agents. It is for this reason that environmental effects will not be assessed as applying directly to the sustainability of Grameen and Shakti.

The negative consequence is that environmental issues are not included in the analysis. Especially in Bangladesh, where Grameen and Shakti are active, deforestation, soil exhaustion and erosion increase the damage from the annual floods in the delta Ganges. As this is a serious threat to the capital of entrepreneurs, environmental sustainability should be of primary concern to Grameen, Shakit and the entrepreneurs. Within the scope of thesis, no analysis of environmental effects is feasible however. This thesis will address the question ‘which approach is more sustainable on the economic and social level’?

§ 2.2.2 Data replaced by incentives

Labuschagne *et al.* (2005) analyze companies or business projects on sustainability by developing market benchmarks for different sustainability standards by means of surveys. In their paper they develop scales ranging from the worst to the best performance. Companies are then measured on each scale in order to assess their over-all sustainability. The evaluation can be made quantitative by means of a cost-benefit analyse, for example net present value. The evaluation can also be made qualitative by means of Multi Criteria Decision Analysis (MCDA) techniques. Figure

2.1 is an example of an elaboration of such a MCDA technique. This radar chart comes from Munda (2005) and visualizes a comparison on sustainability between the cities of New York and Amsterdam.

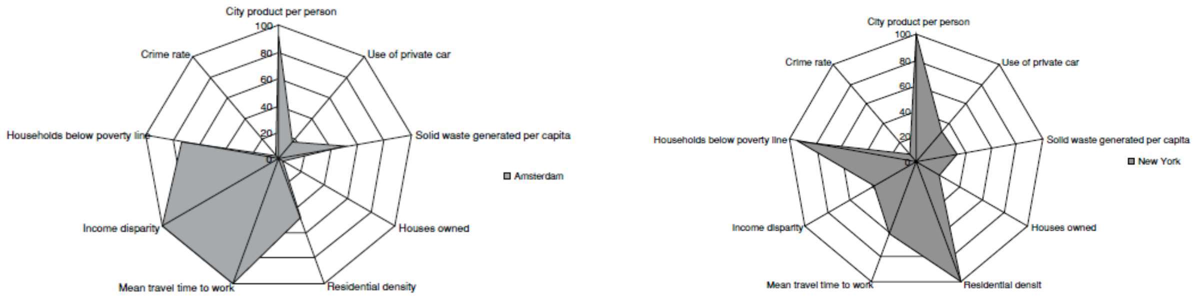

Figure 1. Radar diagram for Amsterdam sustainability benchmarking.

Figure 2. Radar diagram for New York sustainability benchmarking.

Figure 2.1 **Visualization of MCDA techniques**
Source: Munda, G. (2005; p.129).

Much of the quantitative information needed is only imperfectly available. For Grameen, many researches predate 2002, and therewith the change from Grameen I to Grameen II. As such they are not relevant to judge the current situation. For Shakti, too, little quantitative information needed for a complete evaluation is available. The scarcity of information can be explained by the short history of the project.

In this thesis the analyses will focus on the incentives of management of Grameen and Shakti. The incentives for management on the different criteria will be compared to the ideal, the most sustainable situation on that specific criterion. There is no ideal standard that applies to both companies, but whichever company is judged to have most high incentives for management to implement sustainable policies will be considered to be the most sustainable. In short, instead of analyzing data, this thesis analyzes management incentives.

The drawback of this approach is that the analyses will be less quantifiable. Providing a definite answer to the main question is difficult if one misses the essential figures for a quantitative analysis. The incentives analysis that will be applied however, delivers a meaningful contribution to the goal of this thesis. An advantage of using incentives is that they are more comparable across organizations and projects with a similar structure (in the same current) than quantitative statistics would be. This allows a generalization of the case study of Grameen and Shakti to the respective currents of Microfinance and BoP.

Finally, it is clear that the choice to judge sustainability by incentives is vulnerable to criticism on the objectivity of the analyses (for a discussion on this point see § 6.2). Acknowledging this vulnerability, this thesis aims to evoke opinions and future research, rather than to provide an all-encompassing analysis. When the importance of a decision made on the basis of academic results, grows, so does the distrust of the academic's objective position. (Munda, 2004).

§ 2.2.3 Generality at the cost of completeness

This thesis focuses on the core business of both Grameen and Shakti. This choice for core business delivers transparency of the research results, but also brings some costs. In particular for Microfinance institutions, generalizing the findings of one MFI to all does not perfectly do justice to the diversity of the sector. Another limitation is that the nature of Grameen is too complex to be analyzed completely. The focus is only on the core business. On this last limitation one exception is made for Grameen Danone Foods Limited, since this can reveal something about an increase in Grameen's future sustainability.

§ 2.3 Theoretic framework

The criteria and subcriteria of the customized sustainability concept of Labuschagne *et al.* (2005) are visualized in Figure 2.2. There are only two possible scores, high and low. For all the economic and social criteria a high incentive for management is regarded to be most sustainable.

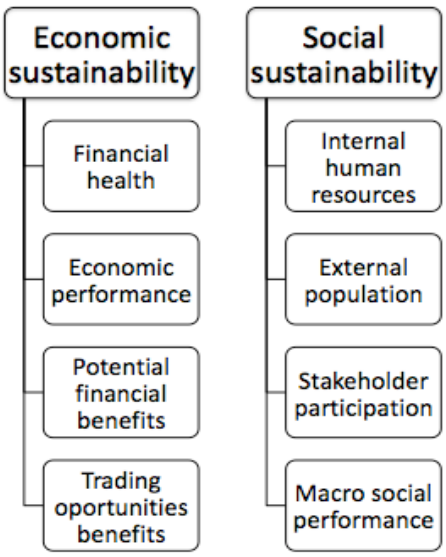

Figure 2.2 Criteria for the incentives analysis.
Adapted from Labuschagne, C., Brenta, A. & van Erck, R. (2005; p. 377).

Economic sustainability

Financial health focuses on the profitability, the solvency and the liquidity of the enterprise. The stability of business operations guarantees the survival of an enterprise and should hence be its primary concern.

Economic performance focuses on the stock profitability, the contribution to the national GDP and the market share performance. In a growing market, market share is equally important as current income for the future profit of an enterprise. A current weak financial position can be defended by brilliant profit prospects.

Potential financial benefits focuses on the enterprise's income except for profits, such as subsidies and grants. A project that is not currently profitable can be supported with subsidies.

Trading opportunities benefits focuses on the vulnerability of the trading network. The higher the importance of the trading network for the enterprise, the higher the incentive will be for management to maintain and improve it for the long term, in order to use it for future products, for example.

Social sustainability

Internal human resources focuses on employment stability, employment practices, health and safety, and capacity development. Employment alone is not enough to be a sustainable business. An enterprise has to take good care of its employees. The work should be of no risk to an employee's health and offer future prospects for development.

External population focuses on human capital, productive capital and community capital. Stakeholders are those that have a direct link to the enterprise, but also citizens who live nearby and enjoy for example the better infrastructure that is built for or by the enterprise. Negative external effects are possible too, e.g. pollution and inflation (since the disposable income of the enterprise's employees increases).

Stakeholder participation focuses on information provision and stakeholder influence. Transparency about the enterprise's actions to employees, neighbors and (foreign) customers or even decision influence can create an atmosphere characterized by shared responsibility. Empowered workers can bring innovative ideas that strengthen the enterprise.

Macro social performance focuses on the macro-economic welfare and the trading opportunities. An enterprise brings in foreign currencies and pays taxes, by which the external economy can be stimulated. The company can be a catalyst for sustainable growth, which in turn leads to a larger market for the entrepreneur.

§ 2.4 Research set-up

The research of this thesis will be set up as follows. Paragraph 3.1 introduces the Grameen strategy. Paragraph 3.2 makes some statements about the current position of the bank. Paragraph 3.3 analyses Grameen's structure. Paragraph 3.4 analyses the incentives of Grameen's management. Paragraph 3.5 is an extension discussing a more recent activity of Grameen; Grameen Danone Foods Limited. Paragraph 3.6, finally, concludes. Chapter 4 will follow the same structure, applied to Shakti, with the exception that there is no extension (fifth paragraph).

Chapter 3 Grameen

§ 3.1 Introduction Grameen

Basic structure

Microcredit at Grameen Bank works as follows (Yunus, 2002). If one starts borrowing, she buys a package of five products. First, there is a regular loan. At he same time however, the borrower gets a personal savings account, a special savings account, a loan insurance, a 100 taka share in Grameen Bank and, if the borrower lends more than 8,000 taka, a pension deposit account ($1≈71 taka (Forexpross, 2010)).

One starts with a (low) basic loan, with a maturity that can differ between 3 and 36 months. The interest rate is approximately 20%. After every loan cycle that is finished correctly, the next loan size can be higher. After a number of cycles, special statuses can be obtained with associated rights. Most important is the right that the loan size increases if the borrower proves to be credible.

Further, every borrower has to save 5% at the time of disbursement. Half of this amount goes to the personal savings account and can be withdrawn at any time. The other half is deposited in a special savings account. Withdrawals from the special savings account are permitted once every three years, as long as 50% of the balance, or 2,000 taka remains in the account (whichever amount is larger).

Every borrower is required to be shareholder in the Grameen Bank. This is a stock with a predefined value of 100 taka. Since 2006, Grameen pays an annual dividend of 30 taka. The shares cannot be sold.

Every loan is insured. The insurance pays the outstanding loan should the borrower die. This is done at the cost of 2.5% percent of the outstanding amount of loan and interest at the end of year 1. From the second year onwards, 2.5% of the amount in excess of the previous year-end balance has to be paid in case a higher loan has been disbursed.

Finally, borrowers with loans of more than 8,000 taka have an obligatory pension deposit account, in which they are required to deposit at least 50 taka per month. The interest rate for these deposits is promised to be 10% for five years and 12% for ten years (Grameen Bank, 2009).

Defaulting

If a borrower defaults, a special arrangement will be made between Grameen Bank and the borrower. Some amount of the basic loan will be transferred to a flexible loan. The borrower then gets a longer payback period for the amount of the flexible loan.

Flexible loans come at higher costs. First, the borrower loses most of her good credit history and therefore her right to more future credit. Second, at the start the borrower has to pay a 50% provision on the flexible loan amount. Third, after two years the borrower has to pay an additional 100% provision on the outstanding flexible loan amount. In addition, interest accumulates continuously.

Bankruptcy is not an option for borrowers at Grameen. Yunus explains this policy as trust in the poor.

> *'Central assumption [is] the firm belief that the poor people always pay back their loans.'*
>
> Muhammed Yunus explains the infinite expectation that poor repay their loans (Yunus, 2006).

Paragraph 3.3 will elaborate on the consequences of this non-bankruptcy policy.

§ 3.2 Where Grameen stands

Grameen has realized a reasonable growth the last decade. The financing of its operations has changed from mainly donor money to savings deposits and it has a more stronger solvency position. Grameen's growth and financing will be outlined in this paragraph and analyzed in the next.

Funding Grameen's growth

Grameen started its operations with grants mainly from abroad. From the beginning of 1996 however, Grameen proclaimed to be completely independent from donor money. In 2002, the bank launched Grameen II, which was in several ways a radical change from its previous way of doing business. The most important of these changes was that the growth had to be financed mainly by savings.

Grameen definitely succeeds in increasing its operations. Between 2001 and 2010 the number of active Grameen borrowers has risen from 2.1 million to more than 6 million. The amount on the different deposits has grown from 7.7 billion taka to 83.0 billion taka, and the value of the outstanding loans has risen from 15.9 billion taka to 79.4 billion taka.

Operational growth was partially financed by the use of Grameen's capital reserves. Such financing did not make Grameen more stable if one takes note of its capital adequacy ratio (CAR)[1]. From 2003 (when it was 19,30%) onwards, Grameen's CAR only decreased. The CAR was 10.46% at the beginning of 2010. This means roughly that Grameen has 1,046 taka in hand for every 10,000 taka it lends. To meet the Bangladeshi CAR requirements Grameen needs 1,000 taka (or more) for every 10,000 taka it lends.

Grameen's market position

Grameen is by far the largest supplier of microcredit in Bangladesh with an outstanding loan market share of 21.6% (see table 3.1). There are numerous small other suppliers, but none has more than 10% market share. Competition takes place

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[1] $\text{CAR}=\dfrac{\text{Tier 1 capital + Tier 2 capital}}{\text{Risk weighted assets}}$. If a bank uses Tier 1 capital it can maintain its operations, if it uses Tier 2 capital it has to cease trading until the bank has sufficiently replenished its reserves (Brealey *et al.*, 2005). In the Basel II accords many countries, including Bangladesh, agreed to a minimum CAR of 10% (Basel Committee on Banking Supervision, 2004).

primarily on customer service and strictness of the lending regulations. The interest rate is set by the market leaders, in particular by Grameen as the largest player in the market, and it is hardly used as a means of competition.

Coverage of Microcredit Programs				
Organization	Number of borrowers	Market share	Outstanding loan (in million Taka)	Market share
NGOs	18,415,878	61.8 %	78,930.57	51.3 %
Grameen Bank	6,908,704	23.2 %	33,235.46	21.6 %
Government programs	1,997,240	6.7 %	7,710.05	5.0 %
Nationalized commercial banks	2,311,150	7.8 %	32,783.45	21.3 %
Private banks	164,113	0.6 %	1.106,46	0.7 %
Grand total	**30,096,836**	**100 %**	**154,383.43**	**100 %**

Table 3.1 Market shares Microcredit programs in Bangladesh
Based on Bangladesh Bank (2010).

Table 3.2 shows Grameen's profits over the past eight years. In proportion to the total outstanding loans these profits are quite low.

Grameen's total loans and profits 2002-2009 (in millions)								
	2002	2003	2004	2005	2006	2007	2008	2009
Profit	1.0	6.2	7.0	15.2	20.0	1.6	19.0	5.4
Total loans	3,620.5	3,986.5	4,416.8	5,025.6	5,954.0	6,685.5	7,591.3	8,741.9
Profit as percentage of total loans	0.03 %	0.16 %	0.16 %	0.30 %	0.34 %	0.02 %	0.25 %	0.06 %

Table 3.2 Profit Grameen Bank since introduction Grameen Bank II
(Grameen Bank, 2010)

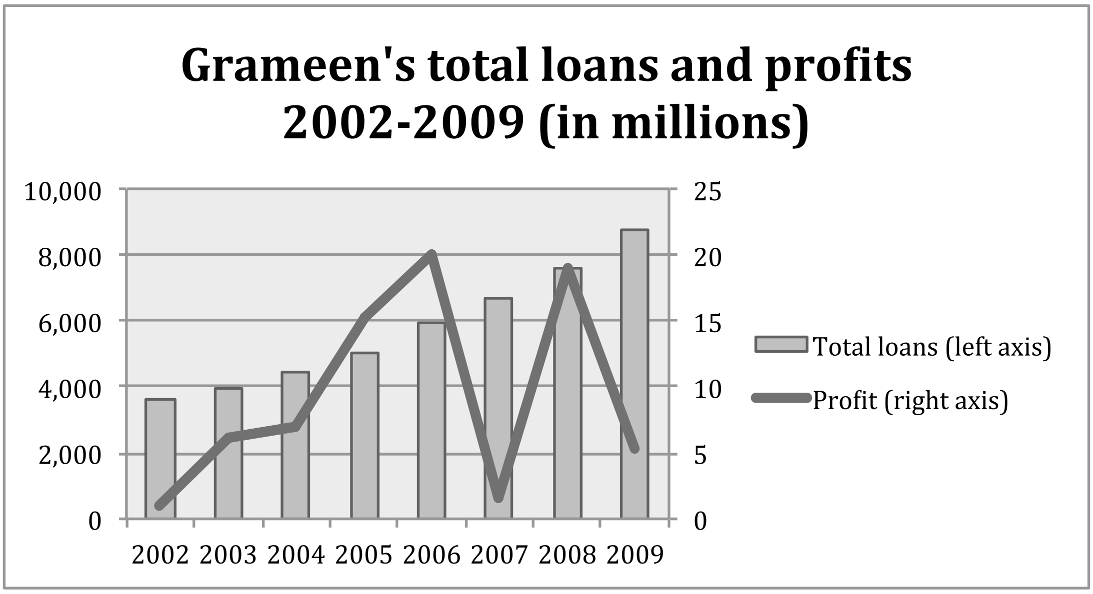

Chart 3.1 **Profit Grameen Bank since introduction Grameen Bank II (Grameen Bank, 2010)**

§ 3.3 Observations on sustainability of (basic) structure

This paragraph interprets the consequences of the structure explained in § 3.1 and the current position explained in § 3.2. The analysis in this paragraph is the lead-up for the main part of this chapter: the analysis of the incentives in the next paragraph.

Defaulting creates a valuable asset

Bankruptcy is, as mentioned before, not an option for borrowers at Grameen, which can produce a paradoxical situation. Imagine that 2,000 taka remains unpaid, while the borrower has 2,000 taka in the special savings account. While the debt could actually be paid off with the money from the special savings account, the bank's rules forbid the use of the special savings account. The following example will clarify what negative consequences those rules may have for a borrower. The debt first rises to 3,000 taka because the borrower enters the rules of the flexible savings account and has to pay the 50% provision. After two years this debt has risen to 4,320 taka because of the 20% interest rate. Then the 100% provision brings total debt to 8,640 taka. In two years an exemplary borrower can get in deep financial trouble.

From a situation where the borrower already has payment problems and is on a tight budget, it seems unlikely that the borrower will ever become debt free. The question is whether this practice is detrimental to Grameen. The bank already has the 2,000 taka from the special savings account in the pocket.

The claim on the borrower is an asset that must not be underestimated. It is possible that the bank receives money for the rest of the woman's life. Imagine Grameen's total return if one multiplies this effect by hundred thousands of defaulting borrowers. Defaulting is a potential money-maker for Grameen.

For the borrower in distress this practice is a trap she cannot escape from.

Grameen's problems with its growth funding

Grameen grew significantly during the last decade. This growth is largely funded by obligatory savings of its borrowers (Grameen Bank, 2009). For the borrowers, this obligation is a constraint in how they can use their money. Because a certain amount cannot be invested directly, the value of a loan must exceed the actual investment. Interest must be paid over a higher amount than strictly necessary. This increases the cost of the actual invested amount for the borrower.

The obligatory savings alone did not provide enough money to finance the operational growth. Grameen employed its reserves, which was possible since the CAR was well above the 10% minimum of the central bank of Bangladesh. Now that the CAR has approached the minimum level Grameen cannot continue operating in the same way as before. A further reduction of CAR is not allowed. Grameen has different options for change.

Grameen could reduce the number of new loans. This may cause problems however. Borrowers have the incentive to pay back as it will provide them with the opportunity to take out a bigger loan. This intrinsic demand for loans may force Grameen to continue expanding its operations. The knowledge that Grameen issues a new loan immediately after repayment will entice people to repay old loans with new ones. A figure that illustrates this mechanism of dynamic borrowing is the rise of the average loan amount per borrower, which increased from 6,134 taka to 8,514 taka since Grameen II was launched in 2002.

Although the growth of the average loan amount will in part be due to good borrowers taking out new loans with higher values, another part is due to dynamic borrowing. Problematic with dynamic borrowing is the bridge loan phenomenon (Roodman, 2009). A borrower with cash shortfall can ask a relative to provide a bridge loan to pay-off the old Grameen loan. After paying-off the old loan, Grameen provides a new higher loan. The borrower uses this money to pay of the relative that provided the bridge loan, but her indebtedness has only risen. Dynamic borrowing is dangerous because it provides good growth figures to the outside world, while the borrower base is of deteriorating quality.

If Grameen therefore stops issuing new loans the danger exists that many clients default on their loan. The delinquency ratio, the number of overdue loans divided by the total number of loans, already made a sharp increase during the last few years. At the beginning of 2010, the ratio is 3.46% (in 2003 the ratio was under 1%). Not issuing new loans can cause more defaulters (bridge loans), which puts the delinquency ratio under even more pressure. Such controversial bookkeeping methods with respect to write-offs already question Grameen's results (Roodman, 2010). Therefore, any action, regarding restrictions on new loans, is not expected.

An option to continue the growth of lending operations without harming the capital adequacy ratio is to increase Grameen's capital base. Examples of such action are an increase in the interest rate for borrowers, a decrease of the interest rate for deposit holders, more (obligatory) share investments or external investments.

The first two options regarding the interest rate are a *de facto* brake on extending new loans. Decreasing the deposit holder's interest rate decreases the amount of money one can use to lend. Increasing the borrower's interest rate has an even less desirable effect. Some low risk projects may remain unfinanced, since the higher interest rate affects the profitability. In the meantime, some entrepreneurs with high risk projects that would otherwise go bankrupt would agree with the higher interest rate as a last resort. In short, altering the interest rate yields no positive results or even negative results when adverse selection effects show up.

The option of attracting external money does not seem a plausible one. Grameen founder and president Yunus reiterated at the 2010 Clinton global initiative:

> *'We oppose that the money of the poor people goes to someone else'*
> Muhummed Yunus explains to be against external finance for Microfinance.

What is true for commercial funds also applies to donors. Grameen is independent from donors since 1996 and wants to keep it that way.

That leaves the option to offer extra shares in the bank to borrowers or forcing borrrowers to buy these shares. Although this share issue has a possitive effect on

Grameen's CAR, after all equity increases, the question is wheter this is a sensible choice. Many real problems, like the financial weakness of the borrowers' base, will remain unaddressed. At the same time the poor people of Bangladesh will be exposed to a significant risk.

Grameen did not restructure its lending operations in one of the ways discussed above. What it did was setting up SBEs in which its borrowers could become financially involved. In this way, Grameen provides more guidance in the utilisation of the borrowed money. If Grameen's guidance helps the poor to increase their profits, this is not only beneficial for the poor themselves but also for Grameen. It is an investment in the quality of the existing portfolio of clients. Social Business Enterprises (SBEs) seems to be Grameen's solution for continuing operations without harming its CAR. Paragraph 3.5 elaborates on the SBE concept. The SBE concept is not a part of the incentives analysis in § 3.4, since the core businesses of Grameen and Shakti are evaluated.

The importance of borrower loyalty

In a banking relationship there is always the risk of safe clients being taken over by competitors. The loyalty of a bank's client base is crucial for the future of a bank. An important role is reserved for managers with much knowledge about the borrowers' repayment behavior.

If a bank has a large market share and loyal borrowers, this promises golden years. Especially in a developing country the relationship with the borrowers must be good, because today's small borrowers may be the major borrowers of the tomorrow.

Are there measurable income effects?

Much research has been done on the poverty alleviation effects of the work of Grameen. World Bank economist Khandker (2005) published a well-respected study that gives clear results about the positive income effects of microlending. Also Rubana Mahjabeen from the University of Kansas leaves no room for doubt in his conclusion about the effects of micro financial institutions (MFIs) in Bangladesh:

> *The major findings are that MFIs raise income and consumption levels of households, reduce income inequality and enhance welfare. This implies that Microfinance is an effective development strategy and has important policy*

> *implications regarding poverty reduction, income distribution and achievement of millennium development goals (MDGs).*
> (Mahjabeen, 2008, pp.1)

As much as it is praised, microlending is criticized as well. The most important critique (Roodman and Murdoch, 2009) questions the methodology of several studies (a.o. Khander's) and revisits them with opposite results.

§ 3.4 *Incentives analysis*

In this paragraph the sustainability of Grameen will be evaluated using the criteria of Labuschagne et al. (2005) that are introduced in § 2.3. This evaluation will be done, in contrast to the original model, by qualitative information in stead of quantitative.

§ 3.4.1 Economic sustainability Grameen

Financial health

Profit:	High The raison d'être for enterprises is making profit. For Grameen the need to make nonnegative profits is even higher because it has some solvability concerns (see § 3.3).
Solvency:	High The Bangladeshi regulations require a CAR above 10%. The license will be suspended if Grameen's ratio is below 10% and lending activities will be ceased (see § 3.2).
Liquidity:	High Trust is crucial for a bank. If there is the slightest suspicion that a bank is running out of cash, a bank run is imminent.

Economic performance

Share profitability:	Low

	Grameen's shareholders are the borrowers (see § 3.1). Since every borrower has just a small share in the bank and there is no representative body for the shareholders, the attention from the shareholders to the board will be small. Nonzero profit is sufficient to continue operations.
Contribution to GDP:	High
	Cooperation with the Bangladeshi government can facilitate doing business. Therefore there is a serious incentive for the board to keep the government's valuation of Grameen's operations at a high level. On the other hand Grameen, as a large bank, has quite some bargaining power. It is likely too big to fail.
Market share performance:	High
	A high market share, i.e. many customer relations, opens possibilities for profitable cooperation with the entrepreneurs of the future (see § 3.2).

Potential financial benefits

Subsidies:	Low
	The possibility to receive (foreign) grants is considerable, reasoning from the fact that similar projects also benefited from donor money. Grameen, however, made the principal choice to refuse donor money since economic independence is at the heart of the enterprise (see § 1.2). The incentive to drop this principal choice and to apply for a subsidy is low.

Trading opportunities

Vulnerability trading network:	High
	In the battle for market share the protection of a bank's managers and client base is crucial (see § 3.2).

§ 3.4.2 Social Sustainability Grameen

Internal human resources

Employment stability: High

The social goal of Grameen is enabling the poor to create employment by themselves (see § 1.2). The incentive does have the constraint of nonzero profit.

Employment practices: Low

Giving decision power to the micro-entrepreneurs, where Grameen's stands for, also implies that they have the power to be a terrible boss for themselves.

Health and safety: -

Grameen has no direct influence on this, as all its clients are independent entrepreneurs.

Capacity development: Low

Grameen does (and will) not provide capacity development possibilities itself, since all such choices are the responsibility of the poor. Within the philosophy of Grameen the poor are wise enough to decide what is good for them.

External population

Human capital: Low

Grameen has its core business in providing credit to the poor. The principle choice to be an enterprise, and not a NGO, results in some distance from charity-related practices (see § 1.2.1).

Productive capital: High

Grameen needs infrastructure for its banking administration (for example phone access and energy supply) and supports its borrowers with such services. These possibilities are therefore easier to access for the external population as well.

Community capital: High

Social cohesion empowers the poor to realize bigger projects. If Grameen helps to facilitate cooperative initiatives, it reaches both the social and the economic goal of the bank.

Stakeholder participation

Information provision: Low

An inherent danger of a bank is a bank run. If operations go well, information provision can be fully transparent. If there is information that can make clients uncertain, there is the incentive to hide these facts. Roodman already noticed that Grameen is unclear about its potentially weak financial position (see § 3.3).

Stakeholder influence: Low

Grameen greatly values its independence. Influence for stakeholders comes at the expense of Grameen's power.

Macro social performance

Macro-economic welfare: Low

Contributions to national issues (e.g. taxes) are a cost for Grameen, and will therefore lower the profit.

Trading opportunities:Low

Grameen is strongly focussed on Bangladesh, and has little possibilities to catalyse the economy with external resources.

§ 3.4.3 Short summary

Grameen feels the pressure to have a solvable position, so the economic incentives are right to foster sustainability. This analysis shows, however, that the impact on internal human resources of Grameen is lower than it appears to be when reading reports written by Grameen. The social sustainability scores lower on this important criterion.

§ 3.5 Grameen Danone Foods Limited

This paragraph briefly explains the Social Business Enterprise Grameen Danone Foods Limited (GDFL), which is co-owned by Grameen. This attention stems from the fact that there are similarities between the joint venture of Grameen and Danone and the independent marketing approach of Unilever in Bangladesh and India. In the basic structure and the observations some similarities become clear. In the discussion there will be anticipated what impact SBEs will have on Grameen's sustainability.

§ 3.5.1 Basic structure Grameen Danone Foods Limited

Beyond lending: the emergence of social business enterprises

Grameen started operations other than its core lending business. These new operations need a short introduction to be understood. In 2006 Yunus, advocated social business enterprises (SBEs):

> *'[Social business enterprises] are social-objective driven. They want to give better chances in life to other people.'*
>
> Muhammed Yunus explains his concept of social business enterprises (Yunus, 2006).

This description of a SBE is closely consistent with the philosophy of Grameen (see § 1.2). A little further, Yunus explains to what extent social and profit objectives can coexist in a SBE:

> *'the social goals remains to be enterprise's over-arching goal, and it is clearly reflected in its decision-making.'*
>
> Muhammed Yunus explains the extensibility of the SBE-concept (Yunus, 2006).

Social business enterprises are firms that have both social and profit objectives. Yunus continues to highlight that the social goal is the most important. The main shift Grameen makes is that it takes control over the investment decision of its borrowers. The poor become entrepreneur, but in line with the regulations of the SBE. With this shift to more security over the borrower's allocation of the loan, Grameen clearly moves the accent more to the economic goal.

Example of a SBE: Grameen Danone Foods Limited

In the 1990s and 2000s, Grameen has created several firms and set up joint ventures with different commercial parties on the basis of the SBE concept. These companies use the Grameen network for their product and services, but have to accept the zero profit objective. Among these firms are health care, education and phone companies. In this paragraph special attention is paid to the joint venture with the multinational dairy processor Danone.

On March 16, 2006, Grameen and Danone set up the joint venture Grameen Danone Foods Limited (Ghalib and Hossain, 2008). GDFL sells 80 gram cups of yoghurt mainly to poor rural people in Bangladesh. The joint venture is owned on a 50-50 basis by Grameen and Danone. Both companies get an annual return on investment of 1%. After three years Danone gets its initial investment of $500,000 back, Grameen keeps its invested money in the joint venture.

GDFL works as follows. Farmers produce milk for the yoghurt that is collected by GDFL on a daily basis. The milk gets transported to the factory were the yoghurt is produced by around 35 workers. Approximately 1,600 sales people buy the yoghurt cups at the factory and sell them within a 25-kilometer radius of the factory. Grameen's job is to select the farmers, factory workers and salespeople from its client base. Danone brings in its production techniques.

Sellers buy the cups for 4.50 taka per piece and sell them at 5 taka. Every seller gets a daily stock of maximum 100 cups, though the average seller takes 60 to 70 cups a day. The income that sellers generate from this job (35 taka ≈ $0.50) is insufficient to meet their daily needs, but form an income supplement.

§ 3.5.2 Observations on sustainability of (basic) structure

Common sense makes clear that the 1% dividend is not the sole motive for both Grameen and Danone to start this cooperation. The annual real economic growth in Bangladesh is over 4% for two decades now (CIA, 2010) and the Dhaka Stock Exchange even doubled the last year (BD Stock, 2010). Investment opportunities with returns above 1% will therefore be present in other Bangladeshi sectors as well.

Rationale Grameen to join GDFL

That Grameen deals with SBEs is understandable if one notices what the existence of a SBE can do for local entrepreneurs. Apart from the direct goals, which vary per specific industry, there are indirect goals that are important in themselves. The higher purchasing power of employees of the SBE will likely increase the profit of local entrepreneurs. One can imagine spillover-effects that stimulate innovation for local enterprises. When there is scope for local suppliers in the supply chain, these suppliers will have a more secure market.

These advantages for local entrepreneurs firstly correspond to Grameen's ideological motives (see §3.1). The settlement of a SBE in an area provides jobs or even entrepreneurship opportunities for locals. Logically, their purchasing power increases. Secondly, the assistance to local businesses also contributes to the strengthening of the client base of Grameen. New entrepreneurs boost the local economy and can easily repay their loans to Grameen and as such increases the bank's prospects on its future solvency.

Therefore, Grameen achieves an increase in the poor's income and improves the bank's balance sheet at the same time with an operation that runs a nonnegative profit. Exploitation of Grameen's network is therewith consistent with Grameen's objective of social business enterprises.

Rationale for Danone to join GDFL

Grameen has a valuable network. The network consists of more than 6 million clients and offices all over Bangladesh. Therefore it knows which entrepreneurs could be interested in cooperation with a SBE. The knowledge in which areas people have high (future) income can help the location decision. In the case of Grameen Phone, for example, the bank noticed the communication needs of its clients and it set up a SBE to meet this need. In short, Danone can take advantage of Grameen's valuable trade information about customers and markets by SBEs.

The rationale for Danone to join GDFL must be sought in that value of Grameen's local knowledge and networks in Bangladesh. Most people in rural Bangladesh are illiterate and do not have televisions. Television or newspaper marketing campaigns do not reach this group. Therefore, advertising by word of mouth through the local networks of these sellers works best. Local knowledge and networks can help Danone to settle in the growing Bangladeshi market. In the future, Danone can make profits in this market outside GDFL if the market is right for that. The cultural barriers are overcome by the help of Grameen, consumers are familiar with Danone's product (see § 4.2 for a better understanding of this point) and if consumer income increases Danone can make profit with products with higher margins. Furthermore, GDFL can help Danone in achieving its social goal, which reads:

> *'bringing progress to the world's neediest people'*
> Danone's social motivation to join SBEs (Danone, 2010).

GDFL sells yoghurt with a high nutritional value which fits well with the strong health need among the Bangladeshi population. Both future growth and social objectives can be seen as the major motives for Danone to join GDFL.

§ 3.5.3 Incentives analysis

Compared to Grameen's core business (§ 3.3), the incentive for management differ at a few point. First, the stakeholder's influence declines. With the choice for more control over the way a loan is to be used, Grameen departs from its philosophy of freedom of investment (see § 1.2). Achieving the target of social development under the constraint of nonzero profit, however, is more feasible, since Grameen provides proven techniques. Second, the capacity development increases. Before locals can work in the dairy factory, they are trained to operate machines.

§ 3.6 Summary

The financial position of Grameen complies with the rules. The way, however, in which the growth has partially been financed in recent years, namely by lowering solvency, cannot be continued, as the CAR has almost reached the minimum requirement.

The economic incentives are in themselves reasonable at Grameen. Preventing a (further) deterioration of the client base quality should be a priority for management. The implementation of SBEs is a feasible way of addressing this concern.

The social incentives are on a medium level. Especially the score on the internal human criterion is a bit meagre. In SBEs, like GDFL, the internal human resources criterion will increase, but the stakeholder participation criterion will decrease.

Chapter 4 Shakti

§ 4.1 Introduction Shakti

Basic structure

Shakti is a door-to-door marketing business in rural India, employing local women. The set-up is as follows. Unilever first chooses villages it wants to enter. These are usually villages with a population of 1000-2000 people (Institute for Fincial Management and Research., 2006). In such a village Unilever visits a self-help group (SHG). SHGs are groups where poor women meet regularly and decide how to invest their collective savings. When a Unilever manager visits a SHG-meeting, he gives a presentation about the possibility to become the local dealer of Unilever-products. Only one of the women is invited to join the Shakti project and become local dealer. Dealership covers about three to five villages.

When a woman enters the project, she gets training on hard and soft business skills, as well as hygiene education. The woman will share this knowledge with villagers, which is good for hygiene awareness and her own turnover. Unilever covers the cost of these trainings. Then the woman has to make a $220 investment in stock at the outset. After getting trained and paying the initial investment, the woman starts her business by selling Unilever products. She has become a Shakti Amma (Amma means mother in the Bengali language and is the term used for Shakti entrepreneurs).

The Shakti Amma has three channels through which the products can be sold. The first one is host retail - retailers in the village she lives in; two, host homes - households in the villages she lives in; and three, satellite retail - retailers in the neighbouring villages (ibid, 2006). Unilever allows a 3% margin for the Amma, when selling to retailers, and 11% for the retailer when selling to consumers (Prahalad, 2005, pp. 200). The Amma's house is used as a warehouse for the products. Unilever delivers products to match sales.

§ 4.2 The Indian detergent market and first mover's advantages

This paragraph discusses the composition of the SHGs, provides some facts on the Indian detergent market and discusses some of the literature on first mover's advantages and franchising. This overview is given to provide a deeper understanding of the facts that lie behind the structure explained in the previous paragraph. The overview, together with the previous paragraph, forms the basis for the observations in the next paragraph.

Self-help groups

A special role in the Shakti-project is reserved for the SHGs. Shakti Ammas get recruited from SHGs and are an important financier for the initial investment. Therefore, it is required to elaborate on the characteristics of these groups.

Self-help groups (SHGs) are groups of men and women that offer financial and social help to each other. SHGs are usually formed and supported by NGOs and the government. Research on the composition of SHGs (Eda rural systems private ltd., 2006) shows that 51% of members are poor (below the poverty line), and another 32% are ‘borderline’ (above the poverty line but vulnerable). From the SHG-members, 74% had no schooling, 11% had some adult education to become ‘neo-literate’ and 15% had some schooling (mainly at primary level).

The figures show that SHG-members are poorer and less educated than the average Indian. One cannot conclude, however, that these figures can also be applied to the Shakti Ammas. Unilever’s selection methods cause deviation from the mean of SHGs. Research (Loman, 2006) found that more than half of the recruited entrepreneurs was chairman or assistant chairman of a SHG.

Central in SHGs is that members regularly pay amounts of money in a group fund, by which particular members' investments can be financed. Many SHGs have been set up at the initiative of the National Bank for Agriculture and Rural Development (NABARD, an Indian state-owned bank). In NABARD's ‘SHG Banking Linkage Programme’ the SHG-members’ payments are closely monitored. After a certain time, a track record of regular payments is built up as well as some capital. With this track record and money the SHG has the opportunity to get a loan from a regular bank. These banks lend at just 4% to the SHG (where 10% is the market rate) and get the interest difference repaid by the Indian government. SHGs thus have more clout than one would predict based on the members’ wealth.

Restrictions for Shakti Ammas

Shakti Ammas must obey some rules of Unilever. It is forbidden to become dealer for other parties than Unilever or to start a shop (Loman, 2006). It is possible for the Ammas to leave the project, but the investment made at the beginning is a significant exit barrier. The main criticism on the project is this restriction and the lack of help for the Amma in adverse business conditions.

The Indian detergent market

Unilever's motive to start the Shakti project is primarily the enlargement of the market share for detergents (see §1.2.1). A secondary motive is the expected social spin-off, such as raising the living standards of the community, increasing the income of the Ammas and empowering the economic and social status of the Ammas (Neath *et al.*, 2008).

The business objectives can be better understood within the context of the competitive situation in the Indian detergent market, which drove Unilever to commence the project. Hindustan Unilever Limited (hereafter referred to as Unilever) is active since 1888 and dominated the market for years. Unilever was only active in the urban areas and from the 1950s onwards mainly with the Surf brand. From the beginning of the 1970s, discounters won significant market share. Unilever reacted by launching the cheaper brand Wheel. In the 1990s, P&G entered the Indian detergent market and since the year 2000 there is fierce price competition to win market share. Nowadays Unilever is still market leader with a market share of 37%, followed by Ghari (18%) and Procter & Gamble (16%). Given the fierce competition, and the observation that P&G has imitated Unilever's strategies in other markets (Morocco, Pakistan) as well, it is likely that they will develop a plan to reach the rural population in India, too.

In the battle for market share, Unilever entered the untapped rural market in 2000. Unilever chose for a door-to-door marketing approach to present its detergents. Though Unilever was not the first supplier of detergents in the rural areas, it was the first supplier that is also active in the premium segment of the Indian detergent market. The premium segment is currently responsible for just 20% share of total volume sales of detergents in India, but the value share is 35% (Indian Soaps and Toilet Manufacturer Association, 2009). Moreover, margins of premium brands are usually much higher than those for the mass products. The focus in the remainder of this chapter is on the competition of winning the loyalty of costumers with small budgets by selling them budget products, as to ensure that they will adhere to the company when purchasing high-margin products once they are in the economic position to do so.

First mover's advantages and franchising

Unilever's main competitor in the Indian premium detergent brands market is P&G. Unilever was present in the rural market before P&G. The entrance on the rural market by Shakti can hence best be explained by discussing first mover advantages.

In the literature there are three possible sources of first mover advantages, according to the classification of Lieberman and Montgomery (1988). The classification distinguishes superior technology, alteration of buyer behavior, and pre-emption of scare assets.

Superior technology covers the industries where technological pioneering yields a lasting advantage over one's competitors, for example in patent or R&D races. Alteration of buyer behavior is the phenomenon that customers prefer the characteristics of the first product they see to those of the second product (Carpenter and Nakamato, 1989). The first mover creates the consumer preferences for the product. Pre-emption of scare assets occur when the first mover can take control of a stock of scarce assets needed in the production or sales process. Such assets can, for example, be physical or geographical production assets, but may also be shelf space.

Important to notice is that there can be interaction between the alteration of buyer behavior and the pre-emption of scarce assets. On the one hand the first mover influences consumer preferences with the result that consumers ask their product supplier for the specific brand of that producer. On the other hand the first mover has the important assets and locations in a market and consumers are more willing to buy an easily available product. In the marketing literature the first phenomenon is called a push factor and the second a pull factor. The interaction between these push and pull factors is what Farris, Olver and de Kluyer (1989) call incremental returns. Consumers ask for broad availability of a brand, which leads entrepreneurs to provide it, which leads in turn to a stronger demand for the product.

Incremental returns occur mostly in markets with *'many low volume stores stocking only a few leading brands'* and with '*the unwillingness of consumers to shop around for unavailable brands'* (ibid). Incremental returns are studied for several markets and products, including the Dutch detergent market where Unilever and P&G fiercely compete. Results were clear in the reciprocal effects of market share and consumer preferences (Verbeke, Clement and Farris, 1994). The Dutch detergent market is in an entirely different development stage than the Indian detergent market, but the interaction effects are similar.

Finally, the literature also discusses that first mover advantages have to be secured by franchising (Michael, 2001). Technological opportunities, for example, are quickly implemented by the availability of venture capital. Similarly, franchising is crucial in markets where outlet share is important, because it will accelerate the conquest of a market. Franchisees can overcome constraints to quick growth, by contributing scarce inputs like capital and good employees. Constraints can be diverse, for example financial or cultural.

§ 4.3 Observations on sustainability of (basic) structure

This paragraph applies the literature discussed in the last paragraph on Shakti. Also the impact of Shakti on the SHGs will be illustrated.

§ 4.3.1 Unilever's motivation to start Shakti

First mover advantages in Shakti

Unilever chose to run the Shakti project. By doing so, Unilever got into the Indian rural market earlier than its competitor P&G. To what extent does this fit with the theory on first mover advantages?

Technological superiority seems not to be applicable for the analysis, since the products are in an advanced stage of development. The alteration of buyer behavior in rural India, seems more applicable, as it is probable that customers are more likely to prefer Unilever products to P&G products. Even if the products of P&G are of the same quality, consumers will prefer Unilever's products because they are familiar with the characteristics of these products.

Pre-emption of the scare assets applies as Unilever had first choice in selecting villages, selecting salespeople to cooperate with, etc. Paragraph 4.2 noticed that Unilever indeed attracts the upper crust of the SHG-members. The sales network could also be organized as efficiently as possible. If P&G would follow a similar BoP strategy as Unilever did with Shakti, it should take into account Unilever's dealer locations. Given that the optimal locations have been chosen by Unilever, P&G is likely to incur higher transportation costs as their location will be sub-optimal.

Incremental returns in the Shakti project are recognizable, since both push and pull factors exist. Because of Unilever's dominant presence in the Indian rural market, consumer preferences are formed on the basis of the characteristics of Unilever's products. Consumers will ask for Unilever products (push). And since Unilever has a dominant position in the Indian rural market for premium detergent brands, it is also the most accessible brand for interested consumers (pull).

Franchising

Retailing to people with low budgets in numerous small villages delivers several constraints for a Western consumer goods producer. Cultural and financial constraints, as well as high distribution costs have to be dealt with to do business profitably. These constraints can delay the exploitation of the first mover advantage. The first mover advantage is in this case taking a lead in terms of outlet share.

An important cultural constraint is that Unilever is accustomed to working with large-scale advertising campaigns through mass media, a way of communication barely reaching the rural media. The Ammas know the local cultural habits and reach new customers by visiting them at home.

Furthermore, the method of finance is important for every business. The Ammas need to collect their own start-up capital and in a way that is beneficial for them. The initial investment comes from SHGs that borrow at low interest. The return on investment (ROI) must be above the interest rate of the SHG to run a profitable business. If Unilever would finance the businesses, the ROI had to be superior to Unilever's internal ROI.

Next is the issue of the distribution costs. These can be rather high per unit compared to Western standards. The Ammas solve this problem by creating warehouses in their home, and thus reduce distribution cost because fewer deliveries are required to take place.

Unilever has secured quick expansion in the Indian rural market, by co-operating with the Ammas in a franchise relationship. A significant proportion of investments are made by the Ammas, and the Ammas also take a considerable risk. Unilever, however, also takes potential risks. What, for example, if P&G leads the Ammas away from Unilever by offering higher margins to the Ammas if they work for P&G? The incentives that originate from this threat are discussed in § 4.4.

§ 4.3.2 Effects for the SHGs and the Ammas

Costs and benefits for the self-help groups

Unilever mostly attracts the women that are in a key position in their SHG. One danger is that the Amma puts less effort in the SHG, thus that the SHG misses its most talented member (Loman, 2006).

An advantage can be that the SHG can make a good return when it lends to its member. Lending to a Shakti Amma for her initial investment seems a good investment for SHGs. The Ammas' income changes after one-year participation in the project are considerable (see table 4.1), so the default risk is small. The new investment opportunity is hence a quality impulse for the SHG's portfolio.

Shakti participation	Pre Shakti income	Post Shakti income		
		Shakti income	Non-Shakti income	Total Income
Full-time	$ 0,45	$ 1,01	-	$ 1,01
Part-time	$ 0,93	$ 0,82	$ 0,89	$ 1,71

Tabel 4.1 Income changes related to participation in Shakti
Adapted from Loman (2006; p. 27).

There is competition on financing the initial investment from micro financial institutions, however. When this competition becomes fierce, the SHG just loses its most reliable borrowers. It is likely that both effects exist.

Another possibility for the remaining SHG-members is that P&G, and other multinationals that use the BoP-concept, encouraged by the successes of Shakti, will try to employ these women. In particular the incentives emanating from P&G copying Shakti is interesting for the SHGs, because both Unilever and P&G are then forced to improve the working conditions of the Ammas.

§ 4.4 Incentives analysis

In this paragraph the sustainability of Shakti will be evaluated using the criteria of Labuschagne et al. (2005) that are introduced in § 2.3. This evaluation will be done, in contrast to the original model, by analyzing the incentives of the management of Shakti (see § 2.2.2), instead of a quantitative analysis.

§ 4.4.1 Economic sustainability Shakti

Financial health

Profit:	High Shakti is founded with the aim of making profit (see § 1.2.2).
Solvency:	High A solvable position of Shakti also improves the position of parent company Unilever India. High solvability lowers the company's risk profile and therefore the risk premium Unilever India has to pay on the capital markets.
Liquidity:	- There is less to say on the need for a good short-term cash position. On the one hand one can imagine that Unilever will globally cover the financial needs. On the other hand, more financial independence makes Shakti more decisive and agile. Because there is no information available about internal arrangements between Unilever and its Shakti, no clear statement about the management's incentive can be made.

Economic performance

Share profitability:	High The Shakti management will feel 'share profitability pressure', although Shakti has no own shares. Through the parent company Shakti needs to meet the international ROI[2] of Unilever.
Contribution to GDP:	High The ambition to have a high contribution to the GDP is inherent to a capitalistic enterprise that wants to maximize profits.
Market share performance:	High

[2] ROI is the return a company has, compared to the investment made. Companies usually work with an international standard for most of their business operations (Brealey *et al.*, 2005).

Market share performance is important in the competition with P&G (see § 1.2). In addition, a big market share creates good profit prospects for the future, since consumer preferences are shaped with the first brand consumers come into contact with (see § 4.3.1).

Potential financial benefits

Subsidies: High

Direct subsidies to Unilever are unlikely, but partnerships with NGOs also increase the success rate of the Ammas and thus the profit of Unilever. The conclusion of such partnerships is very attractive[3].

Trading opportunities

Vulnerability trading network: High

Unilever has much to lose as the core assets of Shakti, the Ammas and their network, could be taken by P&G. Unilever took the risk of being the first mover, providing at least some information on best practice to P&G at no cost. Keeping the Ammas content is crucial for securing loyalty (see § 4.3.2).

§ 4.4.2 Social sustainability Shakti

Internal human resources

Employment stability: High

There are considerable income increases for the Ammas (see § 4.3.2). An incentive for Unilever is the looming take-over of the women by a competitor when working conditions are poor.

Employment practices: High

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[3] An example of such a partnership is the iShakti program with support from over 300 partners, including NGOs and government departments. Shakti Ammas get access to a computer and education so that they can do their bookkeeping on the computer. At the same time the Amma's computer has a social function in the village for other usage. The computer stimulates economically, but also has its social function.

Again, it is crucial for Unilever to secure the loyalty of the Ammas.

Health and safety: High

If the Ammas become an authority on hygiene knowledge, this will be reflected in their turnover.

Capacity development: High

Capable women are better retailers and thus increase Unilever's profit. Therefore Unilever trains the Ammas on soft and hard business skills (see § 4.1 and footnote 3).

External population

Human capital: High

The Ammas give hygiene education to the people living in the villages where she sells her products (see § 4.1). This education increases demand for soaps and therefore Shakti's turnover.

Productive capital: Low

Investments in productive capital stimulate the local economy and therefore the disposable income of the consumers, which can be beneficial to Unilever. Shakti is an innovative marketing approach to overcome the problems related to the difficult accessibility of rural markets. Market development provides the consumers with a higher budget to spend on Unilever products, but this effect is likely smaller than the adverse effect of attracting competitors to a market that is more developed (and where innovative marketing is no longer necessary).

Community capital: High

The value of the Shakti network increases with the strength of social networks. Social networks can increases loyalty to the Amma. Since the Amma sells just one product this Amma loyalty represents *de facto* brand loyalty. Unilever has to ensure that it does not damage the SHG if the chair becomes Amma, as it could jeopardize the relations of the Amma, and therefore her potential for turnover.

Stakeholder participation

Information provision: Low

Very detailed information about the project set-up can help P&G or other competitors too much, which is unattractive to Unilever.

Stakeholder influence: Low

Unilever wants to stay in control of Shakti.

Macro social performance

Macro-economic welfare: Low

Contributions to the national cause (e.g. taxes) amount to a cost for Unilever.

Trading opportunities:Low

Expensive resources from abroad are not attractive to use by Unilever, since it increases costs.

§ 4.4.3 Short summary

The Shakti management has extraordinary high incentives to realize economic sustainability. The social sustainability is lower, as management seems to have only the incentive to keep the Ammas satisfied.

§ 4.5 Summary

There is a broad economic literature that is in support of Shakti (first mover advantages, franchising). This marketing approach provides quickly expanding prospects and has the right incentives for sustainability.

In the future competition from other multinationals is conceivable. The Indian economy is growing and competitors will notice the success of Shakti. This competition will not only exist on the product market, but, equally important, on the labor market. Defense of the sales network, in other words, keeping on board the Ammas, is the biggest challenge for Unilever.

This competition promises to be favorable for the Ammas. The threat that Unilever loses its network pressures Unilever to, for example, increase margins for the Ammas or improve their working conditions. Both examples would add to the social sustainability of Shakti.

Chapter 5 Comparison incentives Microfinance en BoP

§ 5.1 Comparison table

Table 5.1 and 5.2 show the management incentives on economic and social sustainability, which are explained in § 3.4 and § 4.3. The final judgments for the criteria are made on the basis of the scores on the subcriteria.

Economic sustainability	Grameen	Shakti
Financial health	**High**	**High**
- Profit	High	High
- Solvency	High	High
- Liquidity	High	-
Economic performance	**High**	**High**
- Share profitability	Low	High
- Contribution to GDP	High	High
- Market share performance	High	High
Potential financial benefits	**Low**	**High**
- Subsidies	Low	High
Trading opportunities	**High**	**High**
- Vulnerability trading network	High	High

Table 5.1 Comparison management incentives on economic sustainability

Social sustainability	Grameen	Shakti
Internal human resources	**Low**	**High**
- Employment stability	High	High
- Employment practices	Low	High
- Health and safety	-	High
- Capacity development	Low	High
External population	**High**	**High**
- Human capital	Low	High
- Productive capital	High	Low
- Community capital	High	High
Stakeholder participation	**Low**	**Low**
- Information provision	Low	Low
- Stakeholder influence	Low	Low
Macro social performance	**Low**	**Low**
- Macro-economic welfare	Low	Low
- Trading opportunities	Low	Low

Table 5.2 Comparison management incentives on social sustainability

§ 5.2 Comparison Grameen and Shakti

Sustainability is a multi-faceted concept, but not all aspects are equally important. The varying degree of importance is stems from the focus on micro-entrepreneurship. If any of the criteria deals with the position of a micro-entrepreneur, it is considered more important for this analysis.

For economic sustainability, two areas deserve focus. Obviously, *financial health* is of high importance, as businesses need to have an eye on the short-term financial health, to guarantee financial sustainability in the long-term. In addition, the combination of *market share performance* and *vulnerability trading network* is important. When a significant market share is captured and can be maintained for a long time, the possibilities for large investments increase. The combination of present success and profitable prospects fosters economic sustainability.

The focus for social sustainability is on the *internal human resources* criterion. This is inherent to the idea of promoting micro-entrepreneurship, as is the case with Microfinance and BoP. Entrepreneurship poses demands on the individual with respect to creativity, discipline and risk. The reason to adopt such a demanding lifestyle is the future reward in case of a successful enterprise. Microfinance and BoP corporations should therefore make every effort to properly care for their own people, i.e. optimize their internal human resources. Subsequently, it is certainly worthwhile in the long-term to develop good relationships with other stakeholders as well.

If one compares the incentives of Grameen and Shakti concerning economic sustainability there is little difference. Both have high incentives to run proper financial policies and to conquer and maintain a strong market position. The main difference is at the incentives for social sustainability. Grameen has little interest to invest in training for all its borrowers, as it would have too little return. Training those with good debt service records is superfluous, as these borrowers are the best performers who have least to learn from training. Grameen does not have to fear that they run away either, as they will lose all their good credit history. Women at Grameen have to prove themselves every time and are responsible for their own success. Shakti wants to invest as a company in the micro-entrepreneurs, but screens in advance if the woman is worth these investments.

Finally, it must be said that the differences in sustainability are not enormous. Microfinance and BoP have much in common and so the incentives show many similarities. The verdict about the sustainability of the two organizations is based on structures that diverge to a limited extent, which impact mostly on social sustainability.

Chapter 6 Conclusion & Discussion

§ 6.1 Conclusion

In this thesis two visions that support entrepreneurship of the poor in developing countries are compared on their degree of sustainability. The visions in question are the Microfinance movement and the Bottom of the Pyramid (BoP) movement, which are analyzed by means of a case-study.

For the Microfinance movement Grameen has been researched. The economic incentives of the approach are reasonably high. The social incentives, however, are not that high. The actual situation is that Grameen is in a weakening financial position.

For the BoP movement Shakti has been researched. Both the economic and social incentives are high, which predicts a sustainable future for this approach. The actual situation is that good social conditions are hard to implement within this approach.

The key question whether BoP is more sustainable then Microfinance can be answered positively. Looking at the totality of incentives for economic and social sustainability the management of BoP corporations seems to be induced more to implement policies for sustainable development than the management of Microfinance firms.

§ 6.2 *Discussion*

§ 6.2.1 The future of Microfinance and BoP

The financial stability of Grameen is threatened by a rising delinquency ratio and a solvency that just meets the requirements of the national bank. Despite the accounting profits that Grameen presents in its annual reports, the business model seems to be making losses. This means that problems that Grameen experienced under Grameen I, i.e. a rising delinquency ratio and low profitability (Pearl *et al.*, 2001) have remained unsolved in Grameen II. Although no firm conclusions can be drawn here, as it would require a thorough accounting research, it seems Grameen's banking model cannot survive independently.

Grameen could accept donor money to guarantee operations in the long term. The acceptance of donor money will, however, influence their activities, and could thus affect the essence of the company. Survival dependening on donor money tends to NGO practices, which are strongly rejected by Yunus (Grameen, 2010 c).

Problematic in the Microfinance approach is the premise that in every human being hides an entrepreneur. Financial services like insurance and, in a later stadium of economic development, consumption credit, are meant for the masses. This is nevertheless not the purpose of investment credit. Investment credit is for those that have proven to be skilled enough to be worth the trust of a lender. Providing investment credit to poor people who are not entrepreneurs is not a solution to povert.

With SBEs like GDFL, Grameen pioneered a more sustainable endeavor, for three reasons. First, selection of appropriate entrepreneurs takes place for the SBE. This increases the success rate for both the SBE and the entrepreneur. Second, the starting entrepreneur receives guidance from the SBE as to how he should operate. This guidance could mean taking care of some complex operations, which are time consuming for micro entrepreneurs. Guidance may also amount to learning skills that the entrepreneur can apply independently later. Third, Grameen observes who the most skilled entrepreneurs are as in the GDFL project it can monitor the sales performance of the entrepreneur, which it cannot when the entrepreneur works for her own business. This insight provides extra information, next to the credit history, when Grameen needs to make its next lending decision for this borrower. In addition, the borrower is more likely to succeed in her next enterprise, as she received a professional training.

Important to notice is the fact that the entrepreneur's income that from GDFL is insufficient to fully meet his needs. GDFL is a good experience to discover entrepreneurship in practice. The incentive to set up a real enterprise nevertheless persists. Those who are apt entrepreneurs will continue in the field and set up real businesses, while others will search wage labor. Joining GDFL means a good learning experience for entrepreneurial skills, while stimulating the search for market opportunities that can provide sufficient income to fully meet all needs.

The strategy by which Grameen overcomes its financial problems is the exploitation of their network. The realization that the most valuable asset of micro financial institutions is their network should also result in a change of strategy for other actors from the Microfinance movement. Stimulating entrepreneurship by network exploitation should form a main element in their new strategy. It should be noted that the shift to safer customers is also possible, but that a Microfinance bank turns into a conventional bank by such a strategic decision.

Grameen explores new routes in the exploitation of its network. It set up own businesses and joint ventures. The advantage of fully owning businesses is that the Grameen vision can be completely implemented. The disadvantage is that the new product market has to be discovered by Grameen itself. This drawback is remedied through cooperation with a partner with experience in the specific product market. Cooperation can accelerate the establishment of a firm and lower costs when economies of scale and scope are existent. Therefore joint ventures will be preferred to private companies for actors from the Microfinance movement.

Shakti made use of the already existing network of SHGs. This network provided contacts with the potential entrepreneurs and start capital. SHGs have not been able, however, to form an equal partner for Unilever. This can be concluded from the fact that the actual social standards are lower than one should suspect for partners in a successful project. Probably the relation between Unilever and the Ammas would improve if there was more competition in the field. A potential danger is that the Ammas can otherwise be taken over by another Western multinational, like P&G, if the social conditions, under which the Ammas work, are too low.
Unilever has to take better care for the Ammas to build a sustainable relation. Because it is hard to represent the interests of the Ammas within the organization of Unilever itself, Unilever could cooperate with an external partner that supports the women.

Another possibility is for BoP corporations to partner with MFIs. MFIs have affinity with the task of representing the poor, since the interests of the poor are their primary concern.

The BoP and Microfinance movement have much to offer to each other. In the future, growing synergy between the two is expected. This raises a number of questions. What impact does this business model have on poverty? And what is the influence of the business model on stakeholders other than those directly working with the BoP corporation and the MFI? Future research could clarify these issues. The intriguing question is whether such a collaboration is even more sustainable than both individual approaches.

§ 6.2.2 Methodology

A sustainability evaluation between two big currents is no easy task, but even the case study between two companies proved difficult to apply. Grameen and Shakti have very broad structures, so only an abstract version of the complex reality of these corporations could be analyzed.

The lack of quantitative information has been overcome by analyzing incentives instead of business outcomes. This has made the study unclear at times, because even though management incentives are right, the actual situation may deviate quite significantly. When more data is available, a case study on the performances of the companies would provide interesting insights in this discussion. Nevertheless, even though the incentives study may diverge from the actual situation, having the incentives right in a difficult situation is likely more sustainable than having the current situation right, but the incentives wrong.

An incentives analysis is vulnerable to becoming to excessive subjectivity as it hinge on personal interpretation. The aim was to provide maximum clarity as to enable the reader to make personal judgments of the author's interpretation as well.

The complexity of the substance forced a limitation to a study of the incentives of the management of two companies. An interesting topic for future research is to evaluate the viewpoint of micro-entrepreneurs: does the current structure motivate them to be entrepreneurs, and would it change if they had more income?

Finally, the case-study assessed two companies operating in different cultural and economic contexts, so the analysis is imperfect.

Although all these limitations have to be acknowledged, the analysis was done based on the most general concept of the two representative companies, in order to guarantee that the results can be generalized.

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