To Profit or Not to Profit: Is That the Question?

Muhammad Yunus

Building Social Business

The New Kind of Capitalism That Serves Humanity's Most Pressing Needs

PublicAffairs, New York, 2010, 226 pp., $29.95 (cloth).

T his is an autocatalytic process: work creates wealth that can then be appropriated by those who work. Building Social Business is full of examples of business ideas to overcome poverty by enhancing the value of the poor’s willingness to work and by designing effective and self-sustaining solutions to their most pressing problems. (The author is the founder of Grameen Bank—one of the first microfinance organizations. Since the late 1970s it has been making small loans to entrepreneurs in some of the poorest areas of his native Bangladesh. Its lending activities now extend worldwide.) In this, his most recent publication, Yunus shows how child malnutrition can be addressed by hiring crucial micrintrons in a pleasantly flavored yogurt (Grameen Danone); how affordable shoes for the rural poor (Grameen Adidas) combat worm infections; how health services can be offered for a prepaid fee or cata- ract surgery for those who are losing their sight (Grameen Health Care).

“...A book not just inspirational. It aims to create and brand a new social movement based on an entrepreneurial and self-sustaining way of addressing the problems of the poor, clearly distin- guished from charity or from corporate social responsibility, neither of which is self-sustaining. But he also wants to distinguish it from garden variety capitalism—hence the book’s subtitle. The point is not just to build businesses that address the problems of the poor, but to create “social businesses,” where “every- thing is for the benefit of others. It is built on the selfless part of human nature.”

Yunus carefully distinguishes his new brand of capitalism, and his enemy is the profit motive, which he says sooner or later gets in the way of serving the poor. He believes it should be banished. Just as a smocker who wants to quit must avoid even one puff or a Muslim during Ramadan must forgo the smallest snack, busi- nesses must turn their back on profit. Making a complete break from the for-profit attitude creates a huge and important difference for the business- person who really wants to commit himself or herself to social change.

Yunus claims to have invented a new form of social organization in the realm of not-for-profit businesses geared toward solving the problems of the poor. He is careful to distin- guish it from for-profit capitalism, cooperatives, socialism, government, charity, communism, or corporate social responsibility. He claims intel- lectual property rights on microcredit, although Accion International pre- ceded his Grameen Bank by more than a decade. With an intelligent mix of donations and profit motive Accion created organizations such as Compartamos, MiBanco, and Bancosol, which have grown much more dynamically than Grameen Bank, precisely because, unlike Yunus, they did not insist on group lending or oppose profits. The not-for-profit brand does buy goodwill. Grameen has partnered with major corporations such as Danone (for the yogurt) and Adidas (for the shoes), whose association with Grameen has been good for their own brand. However, as things stand, this companies are limited to raise programs managed by their corporate social responsibility departments. New billion-dollar markets would be trans- formational for the poor. Avoiding the profit motive restricts these solutions from truly scaling up, and passing up donations limits subsidization of activi- ties that cannot be organized in a sus- tainable way.

Readers are likely to find inspiration, but should take the social movement Yunus is trying to brand with a pinch—or a pound—of salt.

Ricardo Hausmann

Director of the Center for International Development and Professor of the Practice of Economic Development at Harvard University

In the Eye of the Storm

Rajan’s book addresses a number of key questions raised by the collapse of the global financial services firm: why was the disorderly failure of Lehman Brothers allowed to happen? Did the authorities anticipate the risks and, if so, could they have intervened? If early intervention was impossible, could the authorities have bailed out Lehman at the last moment, as they did another investment bank, Bear Stearns, six months earlier or insurance giant AIG the following day?

Henry M. Paulson, Jr.

The failure of Lehman Broth- ers triggered a run on the global financial system. A sharp reduction in cash availability set off a severe global economic downturn. In the United States, the downturn led to 10 percent unemployment, a 3.7 percent drop in real GDP, and a 15 percent decline in industrial produc- tion. Henry Paulson’s book addresses a number of key questions raised by the collapse of the global financial services firm: why was the disorderly failure of Lehman Brothers allowed to happen?

In this book, Fault Lines, Paulson offers an intriguing approach to avoid- ing another one.


The narrative offers a historical primer. Key market shifts range from the start of the credit turmoil in August 2007 and the failure of Bear Stearns in March 2008, through the conservatorship (nation-
Who’s Afraid of Big Bad Banks?

Simon Johnson and James Kwak


The authors tell a good story, one that features its fair share of villains and a hero here and there. Foremost among the villains are the major banking institutions. The book portrays them as the new oligarchs. They wield excessive economic power and political influence and have reaped the benefits of their too-big-to-fail status, all while taking excessive risks with the expectation that the taxpayer will bail them out. The popularity and support for economic liberalization, the revolving door culture that propels people of influence from the public sector to major financial institutions and back again, and the presence of a few people in key positions at the U.S. Treasury and Federal Reserve helped grease the wheels of exploitation. The IMF is not spared in this critique.

However, the authors do well to acknowledge that many of the villains were at one time considered heroes in handling earlier financial crises and helping promote strong economic growth. No one would deny that there were mistakes along the way, and if we could scroll back and replay history, it’s certain that some decisions would be retracted. The decision highlighted in the book on the regulation of over-the-counter derivative transactions is a case in point. The book suggests that these decisions may reflect the ability of the powerful self-interest of a few to sway the many, but they may have simply been the consequence of poor judgment and ignorance—we are wiser after the fact.

The timing of the book’s publication coincides with the moment in history when the world over has been debating how best to reform the regulatory framework for global finance, and detailed regulatory reforms are now in the works. What makes 13 Bankers valuable is its independent perspective. A central thesis of the book is that almost everyone involved in financial regulation is captured by the nature of the process and is likely to angle the reforms in favor of major financial institutions. This argument, if true, would not augur well for achieving fundamental reform that would lead to lasting improvements. The jury is still out, and it may take a much longer time to discern whether the book’s recommendations are wise enough to be worth the effort of assembling the drafting committees and challenging the case for including the recommendations as part of the reform process.

Andrew Sheng’s new book has arrived just when people need it most. After a lifetime of experience in the West and East, coupled with his background as a Hong Kong financial regulator and scholar, set the stage for this deep, broad analysis of the financial crisis, seen through Asian eyes.

Unlike many analysts, Sheng injects a personal perspective that touches on comparative history, macroeconomics, and microeconomics and sets the book’s framework. In my experience as an Asian journalist, I have never read a clearer or more complete story of the 1990s Asian financial crisis, nor a more convincing analysis of the intrinsic link between the global financial system and the current global crisis. But some readers may find Sheng’s coping with the crisis as a regulator more interesting than his theoretical explanations. Sheng shows how and why current tools and institutional structures are outdated. Among the new topics he tackles: the relationship between financial intermediaries and regulators or governments. In his view, untested finance is at the core of these crises. But the real picture is far more complex. Governments tend to over- and underregulate financial systems simultaneously. This is especially true in Asia, the author says. The financial system needs not more but better regulation.

Regulatory cycles must include constant reviews of outcomes against objectives. These reviews should examine how the strategy, priorities, incentives, standards, structures, processes and execution have been done in the right way.
dimensions and context,” Sheng writes. His argument is reasonable. But how can we guarantee that this happens? In China, such reviews may be impossible at this stage of financial system development. Regulatory capture—that is, when a state regulatory agency created to act in the public interest instead acts in favor of the commercial or special interests that dominate in the industry or sector it is charged with regulating—is common in China. What is needed now are regulators who focus on making and implementing rules, not making market choices. They should improve the trading system, monitor special interest groups, ensure adequate information disclosure, penalize offenders, and educate investors. Yet Chinese regulators show little interest in these tasks. On the contrary, having been hijacked by powerful interest groups, they implement excessively protectionist policies in the name of safeguarding investor interests. This leads to artificial control of stock supply and demand and market distortion, which creates conditions that foster rent-seeking by listed companies, turning investors into speculators. Sheng argues that “transparency is necessary but not sufficient.” That’s putting it mildly. In China, transparency is only a dream. As Sheng points out, “The key structural problem faced by Asian economies is the legacy of a relatively closed, top-down silo governance structure faced with an open, rapidly changing and complex global market.” Exactly. Sheng tells us that after the Asian crisis and the bursting of the dot-com bubble, the financial world undertook its most thorough overhaul since the 1930s in areas that spanned accounting, corporate governance, regulation, and national financial sectors. But these measures were not enough to stem the latest crisis. In fact, some of these measures may have contributed to the crisis. And the world is still seeking answers to critical questions, including those surrounding the problem captured in the expression “too big to fail.” Still, there is hope for the future of financial oversight, even though events of the recent past do not portend well for the future. The logic of the rescue plan enhances the factors that create financial crises, including the current crisis. For example, the incentive mechanism in the financial sector and the principal-agent problem are all intact, if not worse, in the rescue plans. However, Sheng is hopeful. “No financial crisis is exactly alike, but there are common elements that would, I hope, help us identify and mitigate the next one,” he writes.

Our challenges are especially serious in Asia, so Sheng’s Asian regulatory perspective is particularly welcome at this juncture in market history. “There are very few books about the Asian crisis by senior Asian officials who were in place during the crisis,” he notes. “For posterity’s sake, the Asian side of the story deserves to be told.” Sheng deserves praise for being conscious of his responsibility to history. But his most valuable contribution is his understanding of his responsibility to posterity. The Asian side of the financial world undertook the classification in the IMF’s World Economic Outlook. The data is available at www.imf.org/external/np/pubs/ft/weo/2010/02/index.htm.

Credit to the Private Sector Remains Weak

Bank credit continues to fall despite the global recovery

The period preceding the international financial crisis of 2008 was characterized by excess global liquidity and a rapid expansion of credit, especially to the private sector. But as a consequence of the global crisis, the banking system cut back its lending to the private sector, as banks sought to improve balance sheets hit by declining asset prices, absorb a growing number of nonperforming loans and, in general, reduce risk by deleveraging. Bank credit growth has fallen sharply in real terms and is likely to remain subdued across most major economies and country groups. A massive infusion of government funds and credit-easing policies in advanced economies, intended to fight a recession and support bank balance sheets, did not translate into increased credit to the private sector. After growing at an average annual rate of about 7 percent until mid-2008, bank credit growth in mature markets slowed and by the end of 2009 turned negative. Bank credit growth in 2009 dropped the most in the United Kingdom—by about 20 percent. In the United States, by early 2010 credit had fallen by almost 10 percent on year. The euro area followed a similar trend.

Several factors explain why better financial conditions did not result in renewed credit growth to the private sector in these economies. First, as economic conditions weakened, demand for credit declined as firms cut output and households reduced consumption, decreasing their need for credit. Second, banks tightened lending standards in the face of greater uncertainty, weakening capital positions, and rising loan losses. Banks’ balance sheets still remain under strain and funding conditions are becoming tighter. In a flight to quality, banks are favoring government bonds over loans to the private sector. And uncertainty about future regulation may be reducing banks’ willingness to lend.

In emerging and developing economies, the region with the sharpest drop in credit growth is eastern Europe, which benefited from a substantial inflow of foreign funds and cross-border lending prior to the crisis. When the financial crisis struck, credit growth dropped dramatically and has not started to recover, in part because of a reversal in foreign finance to the banking sector. Credit growth in Latin America, sub-Saharan Africa, and the Middle East and North Africa has been quite similar, with growth rates hovering between zero and 5 percent as of end-2009. In contrast, credit to the private sector in emerging and developing Asia did not seem to be affected by the financial crisis. In fact, bank credit growth in these countries increased during the crisis and has only recently begun to fall. However, this development has been heavily influenced by China, where bank credit has grown steadily since 2005, reaching 35 percent by end-2009 owing to strong economic growth prospects and rising asset prices. Prepared by José M. Cartas and Martin McCaugha of the IMF’s Statistics Department.