

Compartamos Banco and Grameen Bank: A Case Study on Microfinance

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Microfinance and micro-credit became prominent in the 1980's when Muhammad Yunus created Grameen Bank. Grameen Bank is one of the most successful micro-credit social businesses and has provided loans to millions of impoverished people around the world. Many similar microfinance institutions have been started across the globe. One of the more prominent "banks" is Compartamos Banco, a microfinance institution started in Mexico. Yunus, the founder of Grameen Bank and founding father of micro-credit, is one of Compartamos Banco's biggest critics, saying that the co-CEOs do not have their priorities in order. Although Compartamos Banco has been successful in terms of profitability, replication, and scale, it is not a high performance social enterprise due to its motivation, innovation, and social impact.

Motivation

"When you are maximizing your profit, you are not looking at whether poor people are getting out of poverty, you are always looking at your bottom line," said Yunus (PBS). The motivation of Compartamos Banco's CEO's, Carlos Labarthe and Carlos Danel, is unclear, but it seems as if they are motivated by profit, not social impact. In 2007, Compartamos Banco went public with their IPO sale, selling 30% of the company's equity and generating more than \$450 million from sales. Neither Labarthe nor Danel disclosed how much money they made from the IPO. Compartamos Banco also charges unnecessarily high interest rates of up to 100%. Although both of these measures ensure that Compartamos Banco continues to generate revenue and expand their reach, Grameen Bank has been successful by keeping their interest rates between 10-15% and without going public. These reasons make it seem like Labarthe and Danel

are motivated by profit, not social impact. They also provide credibility to the claims made by Yunus that Compartamos Banco cares more about its profit than actually helping the people that it serves rise out of poverty.

Business Model

Compartamos Banco is a publicly owned and traded for-profit business. In 2000, Compartamos Banco became incorporated as a SOFOL, which allowed them to take part in certain financing activities and become a for-profit business. In 2006, Compartamos Banco became a commercial bank. Commercial banking is not the future of microfinance because it does not have the borrowers' best interests in mind. A commercial bank has to deal with its private investors and make sure that they are receiving good returns on their investments. This takes away money that could be reinvested in the business with the borrowers. Village banks, such as Grameen Bank, do just that. Grameen Bank is considered a social business, which means that it is a for-profit enterprise and all profits remain in the business. While Compartamos Banco is owned by investors, many of them private investors, Grameen Bank is owned by its borrowers, because its goal is to help the borrowers and bring them out of poverty. Village banking is the real future of microfinance as a poverty alleviation tool – the borrowers are the priority and all of the profits remain in the business.

Innovation

Compartamos Banco's innovation is going public – they were the first microfinance bank in Mexico to have an IPO and become a commercial bank. This is arguably their only innovation. Co-CEO Carlos Danel argues that this was necessary in order to reach capital markets that would not have been otherwise accessible for the

borrowers, but Yunus worries that Compartamos Banco's commercial approach will damage the credibility of micro-credit. This innovation can be considered disruptive because no microfinance institution had done this in the past on such a large scale – Compartamos Banco's IPO brought in over \$450 million. Danel's argument that this expansion was necessary in order to reach new markets is a little ridiculous. The big investors garnered from the IPO are not necessary because Compartamos Banco is financially sustainable due to their high interest rates. These new markets are not beneficial to the borrowers, who run their businesses on such a small scale that they would not be able to access these markets. This is another example to support Yunus' argument that Compartamos Banco exploits the poor – the IPO is unnecessary and just another way for the management to access more capital that the borrowers will not benefit hugely from.

The solidarity group is the innovation that truly distinguishes Grameen Bank and has set Grameen as a role model for other microfinance institutions. The solidarity group consists of five members that support one another in the borrowing process. First, two members get approved to get a loan. If they are successful, then the next two get approved, and then the last one. The group relies on one another to approve each other's loans and for their individual success.

Sustainability

Compartamos Banco is sustainable both financially and operationally. They are able to sustain themselves financially by the high interest rates that they charge. Interest rates can be up to, and sometimes well over, 100%. Although interest rates are usually higher in Mexico because of the high operational costs, this number is absurdly high

when compared to Grameen Bank's interest rates that do not go above 20%. In addition to high interest rates, Compartamos Banco uses the flat-line method for payback of interest while Grameen Bank uses the declining balance method. Flat line method requires borrowers to pay back the same amount each month so, in the end, they will end up paying more interest than those using declining balance method.

Grameen can still sustain itself financially and operationally without high interest rates. Compartamos Banco uses this money earned from high interest rates to expand their reach, but they also use it to provide high returns to investors, which is unfair to the borrowers. It would be interesting to see if Compartamos Banco could operate with lower interest rates and without outside investors. Compartamos has proved to be operationally sustainable. The bank's current CEOs, Larbarthe and Danel, took over for founder Jose Ignacio Avalos. The bank has continued to run and expand across Mexico.

Measuring Social Impact

One can measure Compartamos Banco's social impact by looking at the number of people that it is helping. Today, it has 473 service offices across and it serves more than 2.5 million borrowers (Compartamos). These numbers do seem good, but when compared to Grameen Bank, Compartamos Banco looks questionable. As of October 2011, Grameen Bank had 8.35 million borrowers. Grameen Bank has been in business longer than Compartamos Bank has, but one would expect that with all of the money that Compartamos Banco is getting through its IPO, private investors, and high interest rate, that Compartamos might be trying to expand more. Labarthe and Danel said that the reason they sold Compartamos Banco's equity was to get more money to expand, but Grameen Bank has clearly done much more without the same resources. This also puts

into question how Compartamos Banco is using their money – it is clear that it is not being allocated to the right sources. In the second quarter of 2012, Compartamos Banco's return on equity was 17.52%, which is a good number for prospective investors (EMIS). Compartamos Banco's operating profit margin in the second quarter of 2012 was 21.83% (EMIS), which is also fairly good. These numbers show that Compartamos Banco is providing their investors with good returns and the company looks like a good investment choice – almost like they are focusing more on the needs of the investors than those of the poor. These reasons all feed into Yunus' criticism of Compartamos Banco and how they are using their high interest rates to pay themselves and private investors. They are exploiting the people they should be helping.

Although there are many success stories of people who have risen out of poverty because of the loans they have received from Compartamos Banco, the bank has not made any effort to study whether or not its loans have really improved the borrower's lives. It would be interesting to see how many people Compartamos Banco has helped get out of poverty.

Replication and Scale

Compartamos Banco is both replicable and scalable. Today, it has 473 service offices across Mexico, Peru, and Guatemala, so it has scaled well. In terms of replication, there are many microfinance institutions across the world that work similarly to Compartamos Banco by providing small loans to the poor to help them jumpstart their businesses. Although Grameen Bank is much different in terms of motivation, social impact, and business model, it shows that microfinance institutions can exist all over the world. Muhammad Yunus said that Grameen Bank can work wherever there is poverty,

and that is true. Grameen has been able to scale very successfully without becoming a public company. One way of doing this is providing those interested with lessons from visiting Grameen Bank, then allowing them to build their own versions of Grameen in surrounding countries. Examples of this are ASHI in the Philippines and Grameen Bank Ikhtiar in Malaysia. The solidarity group model is another very important aspect because it gets people to get their friends to join, and word spreads very quickly this way.

Grameen also received funding from the MacArthur Foundation and the World Bank.

Conclusion

Compartamos Banco has been able to provide loans to millions of people, as well as replicate and scale very well. The bank has a lot of potential to be successful and have a large impact, but because of Compartamos Banco's emphasis on investors rather than the poor and their commercial model, they are not a high-performance enterprise.

Compartamos Banco looks very appealing from an investor's perspective, but the money they are giving to investors would be much more effective if it stayed within the organization and was redistributed to borrowers. But, as long as Compartamos Banco's motivation is profit, they will not be able to be a high-performance enterprise.

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