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THE HALAL WAY TO SOCIAL CHANGE

Is there a way to pursue Grameen's social agenda without using interest?

By Ehsan Habib Feroz

Bangladesh's first Nobel Prize belongs to the Grameen Bank and its founder, Dr. Muhammad Yunus, for their outstanding contributions towards social change in the Muslim world. While many people applaud Grameen's empowering the poorest of poor women through micro-financing, devout Muslims dislike its interest-based approach.

Grameen traditionally creates a portfolio of borrowers who monitor each other to prevent loan shirking and to ensure a very high rate of loan repayment with interest. A Shari'ah-based approach would create a portfolio of borrowers (actually potential shareholders) who would increase their ownership shares in the financed asset until they become full owners after paying off their loan in interest free installments.

The proposed bank would initially retain full ownership of the financed asset. As the borrower repays the loan, its share would decrease and the borrower's share would increase until the borrower owns the asset free and clear. The bank's main source of revenue would be based on a profit/loss regime (risk sharing, which the Shari'ah permits) between the bank and the borrower.

For example, suppose that a group of investors calling itself the Grameen Shari'ah Bank (GSB) decides to finance the purchase of a small store for $20,000 so that a fictitious borrower named Medina Munshi could open a thrift shop. Munshi has no tangible collateral other than her organizational skills and her status as a member of the portfolio (a group of five women of roughly comparable socioeconomic status). Her part-time employed husband works at a local 7-11 and lists the couple's car as his only asset. The GSB extends a small loan to her on the basis of zero tangible collateral, as is Grameen's common practice.

Repayment and Shareholding

Her agreement with the GSB states that she must repay the loan according to a fixed schedule of $2,000 per year. To begin with, the GSB will own the premises. However, after she makes the first payment, she will own 10 percent of it and GSB's share will decrease to 90 percent. As she continues to make non-interest payments, her share of ownership increases until she owns the premises.

Simultaneously, the GSB contracts with Munshi to share her thrift shop's profit/loss until its proportionate share of ownership reaches zero percent. In other words, as Munshi's share of ownership increases, her share of the risk rises proportionately.

Naturally, there are agency issues regarding the accuracy of Munshi's profit/loss statements to the GSB and the premises' potential decline in value. In particular, would she have any incentive to pay the final $2,000 if the neighborhood in which her thrift shop is located becomes ghettoized? In order to avoid such problems, the premises' market value must be determined every December, and each party's proportionate share of ownership needs to be redetermined after each yearly profit/loss allocation and asset reevaluation.

Similarly, the loan agreement's "fair usage" clause protects the GSB from any possible misuse of the premises, for Munshi would guarantee a minimum value for the premises when she makes the final scheduled payment. However, she would be penalized for any negligent misuse by having the amount of her loan repayment increased. Hopefully, the "negligence penalty" clause would protect the GSB against such misuse. In any event, it is hard to imagine how any such misuse could possibly benefit her.

Although this simplified example is based on one borrower, it can easily be extended to several borrowers in the same portfolio or even in different portfolios. Portfolio members would monitor each other to prevent loan shirking and to provide incentives for submitting accurate profit/loss statements. Grameen's so-called "sixteen decisions" (see Muhammad Yunus, "Grameeen Bank: Experiences and Reflections" [Dhaka, Bangladesh: Grameen Bank, 1995]) are not integral to the model and can be attached as an optional set of social requirements (but not as a precondition of a loan), as long as they do not contradict the Shari'ah.

The proposed GSB would retain Grameen's positive features (i.e. zero tangible collateral and portfolio approach) while avoiding interest. In addition, it would give borrowers higher motivational incentives to repay their loans on time, since they would significantly reduce capital costs by avoiding compound interest. Finally, and most importantly, the GSB would use a Shari'ah-based interest-free approach to promote a noble social agenda. ■

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