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## **Cooperation, Association and Solidarity in International Finance?**

*Forms of Social Solidarity Investment in Microfinance*

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## Introduction

Can cooperation, association and solidarity – the features of the social and solidarity economy – exist on a large scale in international finance? This paper reviews efforts to build and expand such financial relations through two mechanisms to mobilize financial capital from individuals and social networks in wealthy societies for micro-finance services in low-income and transition societies. The two models are exemplified by Kiva, an internet-based peer-to-peer lending scheme, and Oikocredit, an international social investment network based in networks in the Christian churches. Both encourage not donations but investments by individuals (and in the case of Oikocredit institutions) through funds that use the capital investment to lend to microfinance institutions (and to cooperatives and small businesses).

Markets, including global financial markets, and the values-driven practice of micro-finance intersect in multiple ways, and as micro-finance continues to grow and be seen as profitable under some circumstances, those intersections are likely to grow and become increasingly problematic. Pro-social investment – investment based both on financial and social performance – has made private cross-border finance increasingly important for microfinance. Oikocredit was the second largest private source of finance for microfinance in 2009, and its new investments alone in 2012 were \$265 million. Kiva.org reports loans totaling \$370 million over its eight year history. Loan portfolios in the hundreds of millions USD may be small in the context of global financial flows, but they loom large in the flows of capital to low-income borrowers and savers, which totaled an estimated \$25 billion in 2012.

The possibility of social and solidarity relationships motivating *investment* in this field is significant for several reasons. Investments create a capital stream that is not dependent on donor subsidies. The choice to invest in economic enterprises of the very poor, whether individually or through a fund such as Oikocredit's, opens the possibility of deepening knowledge, empathy and solidarity among investors and borrowers. They may create an enduring institutional framework to mediate these relationships, through religious or secular networks. Finally, they open up the possibility of economically viable financial institutions that build into their operation some of the flexibility and capacity for empathy – characteristics of solidarity relationships – that are important in responding to the economic conditions of borrowers.

I take a broad view of social solidarity. Solidarity across national lines and huge differences in wealth are of interest not for the economic and social benefits for borrowers. But here the investor participates as well, and at best pro-social investment schemes could offer the investor the opportunity to enter into respectful and reciprocal relations with micro-finance borrowers, through investment.

### **The components: microfinance and pro-social investment**

Cooperative credit institutions, especially among the poor and particularly among women, exist in almost every culture. Most commonly known as rotating savings and credit associations (ROSCAs), they allow ten or a dozen individuals to save cooperatively by pooling small contributions from each, monthly, to allow one member each month to receive the collected sum.

Credit and consumer cooperatives, buying clubs and informal labor sharing arrangements are similar expressions of cooperation, and of the SSE. (SSE is understood here to include forms of production and exchange that aim to satisfy human needs, build resilience and expand human capabilities through social relations based on cooperation, association and solidarity (UNRISD 2012), and is also often associated with values of democratic governance and egalitarianism.)

Non-bank financial services for people not eligible for bank loans have expanded rapidly since the 1970s in the form of micro-finance. Microfinance is now an international industry with for-profit, official and NGO participants, standard-setting agencies, growing sets of norms and entrenched ideological camps and debates. Debates over the merits of commercializing microfinance gained wider notice in 2011 when large-scale, for-profit microfinance lenders in Andhra Pradesh, India were subject of exposés revealing excessive lending, indebtedness and catastrophic economic results for some clients.

Microfinance is recognized as a component of some forms of local SSE. Gutberlet (2009) shows how microfinance contributes to solidary relationships among recycling cooperatives in São Paulo. She finds that a microfinance fund managed by women recyclers has given the coops access to capital without the additional costs imposed by intermediaries, and that the availability of capital and presence of inclusive governance structures provide important material benefits.

This paper begins from the premise that such positive contributions are possible in many local and regional microfinance initiatives, and examines the possibility that investors can also be part of relationships built on informed solidarity and mutual benefit. Most microfinance lending is capitalized at least in part by international sources. The mix of official development assistance, charitable sources and savings and investment has shifted over the years. Official aid from bilateral and multilateral donors still provides more than two-thirds of reported cross-border financing for microfinance, with private sources at \$8 billion (33 percent) in 2011 (CGAP, 2012). For several years, private finance has grown at a somewhat faster rate (19 percent/year) than public sources (17 percent/year), and private finance is likely to remain a significant factor.

The forms of private investment have also grown and diversified. Two primary nonprofit forms, microfinance investment vehicles (investment funds of various kinds) and online peer-to-peer investment, are represented by Oikocredit and Kiva.org, respectively. These two exemplars of nonprofit finance are examined and compared to commercial microfinance investing, exemplified here by Blue Orchard Microfinance Investment Managers.

Commercial microfinance investment has implications for microfinance institutions (MFI) (which lend to individual low-income borrowers), and for their borrowers themselves. As commercial for-profit investment funds came to see microfinance as a profitable investment, they increasingly targeted the best-established, most profitable MFIs. The preference for these so-called “Tier One” MFIs is not new – aid donors often showed the same tendency – but it was pronounced as investment managers sought to minimize risk and maximize returns. CGAP, the Consultative Group to Assist the Poorest, reports that 90 percent of international investment in microfinance flows to Tier 1 MFIs (quoted in Grameen Foundation 2012).

This pressure is often thought to affect the mission and orientation of microfinance lenders and borrowers themselves. Capital from an investment fund is less likely than an NGO or official donor to be tolerant of returns that fall short of expectations because a MFI made loans to higher-risk, borrowers. Indeed debt offerings such as the \$40 million Blue Orchard fund involve commitments to place investor representatives on the board of directors of the MFI, to monitor lending and financial practices.

The tension between repayment rates and outreach to very poor borrowers is longstanding, and large-scale private investment intensified the tension and in some cases tipped the balance. Rosenberg (2007) worries that balancing commercial and social objectives becomes harder “especially when there are choices to be made about whether money goes into shareholders pockets or clients pockets?” These pressures – sometimes labeled mission drift – mean that the role of non-profit, poverty-focused investment organizations is now particularly important.

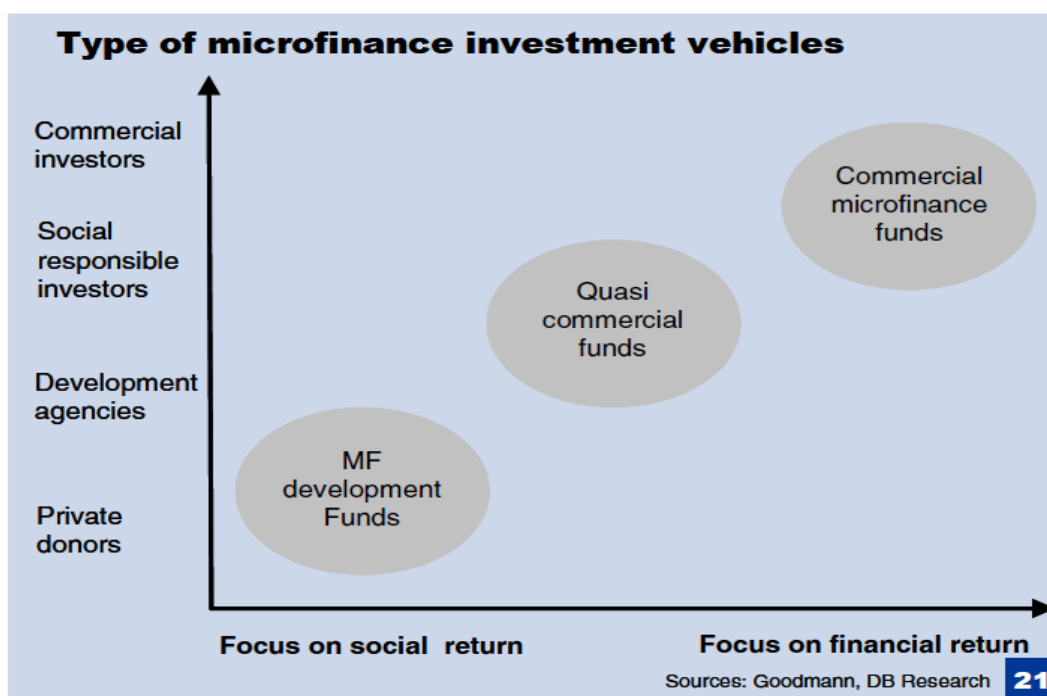
I have chosen two – Kiva.org and Oikocredit – that explicitly aim to establish relationships of solidarity and that have substantial records. The objective is not to compare Kiva and Oikocredit, which have somewhat different functions in the microfinance investment world, but to use the approaches that they collectively offer to illustrate the potential and the actual dimensions of solidarity in these forms of pro-social lending.

### **Pro-social Investment**

The pro-social investment examined here should be seen in context of a larger movement for socially responsible investment, in which investors avoid certain categories of investment (tobacco, weaponry, fossil fuels for example) and/or actively invest in industries they support (organic agriculture, renewable energy).

Private investment in microfinance takes several forms, and typically combines investors’ interests in profitability and security, and concern for social impact or return, in different measures. Dieckmann’s study for Deutsche Bank sharpens the distinctions among types of private microfinance investment vehicles. While all microfinance investors stress the “double bottom line” of social and financial returns, he distinguishes three categories (Figure 1). Large “commercial microfinance funds” put greater emphasis on financial returns than do “quasi-commercial funds,” promoted as socially responsible investing and marketed with a greater emphasis on social impact. The most strongly oriented toward social returns are non-profit microfinance development funds, which “primarily target the development of MFIs by granting capital at favourable financial conditions without necessarily seeking a financial return” (12).

**Figure 1. Pro-social and commercial microfinance funds**



Source: Dieckmann, 2007.

Kiva and Oikocredit both fit squarely in the microfinance development fund category, as do funds sponsored by Accion International, Deutsche Bank itself, and a handful of others: they are nonprofit organizations facilitating investments. Kiva's online individual-to-individual lending format has attracted journalistic and scholarly attention, and published studies already examine the effects of groups-formation among prospective lenders on loan size and frequency (effects are minimal); and test laboratory findings about altruistic behavior, by asking whether lenders prefer borrowers who are socially proximate, of the same (or different) gender, and even have the same first name or initial (Galak, Small and Stephen, 2011). Roodman's (2009) essay succeeds in showing that Kiva's claim that investors choose and invest in an individual is not strictly true – Kiva in fact allocates funds to a proposed entrepreneur, then collects investments that keep the capital flowing – but he also argues that Kiva's actual practice is superior to the public image of how investment works.

**Figure 2. Kiva.org and Oikocredit**

	<b>Size, scale</b>	<b>Social performance</b>	<b>Online presence</b>
<b>Kiva.org</b>	HQ San Francisco Founded 2005 110,000 loans, total \$89 mn. \$399 average loan  Investment: minimum \$25; average \$703. Average: 9.39 investments per individual.  83 full time staff, 12 in field	Kiva loans are managed by the “field partners”, MFIs who post individual entrepreneurs’ profiles on the Kiva website	The foremost online peer lending platform; an online loan is made on its website every 22 seconds on average.  Encourages donations as well as investments; gifts cover staff costs, so all investments go to borrowers.
<b>Oikocredit</b>	HQ Amersfoort, Netherlands Founded: 1975  45,000 investors, 267 loans*  222 full time staff 36 regional or country offices  36 support offices or associations	Emphasizes its involvement in social performance standards  project partners sign and adhere to Smart campaign standards.	Online investing possible through MicroPlace; online recruitment is not a significant factor.  Accepts donations but does not encourage; pools donations to purchase shares

\* Oikocredit loans are to Microfinance Institutions (and credit unions) not to individual borrowers, and they average E 825,000 (USD 1.08 million). MFIs in turn lend to hundreds or thousands of individual borrowers, so loan figures are not comparable to Kiva’s. See estimates of number of individual borrowers supported.

### *Kiva.org*

Founded in 2005 by Matt and Jessica Flannery, allows individuals to lend to an individual borrower of their choice, chosen from profiles on the Kiva.org website. Minimum loan is \$25, and a loan request can be fulfilled by contributions from multiple, unrelated lenders. Kiva recruits its individual borrowers from established micro-finance lenders (Kiva’s “field partners”), who also handle management, oversight and repayment of the loan once funds are available.

Kiva reports that almost 850,000 lenders have made loans totaling more than \$370 million in 66 countries. For micro-finance institutions, then, Kiva is an opportunity to bring capital into their

operations and make loans to specific borrowers. To more than 850,000 lenders to date, Kiva is an opportunity to lend (at zero interest), rather than donate, and to allocate funds to an individual, rather than to an organization or program. Kiva affirms this prominently in its mission statement: Kiva exists to “connect people through lending to alleviate poverty” (“About us”).

Kiva is perhaps the best known of a several websites offering altruistic peer-to-peer lending, but other initiatives offer opportunities within the United States (Prosper.com, Solidarity). Trickle-up and Global Giving both offer guidance and services to prospective donors. In 2009 Kiva created a mechanism that allows allowing individual lenders to affiliate in “lending teams,” and cooperate to make a loan as a group. Hartley (2010) shows that the group (school groups, church members, friends, family) experience has been mixed, with little evidence that the psychology of group lending has led to more or larger loans.

### *Oikocredit*

Oikocredit, established in 1974, has \$656 million in loans outstanding as of November 2012, most to microfinance institutions, credit unions or cooperatives. Founded as an agency of the World Council of Churches, as the Ecumenical Development Cooperative Society, Oikocredit is now an independent agency headquartered in the Netherlands. In 2013 it reports 48,000 investors worldwide, 3,000 of them new investors in 2012 (Oikocredit.org).

Oikocredit promotes and markets its “ethical investment alternative” through networks of national offices and national and local volunteer “support associations” across Europe and North America. It leaves no doubt that it sees investing as more than solely a financial decision, calling itself a “worldwide movement of investors”: “Oikocredit is about people investing in people. It is a ... worldwide financial cooperative that promotes global justice by empowering disadvantaged people with financial inclusion, and a worldwide network of investors who make it possible” (Oikocredit, 2013).

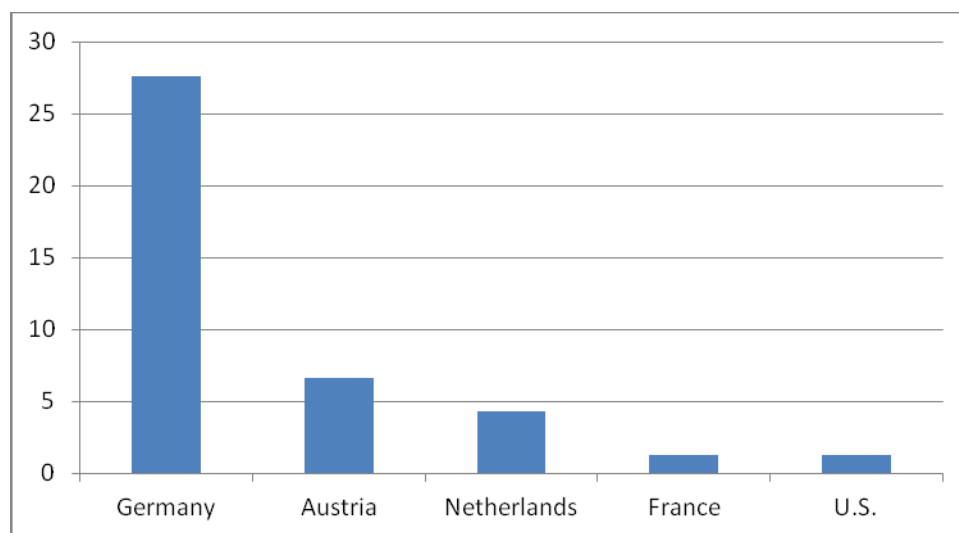
Structured as an international cooperative, the flow of finance and services in Oikocredit begins with investments by 48,000 investors, of which 595 were cooperative members in 2012. New investments totaled USD 256.5 million in 2012; it has made 2632 investments in its history, working with 854 partners. National offices and volunteer “support associations” in Western Europe and North America work to raise investment capital. Lending that capital, monitoring social performance, communication and other functions are led by an international headquarters office in the Netherlands and supported by 42 national and regional offices.

Oikocredit lends to its “partner institutions,” primarily microfinance institutions but also credit unions and cooperatives. We will focus on microfinance institutions, which borrow capital primarily in order to re-lend to individual small borrowers. In 2011 these project partners lent to a total of 26,000,000 borrowers. Oikocredit chooses these project partners to balance financial security with the desire to support new institutions that are reaching more marginalized borrowers. To increase its emphasis on “mission-driven MFIs”, it has a multi-year commitment to prioritizing lending in agriculture, lending to small and medium enterprises, and lending in Africa (Annual Report 10-11).



Who invests in Oikocredit shares? Western European investors are greatest in number and total investments: Figure 4 shows the top five countries in number of investors and net investment inflow in 2011. Oikocredit has had greater success winning very large institutional investors in Europe, but US and Canadian affiliates have recently seen rapid growth in investments.

**Figure 3. Top five Oikocredit investing countries, 2011**  
Net inflows, in millions of Euros



**Source: Oikocredit (2012).**

Volunteer Support Associations are responsible for recruiting significant investments in all the investing countries. Some of this investment, and the development education work that supports it, is done on a face-to-face “retail” basis through individual presentations in churches and civic organizations. Institutional investors – pension funds of religious orders, hospitals and other institutions, individual houses of worship, and other religious bodies – account for many of the largest investments and are often recruited by staff of national offices.

#### *Commercial microfinance investment: Blue Orchard*

Blue Orchard Microfinance Investment Managers, based in Switzerland, is “a leading commercial microfinance investment manager, ... provid[ing] funding to microfinance institutions (MFIs) since 2001” (<http://www.blueorchard.com/jahia/Jahia/pid/20>, accessed April 22, 2013). A financial services company specializing in microfinance investing, it offers a variety of financial products for investors, provides financial services to MFIs themselves, and reports in 2013 that it has funds worth more than \$800 million, providing capital to MFIs.

Although it is a commercial investment fund it shares concerns with Oikocredit and others about practices in microfinance: Blue Orchard is, for example, co-sponsor with Oikocredit of a 2013 report about causes of over-indebtedness among microfinance borrowers in Cambodia, and maintains staff charged with monitoring social impact. Diverse investment funds and products

and Blue Orchard’s due diligence and close monitoring of its partners, “the world’s leading microfinance institutions,” produces “a win-win investment that delivers stable and competitive financial returns and achieves socio-economic development in emerging markets by encouraging entrepreneurship at the micro level.”

Conning and Morduch describe the workings of a \$40 million Blue Orchard Fund, and I quote them at length because the risk dynamics are important for our understanding of the nonprofit alternatives. The 2004 debt issue, called Blue Orchard MF Securities I, provides diverse risk and investment options:

Ninety investors pooled money that supported nine micro-lenders. The deal involved five tranches, with varying returns and risk. In the most subordinated position was an equity tranche. Above that were three subordinated tranches priced at the return on US Treasury plus 2.5 percentage points. These tiers were taken by social investors, foundations, and non-profits, many with a strong international presence. In more privileged positions [i.e., with less risk] were senior notes earning US Treasury plus 1.5 percent with a 75 percent guarantee from the Overseas Private Investment Corporation, a US government agency. Here the investors ranged from individuals to pension funds. The deal allowed institutions in Cambodia, Russia, Peru, Bolivia, Nicaragua, Ecuador, and Colombia to reach more under-served—and allowed a large group of socially-minded investors to avoid taking much risk Conning and Morduch, 18).

### **Microfinance, investment and the elements of social solidarity economy**

Pro-social investment funds by definition have two sets of purposes: to mobilize capital for positive social objectives, and to permit investment and savings. In this context, how can we assess the contributions of microfinance investment to building institutions of a social solidarity economy? I propose five broad indicators in addition to the widely-discussed indicators of social performance – gender impact, debt management and client rights and protections – which are subsumed in the fifth indicator (influencing the industry).

These broad indicators emphasize the creation of enduring cooperative and solidary relationships and institutions. Some of these indicators are economic in nature (risk sharing and distribution), others social (knowledge and intention, institution-building), and some relate to governance. Collectively, they provide a means of assessing what elements of social solidarity are present in microfinance investment, and of refining or testing our understanding of social and solidarity economy at the transnational level. In the following pages I use publically available information from Oikocredit and Kiva.org to begin to answer the questions implicit in these indicators.

#### **1. Risk-sharing and responsiveness**

Investors typically seek to balance security with returns on investment, and will often sacrifice higher potential returns in order to gain security, as in insured bank deposits or treasury notes. Borrowers, in most transactions, bear most or all of the risk, with lenders protected provided by physical collateral or other arrangements. (Lending under Islamic finance law is an important exception, in which transactions must be structured so that lenders share the risk.)

Microfinance schemes distribute risk in a variety of ways, including by organizing groups of borrowers who provide a kind of social guarantee of repayment, and by choosing borrowers carefully to balance risk against security of revenue flows through repayments. Microfinance repayment rates are famously higher than many conventional bank loans, often above 95 percent.

In lending for microfinance, solidarity entails accepting risk. Pro-social funds for microfinance and lending to other small- and medium-scale enterprises have in general been very safe, but are uninsured. Investments in Oikocredit and through Kiva.org are not guaranteed or insured. While Oikocredit has consistently paid dividends and repaid principal since 1974, investments of this kind entail some risks, and when individuals or houses of worship invest substantial portions of their savings, endowments or pension funds in such a fund, they weigh this risk.

Kiva.org also advises prospective investors that investments are not guaranteed, though the organization emphasizes the historic 99.01 percent repayment rate. Its “Risk and Due Diligence” statements specify that because much of the vetting of individual borrowers is done by field partner MFIs, risk is distributed unevenly across investors. That is, an investor whose chosen borrower defaults bears that individualized risk, rather than the risk and loss being spread across a lending portfolio.

I identify three specific factors to assess risk-sharing:

- Willingness to provide equity investment
- Willingness to provide local currency loans, bearing the risk of currency value fluctuations;
- Willingness to absorb costs associated with natural disaster.

(a) Equity investment and forms of loan guarantees entail costs and risks for the investor, and their presence is an indicator of a solidary approach to risk. Most private finance for MFIs comes as loans, but some MFIs express the need for equity financing, in which the investor buys a minority share in the enterprise. Equity lending has several advantages for the MFI: it provides a permanent financial partner, a source of capital that can be used for organizational expenses, and sometimes makes it possible to secure other loans and investments by making the investor a partial guarantor of loans. Equity investment ties up investment capital, and when an organization such as Oikocredit agrees to begin expanding equity investments in partner agencies, it is seen as a commitment to the partners’ long-term growth and strength.

Oikocredit’s total equity portfolio is some \$45.7 million, 6.7 percent of its nearly \$680 million portfolio (Oikocredit 2012). Most of Oikocredit’s equity portfolio is in microfinance institutions, but it has also purchased minority shares in fair-trade and renewable energy enterprises. Its equity investments are geographically diverse, but the largest number (16) are in Africa. Kiva recruits only debt financing (loans) from its investors; its function is to bring individuals into microfinance investing by setting the threshold very low and giving investors the choice of individual enterprises.

(b) Risk associated with fluctuating currency values: more than 70 percent of all international debt financing is in hard currency, a practice that exposes the MFI to risks associated with the changing values of currencies. Loans made in the national currency of the borrowing MFI place this risk on the lender. *Local currency lending* is an option for Oikocredit but not for Kiva.org, all of whose loans are in US dollars. Oikocredit's shareholder members first authorized such local currency transactions in 2007. The cooperative also maintains a local currency risk fund, approximately 36,000 E in 2011, funded by donations and other sources as a protection against these risks (*Annual Report 2011*, 45).

(c) Recent experience suggests a third indicator: willingness and ability to work with MFIs to absorb costs associated with natural disasters or extreme market failures. Borrowing MFIs occasionally confront situations that make it virtually impossible to repay – in the aftermath of a natural disaster, or at wartime, for example (Briceno, 2005). After the Haitian earthquake in 2010, Oikocredit and other lenders refinanced their loans to Haitian MFIs, so that the MFIs could restructure or write off loans to individuals whose lives and businesses were devastated, and be ready to lend in support of recovery and reconstruction. (In the Haitian case, the fact that Oikocredit was an equity investor – part owner – of the MFI *Fonkoze* facilitated decision making in the post-disaster period.)

## 2. Knowledge and intention

Solidarity entails understanding and awareness of other actors, and social investment that capitalizes microfinance and builds solidarity will feature investors who are aware and actively supportive of the uses of their capital. This places a substantial focus on the intentions of investors, some will object (correctly) that this is less important than the economic and social effects of microfinance activities on borrowers.

In examining the possibility of finance that creates solidarity relationships between investors in rich societies and users of micro-finance (mostly) in poorer societies, *knowledge* and *intention* matter. This premise is subject to debate: who cares what the wealthy investor in Chicago or Stuttgart knows, as long as his/her capital is enabling microfinance lending on terms and with institutional arrangements that are advantageous to the borrowers? The answer in principle is that each individual's awareness is of value and that a genuine effort to be in relationship with a far-removed neighbor is a step in the development of that person's human capabilities. In this sense, developing social solidarity is a process of developing the awareness and deepening the humanity of rich as well as poor people.

The more practical answer is that investment with awareness is more likely to remain available, longer term, when conditions that make investing in microfinance funds advantageous change. For most of the period 2010-2013, for example, Oikocredit's available two percent return on investments are competitive, and far better than the most secure investments in banks or US Treasury notes. When interest rates for other investments eventually rise again, the investor who was attracted by the mission of microfinance, and developed a deeper understanding of it, is more likely to remain an investor rather than moving for higher returns.

Knowledge and intention might best be assessed by direct interviews with investors. This paper takes a more preliminary first step by examining how the agencies characterize their investments, and how they educate investors and others.

Oikocredit, with a face-to-face outreach strategy and strong commitments from some Church bodies, particularly in Western Europe, carries out vigorous education and outreach aimed at deepening the knowledge of volunteers and investors, and educating a broader potential investor public about microfinance. Initiatives in 2011 included a study tour to Guatemala for investors and others, speaking tours in investor countries by staff and field partners, and media outreach including advertising in widely-read religious periodicals. The Oikocredit Academy provides training in outreach and communication twice a year, and sponsors study tours, lecture tours by staff of borrowing partner agencies, and other means of informing the potential investor public.

Kiva.org presents investors and prospective investors with a wealth of materials on its website, including a lengthy essay on microfinance, resources on understanding social performance of loans, and other materials. Kiva also recruits and supports unpaid Kiva Fellows every year. Fellows are placed with a microfinance institution and provide training and communication services, while gaining personal (and sometimes professional) experience.

### **3. Sustained participation**

An investor who opts to renew a certificate, to make a new investment or loan, or to increase his/her investment demonstrates a high level of commitment. Two concrete measures of sustained participation are available: the duration of loan (how patient is the capital?) and the presence of repeated investments, or decisions to renew existing commitments. One of the signals of economic anxieties during the recession of 2008f was the growing number of “redemptions” of investments by investors who chose not to renew.

Oikocredit refers to its financial role as providing “patient capital,” loans to MFIs that are relatively long-term (4-5 years). Kiva’s individual investments are generally shorter-term, but its arrangements with field partners have been enduring. This section is based on only partial information about the behavior of individual investors associated with the two.

Kiva presents an interesting question: can internet-mediated relationships inspire the kind of loyalty and commitment that face-to-face networks such as Oikocredit have managed across the decades? In addition, the case of Oikocredit suggests a second issue: can the personal empathy that motivates an individual to invest in support of a single person be sustained and grown on a large scale when institutions intervene and the appearance that one can invest in a single individual or enterprise is absent?

Data about repeated investments is readily available only for Kiva, which reports that the average investor makes 9.39 loans.

### **4. Group and institution building: democratic participation and decision-making**

The issues of group formation, institution-building and governance arise on both ends of the investment transaction. Many microfinance schemes rely on group lending, under which peer pressure functions to keep repayment rates famously high. Few microfinance transactions build permanent institutions at the community level, though small-scale lending has encouraged the creation of cooperatives. Many pro-social investors are individuals; others are institutions (pension funds, others); a few actively encourage the formation of groups, either local or virtual, and (in the case of Oikocredit) rely on local and national groups and on a global system of governance by members in a cooperative structure.

At the regional and even global level, microfinance has also led to the formation of significant self-governing institutions. Grameen Foundation, created to support and promote the work of Bangladesh's Grameen Bank, encourages adoption of its lending methods. Regional federations of MFIs have become standard: the South Asia Microfinance Network, for example, is governed by a board of its seven national MFI members.

As a cooperative, Oikocredit has a distinctive international self-governing structure, which also encourages deepening participation by volunteers. Members of the international cooperative own shares in Oikocredit, and vote at Annual General Meetings on organizational policy questions, to elect board members and to ratify policy decisions by staff. Group formation occurs at another level in Oikocredit, where individuals participate in support associations formed at local levels to promote investments. Interestingly, Kiva has sparked several studies of online group formation and its effect on investment, but similar research on Oikocredit's face-to-face group formation has yet to be done.

Forming identity-based lending teams is not a form of democratic self-governance, but it is a way of building social capital and leveraging that social capital to encourage lending. At Kiva.org groups allow members to "connect with each other and rally around shared goals." Groups (some open to new members, some closed) are local, family, professional, regional, and the two perennial leading groups are "Kiva Christians" (11,000 members, 197,000 loans) and "Atheists, Agnostics, Free Thinkers and Skeptics" (25,000 members, 366,000 loans). Hartley (2010) reports on group lending dynamics among groups of different size, identity factor, and between open and closed membership groups. He does not report on the question most of interest here: do team members invest differently than non-team individuals?

We can approximate an answer by reporting average size and number of investments for some leading teams, and for Kiva investors as a whole. "Christians" and "Free Thinkers" members have averaged 17.8 and 14.5 loans per member, respectively, compared to 9.39 for all investors. Is the team dynamic simply encouraging multiple small investments? Possibly. The average individual loan by Kiva investors is just under \$50, the average per "Christian" \$35, per "Free thinker" \$29. If group members lend more frequently (Hartley shows that they do), and if teams help to recruit investors, then the lending team construct is a positive one for Kiva.

## **5. Influencing the industry: non-profits and the mission of micro-finance.**

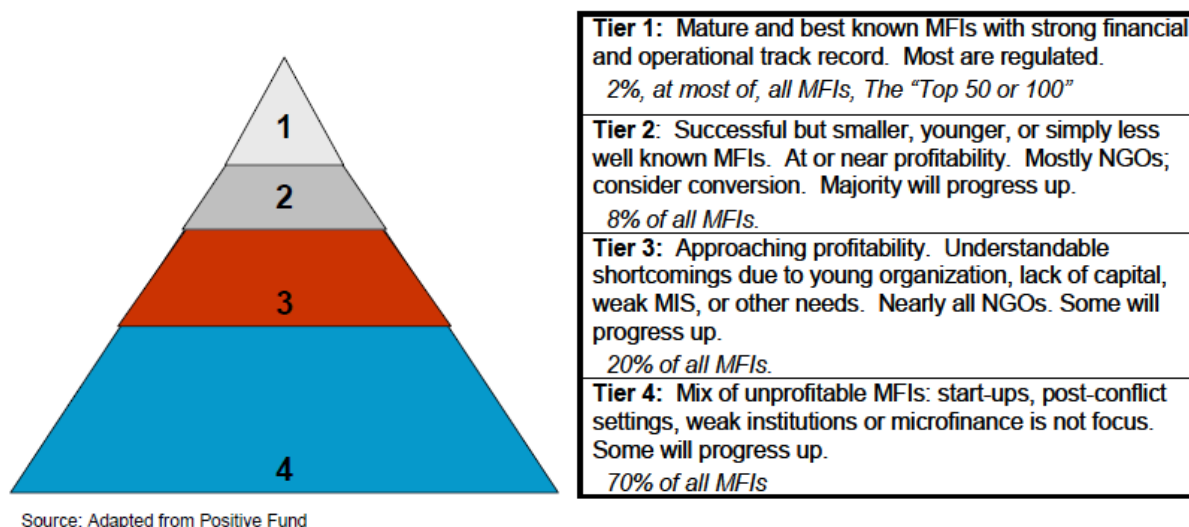
Commercial microfinance lenders have come under criticism for marketing loans and allowing some clients to go more deeply into debt than is prudent. Commercial private investment in

microfinance is sometimes seen as a driver of this kind of lending, and nonprofit microfinance investment vehicles (MIV) face what may be a critical challenge, to invest sustainably while helping set clear standards for client protection and social impact/performance, and pull the microfinance industry toward compliance. We examine nonprofits' role in the standard-setting process and their record as investors in less-established, riskier and capital-starved "second and third tier" microfinance institutions.

In recent years the microfinance community has been rocked by revelations of the impact of large-scale commercial micro-lending in South Asia and in Mexico. Reporting of unscrupulous lending practices by for-profit microfinance lenders, of extreme levels of indebtedness among poor farmers who had been encouraged by borrow repeatedly by agents of the banks, led to widespread skepticism about microfinance. The dramatic growth and profitability of the Mexican MFI *Compartamos*, which launched the industry's first public stock offering in 2008, further fueled the debates over social mission, profitability, and the future of privately-financed microfinance lending.

Here the role of mission-driven non-profit MIVs such as Oikocredit becomes important. Much of the rapid increase in private investment in microfinance was driven by the rise of a "tier" of successful, profitable, and secure micro-finance institutions. These "tier one" MFIs make up perhaps only two percent of the total number of MFIs, but they attract a great deal of capital (Meehan (2004) estimates 90 percent), whereas Tier 3 and 4 MFIs have no access to financial capital (see Figure 4).

**Figure 4. Four "Tiers" of Microfinance Institutions.**



**Source: Meehan (2004) p. 7.**

The profitability of these Tier One MFIs attracted finance capital into the microfinance industry in the early 2000's, and drove the growth of for-profit MIVs (Dieckmann, 2007; Ming-ye,

2007). The rapid growth of for-profit micro-finance and the challenges it poses to the credibility of microfinance as an enterprise mean that upholding and strengthening the social mission of microfinance has been doubly important, to the social and economic impact of microfinance and to public perceptions. For-profit lenders have provoked serious concerns about the interest rates charged by some MFIs, aggressive marketing of loans to clients who may already be in significant debt, and the need for stronger client protections and standards for MFIs.

Microfinance institutions and some nonprofit investment vehicles have taken steps to reinforce social performance and public and investor perceptions, and Oikocredit has been actively involved. The most prominent package of client protection standards, launched in 2013 as a vehicle for certifying MFIs, is led by the Smart Campaign, “a global movement to embed a set of client protection principles deep within the microfinance industry” (Smart Campaign 2013).

Complementing these standards, Grameen Foundation and Oikocredit have been among the leaders creating and implementing measures for monitoring and reporting social performance, and for measuring concrete material benefits to borrowers, through the Progress out of Poverty Index.

## **Conclusions**

A preliminary paper like this one produces few hard conclusions. Beyond identifying several strategies for research and action, it is possible to make three points definitively.

First, investment in microfinance can create conditions for solidarity relationships that extend from investors in North America or Europe to borrowers mainly in the global South. There is reason to believe that many investors through Kiva.org and Oikocredit are motivated by a desire distinct from charity, to transform economic possibilities by committing resources of their own. Whether this is true or not in particular cases depends a great deal on how MIVs perform as institutions: how they market, mobilize, educate potential investors, and on the quality of financial regulation within the microfinance industry and in the countries where it operates. And nonprofits make up a significant minority of cross-border private microfinance investment. A next step in assessing investment will be a closer look at commercial investment vehicles.

Second, while knowledge and awareness on the part of investors may be significant, the quality of financial institutions has a major impact on outcomes. The relatively ineffective oversight and regulation of commercial MFIs in Andhra Pradesh allowed market forces to make microfinance an economic trap for some borrowers. On the supply side, the very extensive private investment from Germany (see Figure 4) is driven by effective and well-known bank-managed investment funds. Deutsche Bank’s commercial microfinance investment funds have been joined by the new GLS Bank, a “social and ecological” bank that is further expanding pro-social investment among Germans (Oikocredit 2012).

Third, the issue of scale, and of the possibility of rapid growth to meet financial needs of more of the 2.5 billion people without adequate financial services, poses enormous challenges. The present modest growth of investment for microfinance (19 percent last year) would have to accelerate dramatically to expand services significantly. But periods of rapid growth have



presented regulatory challenges and been associated with serious abuse as in Andhra Pradesh. Research that examines other periods of rapid growth in MFI lending could help to clarify the conditions that allow growth without serious problems.

Microfinance faces real challenges in the decade ahead. But its expanded investment base, newly reinvigorated self-regulation efforts mean that it should also be seen as a key component of strategies to build social solidarity economies.

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