

Labeling Microfinance as Socially Responsible Investing: What's the Risk?

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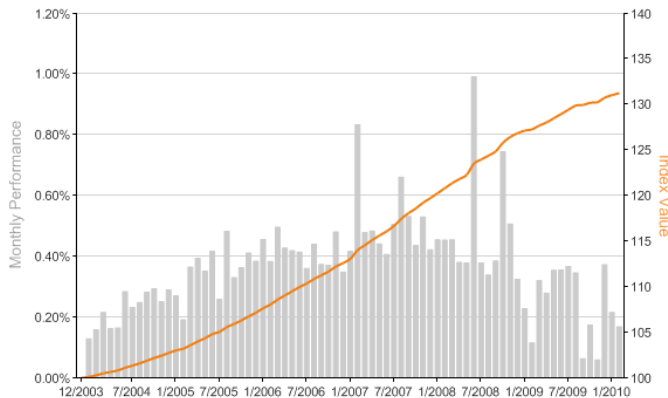
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In the wake of the worst financial results in 60 years, microfinance became one small bright light attracting attention from investors who would not normally venture into such street level economic activity. As Microfinance institutions (MFI) have matured and sophisticated information and communications technologies have become widely available, data about MFI's unique risk/return characteristics has percolated upwards. Industry associations have morphed into professional services providers and intermediaries providing indexes, benchmarking and rating services for the investment community have cropped up to keep pace with the demand for information about this emerging financial sector. While the overall size of microfinance activity is small, the potential market of the "unbanked" is estimated at 2.8 billion people, half the world's adult population (CGAP, 2009).

SMX USD - Symbiotics Microfinance Index - U.S. Dollars



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While the jury is still out on final impact of the financial crisis on MFI's, positive reports continue to garner interest from both mainstream financial media and the investors they serve. The Symbiotic Microfinance Index (SMX USD) reports 2009 yields at 3.21% and a volatility rate of .54%, microfinance investments continue to represent an intriguing alternative investment class.

What has become clear is that a global, albeit diminutive, microfinance industry has materialized from what was previously a loose collection of far flung grassroots organizations. No longer is the primary issue the struggle to find funds to support their operations, MFI's and investors are now confronted with an increasing complex array of options ranging from venture capital and private equity to networked peer-to-peer lending platforms on the internet.

These funding sources are both a blessing and a curse to MFI's. A diverse and ready alternative source of funding can extend the reach of MFI's providing much

needed financial services to the poor. But on the other hand, the culture of commercial investment organizations is not an easy fit with the traditional social agenda of the microfinance community that advocates poverty alleviation, empowerment for women as well as a number of joint issue specific activities including AIDS, education and health. Much has been written lately in the press about the inherent conflicts in microfinance funding and operations (New York Times, 2010). There is potential for abuse at both ends of the funding chain – loan recipients charged excess interest rates and onerous loan conditions and donor money being used to fund overhead while investors are rewarded with above market returns.

Microfinance Investment Vehicles (MIV) are generally marketed under the rubric of Socially Responsible Investments (SRI). Not a large share of the overall market, SRI is the stepchild of the mainstream investment fund family. It is relatively easy to construct portfolios that address the demand for investments that eschew the production and distribution of tobacco, alcohol, and firearms and even to include investments with more subjective attributes such as green operations, fair trade, equal treatment, etc.

Microfinance SRI stands out as a more complex case. Because the activities of the organizations in which these funds invest are financial entities themselves, there exists the significant potential for the profit motive to overtake the social objective. Indeed, just because the loans are small and the clients are poor does not in and of itself assure that MFI activities promote social good.

Even with allowances for different regional circumstances, there is substantial latitude in interest rates charged to MFI clients. The range is wide and is on bounded on the high end by the going rate for informal loans in the neighborhood and on the lower end the rate that is essential for the long-term sustainability of the MFI. While NGO and government agencies have included loan covenants and monitoring requirements in their contracts with MFI's to control for abusive practices, it remains to be determined whether commercial funds will follow suit.

Research Focus

The purpose of this qualitative study is to explore the identity and disclosure messages presented on the web pages of organizations that market MIV's. Specifically, the focus is to document and describe the range and content of marketing material with regard to social responsibility and social performance. The study scope is limited to the content of the organizations' web pages as presented on their sites.

The sample frame are the firms classified as funders on the Microfinance Information Exchange (MIX) at <http://www.mixmarket.org/funders>. MIX lists 93 Funds and 20 financial institutions for a total of 113 funding sources. Closer examination reveals interconnections between many of the funders and between the funders and the banks, with funds acting as investment managers for banks, multiple funds managed by umbrella organizations and partnerships between

banks and funds, so the total number of actual discrete funding organizations is much lower.

Data collection and analysis is iterative, ongoing and framed by the constant comparative method and grounded theory (Glaser and Strauss, 1967) (Glaser, 2002).

Analytical Framework

As is sometimes the case in exploratory research, the initial data that has emerged from the setting has quickly indicated that the original study design is inadequate to detect the true nature of phenomenon under study. What was originally conceived as a relatively straightforward content analysis design requires three separate data collection pathways:

1. Tracking of embedded threads and conduits within the websites.
2. Mapping the actors and interconnections among funders.
3. And, finally, content analysis of the messages within the frameworks created in the above two pathways.

Data collection and analysis continues along all three pathways, however some preliminary findings and conclusions have emerged.

1. Tracking Threads and Conduits - From Website to “Webpresence”

Some of the organizations in the sample use a relatively simple paradigm of presenting information in the style and format used in print communications only

slightly modified to take advantage of the Internet's superior graphic capabilities. Other organizations are taking full advantage of the interactivity and social network functions that are radically changing marketing processes and corporate identity messaging. This emerging paradigm shift is not exclusive to microfinance by any means; on the contrary the change is pervasive in all sectors of the economy and in social life. The concept of a static, fixed and asynchronous web site is becoming an anachronism as widespread high-speed Internet capabilities lead to ever increasing potential for interactivity and synchronicity.

From Web Pages to Web Presence

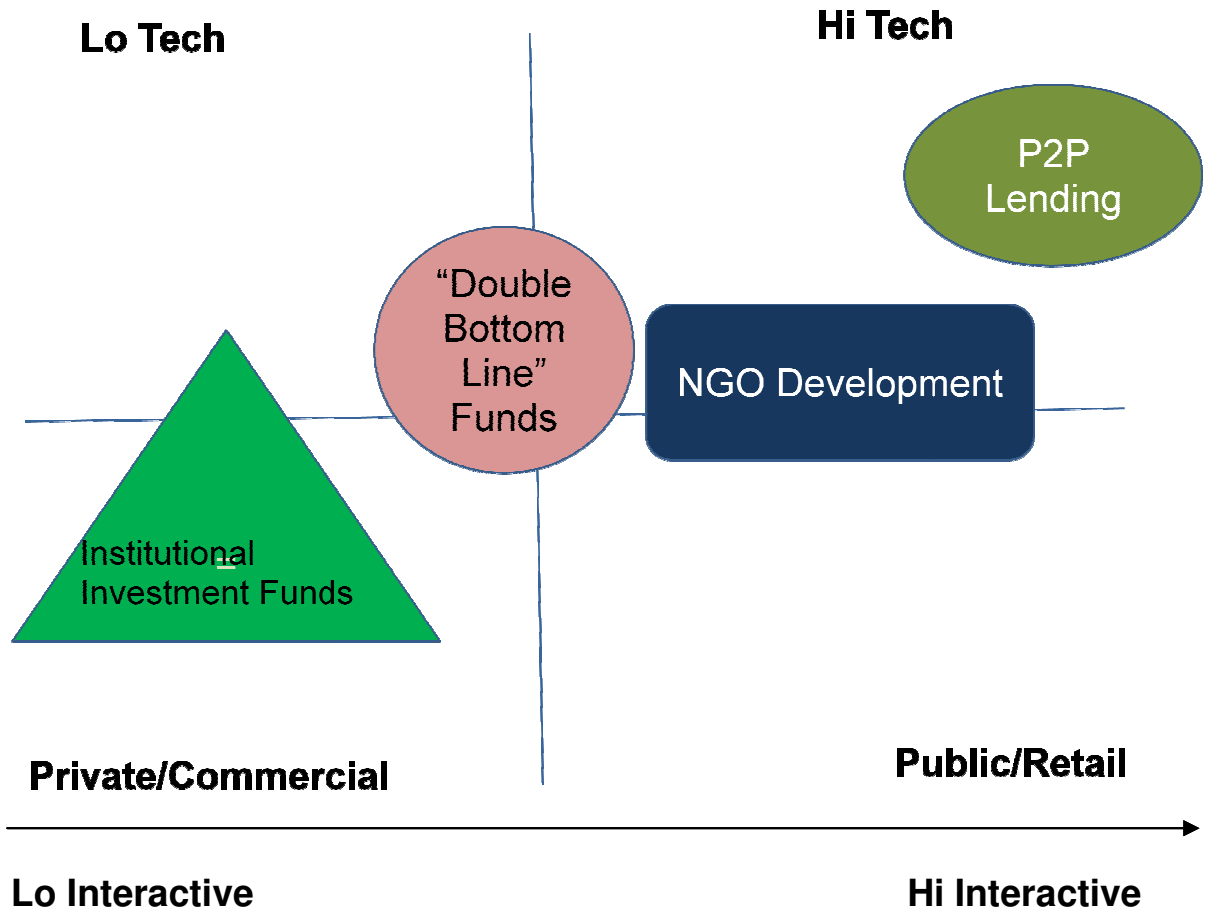
	Web 1.0 - Web Pages	Web 2.0 - Websites	Web 3.0 - Web Presence
Capabilities	Read	Read Write	Individualization
Organizational Objective	Inform "Presentations of Self"	Monitor "Image Control"	Create "Interest Group Management"
Content	Public Relations	"Define or Be Defined"	Promote Community
Tools	Text Graphics Video	BLOGs Social Networking	Synchronicity Virtual Reality Semantic Web

This evolution appears to have as yet unclear but important implications for how organizations manage transparency and disclosure. And, it became clear early in the course of this research that a significant amount of effort would need to be spent merely understanding and documenting how funders are using the Internet.

The scheme that has emerged organizes the data along two dimensions, the degree of technical sophistication within the website and the amount interaction between the website and stakeholder communities. Because the concept of web presence has only recently surfaced, it is too soon to tell whether position along these dimensions is a conscious strategy or whether the organization has simply not yet focused on determining the optimal use of its web presence. However some interesting trends do seem to be emerging:

- High technology/high interactivity does not appear to be related to increased disclosure and transparency, however it does appear to be related to securing funding in organizations soliciting donations or promoting peer-to-peer lending.
- Significant efforts to build community were observed in sites where the funder model includes donations.
- All sites made use of PDF files for many legally required disclosures such as prospectuses and many used agreement to terms and conditions functions to control access to more detailed financial information.

Microfinance Funders Web Presence

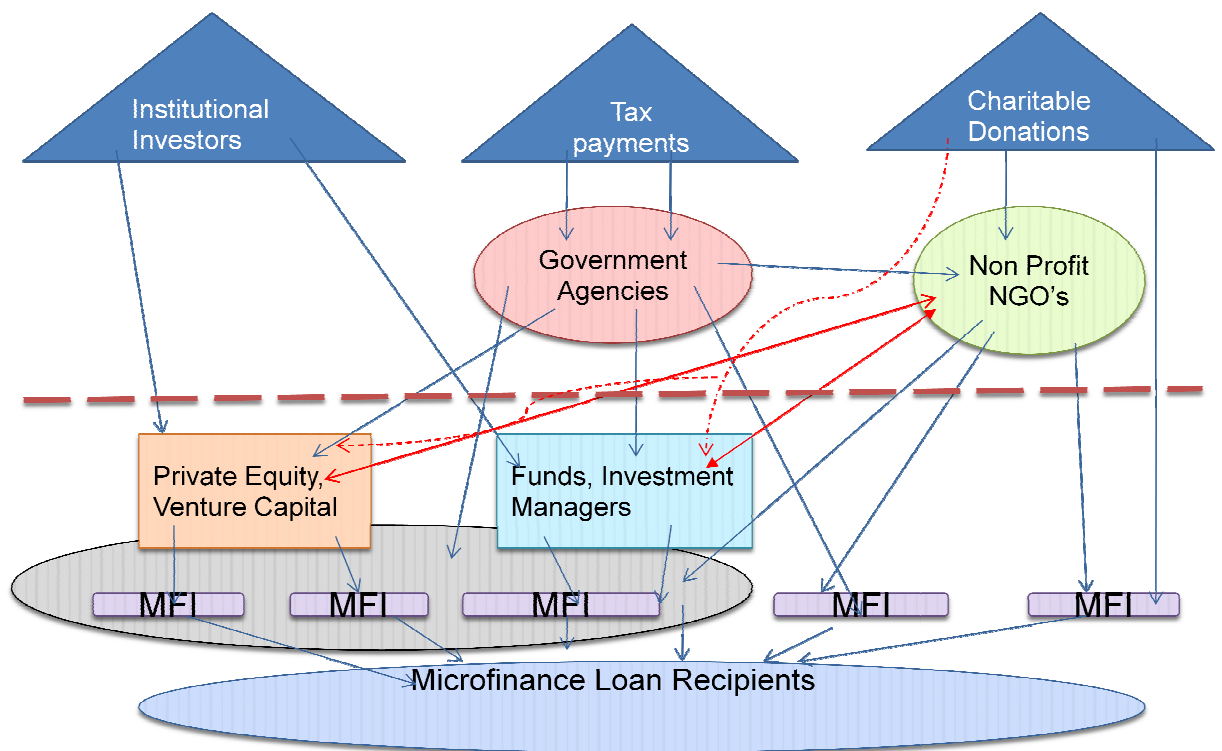


While Web 2.0/3.0 has the promise for rich, detailed and individualized communication between investors and funding opportunities, the complexity also creates the capacity to obscure and obfuscate in ways that were previously not possible.

2. Mapping the Connections - Who Funds? Unraveling the Web

The world of microfinance funding is a complicated maze of banks, government sponsored agencies, charities and investment managers. Closer examination of website content revealed the high degree of overlap amongst and between the various actors funding microfinance institutions. So the second pathway that emerged in the study was a need to map these interconnections. Funding sources are a unique combination of institutional investors, government aid and charitable organizations and individual donors.

Flow of Funds to Microfinance Institutions (MFI)



Funds from institutional investors that flow directly to investment managers that serve as intermediaries with the MFI and Tax payments that flow to government

agencies which are in turn used to promote economic development and social agendas are relatively uncomplicated. The relationship between the commercial sector and the philanthropic community is less clear.

3. Message Content: What Are They Saying?

The following is a very preliminary discussion of the content on the websites and should not be construed as definitive or generalizable. The following are some substantive preliminary “finds” among the data that are serving to guide further data collection and analysis deserve mentions.

- There appears to be a remarkable consistency in the home page formats and messages regardless of the type of fund. Mission statements and messages regarding investment strategy are usually present. Graphics are predominately pictures of women in native dress in the process of carrying out some activity that might be construed as their microloan related work. At first pass, the uniformity is notable and the content indistinctive.
- A portion of the funds websites included pages with statements on their own values regarding CSR and the management of the organization and responsibilities towards employees, clients and stakeholders.
- A small proportion of those websites then extend their statements to include their expectations for CSR in the MFIs in which they invest. How

ever these statements do not extend beyond the management of the MFI itself.

- Even smaller proportions of the sites make mention of the MFI's responsibilities towards its clients and the statements are general in nature.
- To date the data collection and analysis has uncovered only one fund website that states they adhere to PRI although a cross check of the PRI Signatories list does indicate that several of the larger financial institutions with microfinance activities are signatories. One other website states that they follow the CGAP Client Protection Principles in Microfinance.

The lack of specific information regarding the funds' investment management activities and how they assess MFI business models, interest rates and loan conditions that is easily accessible and transparent is noteworthy.

Also significant were instances uncovered that appear to be deliberately obfuscating the salient CSR issues.

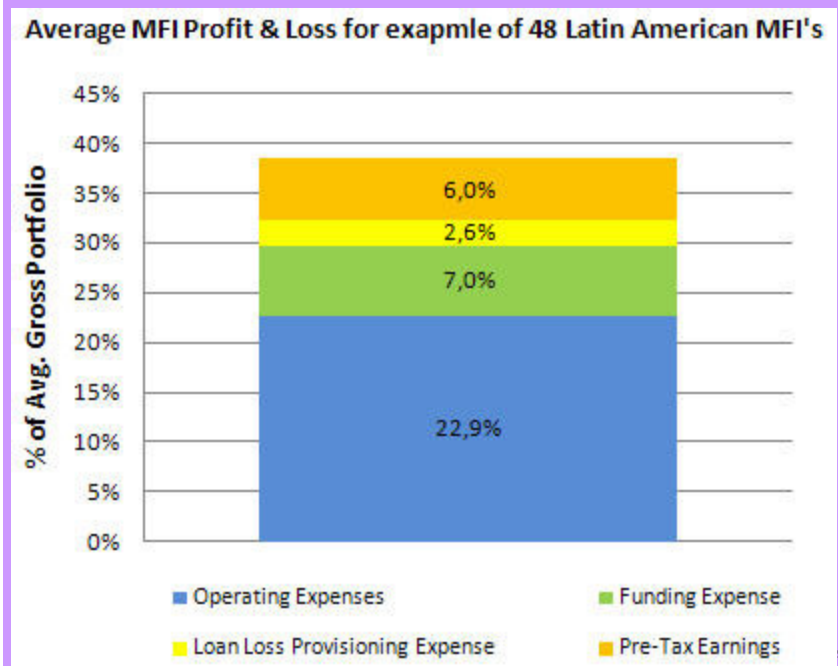
- *Regarding to MFI interest rates charged to their clients.*

For example the following section is quoted directly from the FAQ's page of a fund that is marketed as a dual return fund and whose mission statement includes "Help others to help themselves!":

"How high are the interest rates that micro entrepreneurs have to pay for a micro credit and what are the components?"

The interest rates for a microcredit are 2 – 4 % per month. These conditions are very attractive to micro entrepreneurs as local money lenders charge usurious interest of up to several hundred percent per month.

The interest rates consist of the following components:



What is remarkable is the lack of basic information on the interest rates charged that is usually required by regulations to be provided to consumers and investors in other sectors of the financial industry such as credit card companies and retail banks. The link between interest rates and MFI operations is interesting but also incomplete and could be construed as misleading.

- *Pervasive co-mingling of messages regarding requests for donations with investor solicitation and verbiage.*

For example, a request for donation that was tucked in to a page that lists the opportunities to invest in the organizations' commercial funds. (Names changed):

"For investors

Investment procedure

There are several ways to join MFINVEST Investment Management in investing in microfinance!

Get involved

You too can become part of the MFINVEST future: apply now as MFI or become an investor in microfinance.

Investor

There are several ways to invest in the MFINVEST microfinancing future. In addition to its own portfolio, MFINVEST manages several other microfinance funds, each with their own specific profile. See which opportunity fits your investment needs best. [Become an investor.](#)

As shareholder

MFINVEST is a cooperative society with social objectives. Any private company, association or private individual can become at any time a shareholder of MFINVEST. MFINVEST issues shares at 2,604 euro per share (nominal value of 2,480 euro + 5 % entrance fee) and 1/20° shares at 130.20 euro (nominal value of 124 euro + 5 % entrance fee). The ordinary MFINVEST shares are intended primarily for larger investors, whereas the 1/20° MFINVEST shares are targeted to private investors.

Shares can be subscribed by transferring the correspondent amount to account 890-0142924-74 of MFINVEST with *****bank.

As soon as the transfer is registered on our account, MFINVEST sends a shareholders' certificate. The shareholder receives by e-mail the three-monthly MFINVEST Newsletter and will be invited each year to the Annual Meeting of MFINVEST (last Wednesday of April).

A purchase of 100 shares (EUR 260,400) entitles to a seat on the Board of Directors.

With a tax-deductible donation

Gifts can be remitted to the account of MFINVEST with the ***** Foundation.
Account number: 000-0000004-04 of the ***** Foundation
Message: "L79539 – MFINVEST"

From EUR 30 upwards your donation entitles you to a tax certificate (art. 104 of the *****Income Tax Code).

The ***** Commission for Banking, Finance and Insurance approved the prospectus for the issue of MFINVEST shares. The prospectus is available at simple request with the MFINVEST office or by download: Prospectus 2008 (PDF, 1MB).

Next Steps

Work continues on all three pathways of the study. Analyzing web content is also a moving target and what appears today may be modified and replaced tomorrow. The goal of the study remains that the findings will facilitate the development of a decision framework to assist investors seeking a return of social good as well as quality stewardship of their financial assets; and in constructing portfolios in which the investment strategies of the funds, and the activities of MFI's to which they provide capital, are consistent with the investor's values. Based on findings to date some conclusions can be made:

- Microfinance is a unique class of socially responsible investment but the guidelines and regulations concerning transparency and disclosures needed by investors to make informed decisions must be specifically tailored to the hybrid purposes and processes within the micro finance arena.
- The process of disclosure and transparency by MFI investment funds is changing as we speak. Transparency and disclosure information required by investors and regulatory agencies must be updated to reflect the realities of communication technologies of the World Wide Web and the Internet age.

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