GANDHI VS GAUSS: ETHICAL ISSUES IN MICRO AND SMALL BUSINESS FINANCE

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Abstract

Efforts to discern ethical behaviour can lead to quite different results. Gandhi uses the most wretched person as the guide, Gauss stresses central tendencies, and Hayek suggests that specialisation is essential for a productive society. Use of finance has always been a lightening rod for ethical debate.

Microfinance (MF) serves the entrepreneurial working poor, getting people into business for themselves and moving the frontier of formal finance somewhat closer to Gandhi's benchmark. MF that succeeds on a commercial basis generates other positive social effects through financial markets. For many microentrepreneurs, MF may enable them to participate in their first formal contract. Formality advances the power of contracts rather than of class, tribe or status to strike mutually remunerative commercial transactions. Power diffusion is more likely. Women are especially suited to these new opportunities: Grameen Bank in Bangladesh issues loans to women who have never before held a coin or banknote in their hand. However, savings, not credit, is historically the engine of enterprise. Few microentrepreneurs become small business people or build medium-size firms. Competition and capacity tend to keep micro micro.

Micro and small business interest rates may appear "high", but they are often the lowest available. In a sense, interest rates are a mathematical abstraction – the microentrepreneur's concern is the size of the payment due and whether the loan was helpful. Transparency, with uniform rules of calculation, constitutes best practice.

Tangible collateral is not very important in MF when information and incentives are properly aligned. Loans to small and medium businesses are usually collateralised because these entrepreneurs have more options and hence more complex cash flows.

Micro, small and medium-size businesses in many countries face dreadfully inefficient financial markets. World Bank economists have found that financial market development is pro-poor because it creates jobs and economic activity generally.

MF is subsidised, creating ethical ambiguities. These appear in ownership patterns and in economic rents, and will continue as long as subsidies flow to microfinance institutions.

[1] This article is extracted from a presentation at the EBEN (European Business Ethics Network) Research Conference on Finance and Society in Ethical Perspective, held in Bergamo, Italy, 21-22 June 2007.

Mission drift is said to occur when service to an original target group is expanded to embrace other target groups. This is usually justified by a desire to grow with clients, by providing access to formal financial services, and by creating employment. Consumer finance is often non-transparent, costly and unproductive. It is the biggest threat to MF.
Pensions lose value when currencies collapse. If history is a guide, collapses are likely to occur in many countries over a working lifetime. How could the savings of nascent middle classes and of the working poor be protected when hyperinflation occurs?
Finally, Compartmos, a highly successful Mexican microfinance institution, made a secondary offering on the New York and Mexican stock exchanges in 2007. Its individual and institutional shareholders reaped extraordinarily returns. At the same time, Compartmos has achieved very high rates of expansion, serving more and more poor Mexicans. The scale of its returns has created a large stage for ethical debate.

> "Whenever you are in doubt… apply the following test. Recall the face of the poorest and the weakest man whom you may have seen, and ask yourself, if the step you contemplate is going to be of any use to him. Will he gain anything by it? Will it restore him to a control over his own life and destiny? [W]ill it lead to *swaraj* [freedom] for the hungry and spiritually starving millions? Then you will find your doubts and your self melt away".
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> *Mahatma Gandhi*, 1958, *The Last Phase*, Vol. II, Ahmedabad: Navajivan, p. 65.

Johann Carl Friedrich Gauss (1777-1855) discovered the normal curve, or Gaussian distribution, which has great practical application. The distribution characterises behaviour over large samples, which differs systematically along the curve. It also enabled the classification of derivative behaviour that does not conform to the normal distribution. For example, a rule of thumb or rough estimation used by some commercial bankers in the US is that 20% of their clients – at one end of the distribution – create 80% of the bank's net income. Clients at the opposite end create net losses for the bank.
Gauss complements Gandhi by providing a theoretical anchor in the form of the most wretched person, and those ever so slightly better off as the curve ascends. But what proportion of society's energy, wealth, talent and income should be devoted to the tail end, which may be quite hopeless? Great societies tend to provide more assistance to the wretched tail, but to what extent? Most of us are standing naked next to Gandhi's plea.

Hayek provides a footnote to Gauss and Gandhi: "An order in which everyone treated his neighbour as himself would be one where comparatively few could be fruitful and multiply. If we were, say, to respond to all charitable appeals… this would exact a heavy cost in distracting us from what we are most competent to do… It would not provide a proper cure for misfortunes about which we are understandably concerned".

Hayek F.A. (1998), *The Fatal Conceit: The Errors of Socialism.* Chicago University Press, p. 13.

These perspectives – Gandhi's compassionate engagement, Gauss' systematic dispersion of results, and Hayek's literal concern for transaction costs, opportunity cost and comparative advantage – offer a framework for ethical considerations of micro and small business finance. Small businesses along the curve are included because of their role in job creation and because many of them have never received credit from a formal source.

1. THE CONTEXT OF MICROFINANCE

Microfinance is not a suitable means of comforting Gandhi's most wretched person, who is probably ill, disabled, or distracted. Nor does microfinance generally speak to the condition of the destitute, who tend to have problems that overshadow their lack of money. Microfinance serves the working poor, who have jobs that they or their family members have created. Microfinance may also assist start-ups, getting people into business for themselves. The victory of microfinance is that it moves the frontier of formal finance closer to Gandhi's benchmark. Formality has advantages. These include size and scope and therefore efficiencies, norms and enforcement that extend beyond face-to-face interactions, and social and commercial space that creates expectations that attract the curious and experimental.

For many, microfinance may be their first formal contract, their first opportunity to use their address as a place where they can be found and where they can be held accountable to strangers or a formal institution. Microfinance that succeeds on a commercial basis generates other positive social effects through financial markets. An ethical practice that advances business generally is that for any single instrument or product, every client earns the same return on savings or pays the same price for credit and remittances. The practical outcome is a tremendous reduction of transaction costs, saving time. Formality advances the power of contracts rather than of class, tribe or status, to strike mutually remunerative commercial transactions. Power diffusion is more likely. Experience demonstrates that women are especially suited to these new opportunities.

Depending on the country, microentrepreneurs occupy different parts of Gauss' distribution. They may be to the right of the mean in poor countries, but far to the left of it in rich ones. Microfinance has enabled a lot of poor women in poor and some middle-income countries to better their lives. Microfinance introduces women microentrepreneurs into new activities and objectives, and they respond. Grameen Bank in Bangladesh has issued loans to women who had never before held a coin or banknote in their hand.

The primary ethical concerns attached to microfinance seem most likely to arise from its commercialisation. In my experience, asymmetrical responses surface, with profit as the dividing force. Different levels of scrutiny are applied. Hence, our focus here is primarily commercial microfinance and its extension into small business finance.

Microfinance has no particular definition. How small or big is micro? There is great variation among markets. For example, € 10,000 might be the upper limit of "micro" in Ukraine, while € 1,000 might be the limit in an African country. We are making progress, however. In the 1980s bureaucrats in development assistance organizations struggled to define a "small farmer". In a whimsical moment at a meeting at the World Bank, Claudio Gonzalez-Vega defined the small farmer as one who could not get any credit. Now at least we have some numbers to play with[2], and entrepreneurs who had never had access to formal credit are considered by some as a microfinance target group.

1.1 The scope of microfinance

Microfinance is a great liberating force but not a panacea. When anything in development assistance seems to work, it is trumpeted loudly. When done properly it does indeed work, and sustainability is a widely-shared aspiration and accomplishment in microfinance circles. But Thomas Dichter, a very stern critic, notes that, "While much has been learned about managing microcredit in a sound manner, many newcomers to the field succumb to the temptation to trumpet success prematurely"[3].

A related concern articulated by Dichter is that few users of microfinance continue to expand their operations: "...there is little reason to think that mass credit would in general lead to viable business start-ups"[4]. He cites historical experience that indicates that development – the creation of wealth – has always come first, creating scope for credit, which is used largely for consumption. "We should not expect microfinance to noticeably affect growth or successful business development"[5]. Most micro borrowers simply reach a new equilibrium or enjoy a stronger safety net. Microfinance is not a tide that raises all ships. While a small

2 Islamic finance is not explored here although interesting parallels exist.

3 Dichter T., 2006, "Speaker's Corner 10: Hype and Hope: The Worrisome State of the Microfinance Movement", Microlinks; Microenterprise Learning Information and Knowledge Sharing. Online e-conference, May 23-26.

4 Dichter T., 2007, "A Second Look at Microfinance: The Sequence of Growth and Credit in Economic History", Center for Global Liberty & Prosperity, Cato Institute, Development Policy Briefing Paper, February 15, p. 1.

5 Ibid.

part of the household economy may benefit, the macroeconomy may not be much improved. However, the impact at the household level can be powerful.

There is some merit in Dichter's dismissive concern. But microfinance has lots of company. Could the implicit and explicit subsidies that pervade microfinance be used for alternative purposes? Of course, but microfinance is possibly one of the better examples of outside efforts at development. The general failure of subsidised development assistance is demonstrated most forcefully in financial terms by debt forgiveness by major donor countries and organisations. The Millennium Goals offer a more intelligent approach, which implies a learning curve, that progress in understanding the causes of poverty and its alleviation are improving. Microfinance has promoted the feminist agenda, created some pioneering microfinance institutions that are commercially sustainable, and has helped some enterprising people realise their capacity. New frontiers have been opened at the small end in retail financial markets.

A concern that has not received much attention is whether microfinance produces a displacement effect. In a crowded physical market, for example, do traders that have access to microfinance increase the size of their businesses at the expense of their competitors who have not obtained micro loans, or who continue to use informal finance that is more costly.

1.2 Ethics applied to microfinance

As suggested by the three giants cited at the outset, ethics has many facets and interpretations. Ethics as standards of conduct may contrast with obligations and duties which are opposed to each other. Hence, ethical behaviour in practice has always been deficient in one way or another to someone or other. Hopefully it will always continue to be, as new standards evolve that empower more people in new ways. Ethical behaviour is perpetually redefined, which is positive to the extent that it creates a better society. The task of each generation is to embrace the ethical realm, explore ethical questions and act in ways that will create peace, help the poor and empower everyone in constructive social and economic activity.

Microfinance through an ethical lens is probably best discussed using comparisons of different motives and practices and their outcomes. Contrasts with ethical implications are not hard to find. Areas of exploration here include interest rates; disclosure and transparency; subsidies and the typologies of microfinance institutions (MFIs) and their implications; mission drift; micro pensions and institutional transformation. The objective of this paper is to point out ethical concerns that are debated in microfinance circles, especially concerning commercial microfinance.

2. INTEREST IN ETHICS OR ETHICS IN INTEREST?

Interest rates are an ancient and continuing ethical concern. In 1963 Sydney Homer[6] wrote *A History of Interest Rates: 2000 BC to the Present*. One edition included a subtitle, "From Tribal Brotherhood to Universal Otherhood", based on the instruction in Deuteronomy 23, 19-20, "You shall not lend upon interest to your brother… To a foreigner you may lend upon interest, but to your brother you shall not lend upon interest…." (Revised Standard Version, 1952). In other words, the saga of interest rates is a history of transactions that increasingly use and justify the use of interest.

Homer recounts efforts to control interest rates (Hammurabi, the Romans, Charlemagne) and laisser-faire approaches (Solon, England following the Reformation). He also notes that rates in commercial markets tend to be volatile, reflecting changing economic and other conditions. In the last century the range was enormous: from a high 10,000% in Berlin to a low 0.01% in New York. In Caesar's Rome, 12% was the legal limit. The rates Homer records vary widely, but from the Middle Ages onward, commercial money market rates appear generally to have been as they are now, say from near zero to around 12% per year in stable times. However, Homer cautions that rates are often not comparable because of differences in their derivation and application. This is recognised by CGAP[7] and is also the basis of Truth in Lending laws, such as in the US, which create standardised like-for-like comparisons.

The defense of any interest rate is often a thankless task. The problem is seen most vividly at the frontier of finance, where the formal sector meets the informal sector. Rates inside the formal sector may be controlled, but legal ceilings in many countries are generally much higher than the rates that are common in formal trade. Formal rates reflect the fact that risk is understood and managed and that contract enforcement mechanisms are in place. While economics exists only because resources are scarce and hence command value, financial markets also exist because they generate resources that are plentiful.

2.1 Microfinance is a bargain – and should be transparent

The informal sector beyond the frontier is the point where microfinance can make a difference through formalisation. In fact, microfinance interest rates of 30% or more per annum are low. Low because these rates are the best that mi-

[6] Homer S., 1963, *A History of Interest Rates: 2000 BC to the Present*, New Brunswick NJ: Rutgers University Press.

[7] Rosenberg R., 2002, "Microloan Interest Rates", *CGAP Occasional Paper*, No. 1.

croentrepreneurs can find, and because access to credit empowers them, creating economic activity where there was none before or where it was more costly to transact business before.

For this assertion to be credible, the critic should put herself in the microentrepreneur's sandals. At this level, where empowerment occurs, *interest rates are an abstraction*. Microentrepreneurs do not walk in the door and inquire about the interest rate. They want to know if they can repay and profit from the transaction. From this perspective, interest rates are an abstract number, another but not very useful way of viewing an opportunity.

The prospective borrower wants to know "Can I afford to repay?" "Will this help my business?". Best practice in microfinance is to ensure that the borrower knows the amount of interest to be paid. If a loan of 1000 is issued, the borrower should also know that she will have to pay 400 (for example) in interest. Transparency – the ethical root – is especially important here. Best practice dictates that disclosure of the interest amount is required when the loan is negotiated, and that this information is communicated orally, as well as in writing (even if the borrower is illiterate), as an amount and in the form that is most easily understood by the borrower. The rational micro borrower can then decide whether the loan is worthwhile in terms of the net gain that she will earn from the loan by investing in the additional time and effort that she can apply by using the borrowed money.

A reason why microfinance seems "costly" is that the issuing of a microfinance loan is costly relative to those of a normal commercial bank loan. Transaction costs are spread over small loan amounts in microfinance. For example, commercial banks' operating costs rarely exceed 5% of their total assets, while the operating costs of efficient MFIs (microfinance institutions) are between 12% and 15% of their total assets[8]. "High" interest rates are required to cover the administrative costs of the small transactions of microfinance, to offer incentives that will attract new MFIs into the market, to provide for risk and to finance growth.

In contrast, interest rates are the common currency of advanced financial sectors. They are used to determine whether a transaction makes sense. At this level, interest rates are used to test whether a real-sector transaction is likely to be remunerative. The interest rate is a benchmark, a standard of comparison, that permits an entrepreneur or investor to judge whether an enterprise is likely to be remunerative, or whether an alternative use of funds is likely to produce better results. Is the proposed investment's internal rate of return at least as high as the interest rate, that is, the cost of money?

[8] Ivatury G., 2006, "Using Technology to Build Inclusive Financial Systems", *CGAP Focus Note*, No. 32.

2.2 Microfinance finds a way

The fact that microfinance exists at all, and that it is viewed positively with few loudly-voiced ethical challenges, is something of a miracle. Add to that the fact that poor women will abide by contracts with high degrees of fidelity, which is heralded as a great discovery, one that liberates them to some extent financially. What has not been equally celebrated is the fact that these rates have been accepted in many societies – with very few complaints.

The most vocal complaints come from critics who believe that "making money on the backs of the poor" is unethical. The counter-argument is that commercial transactions are spread more easily and in more sustainable ways because of the information and incentives they generate. Put differently, this approach holds that commerce is a better generator of legitimate enterprise than are noncommercial activities, including charity. Microenterprise includes both approaches: providing a market for charitable efforts focused on individuals and for the greatest good for the greatest number. There are also many entities that are not entirely commercial that are willing to prime the commercial pump – which is the story of microfinance.

This fact is of historic interest[9] – relatively large numbers of poor people gaining access to finance at cost-covering rates, making microfinance possible as a commercial proposition and therefore sustainable. And, collateral is not a key feature in microfinance. One reason is that courts in many countries deliver justice slowly and poorly, reducing a rational creditor's claim to low and uncertain prospects for recovery.

But more important was the creation of a new framework that greatly influenced the understanding of credit relationships. The previous paradigm was that of Neoclassical Economics, which held that human behaviour is determined by costs and benefits. The New Institutional Economics gathered force in the 1980s with the insight that human behaviour is a function of information and incentives. A serious lender's task is clearly to provide information and to align incentives so that productive behaviour would result. Collateral is a secondary consideration in microfinance.

The working poor are prepared to repay when given productive incentives, in spite of the transaction costs imposed on them by group credit models. But these transaction costs – of meetings, of taking time out from their businesses or families, for example – demonstrate a positive aspect of collective action. This occurs when the transaction costs of collective action are perceived as ben-

9 Antecedents include pawnshops in Italy and Spain with hundreds of years of history, local savings banks in northern Europe from the 1800s, and credit unions in Canada and the US from 1900 on. See Thomas Dichter, "A Second Look at Microfinance".

efits rather than costs. In the case of group credit, members generally enjoy the meetings, taking a break from incessant chores, getting together with friends, affirming each other and their goals, having fun, learning useful new things and increasing their self-esteem.

However, the basic model and dynamics of group credit may change if some members want only to save, if meetings become tedious, or if some group members do very well, taking loans that are a multiple of the norm, which can erode the control that the majority can exercise over the most successful borrowers. The dynamics also change when someone fails to repay. There is a range of responses to this problem. At one end of the range, the group is supposed to encourage the defaulter to repay, but the other members have no binding obligation to cover the defaulter's loss. At the opposite end, if failure is not rectified the group is disbanded and members are barred from further participation. Group lending coupled with other financial and non-financial services for group members increases the incentives for good behaviour.

2.3 Taming inefficient financial markets

The interest rates that are common in microfinance suggest that the small end of financial markets are dreadfully inefficient. Inefficiency is indicated by large spreads between the interest rates paid by the lender and those paid by the client. In Mozambique, for example, consignment transactions of wholesalers and retailers of certain products that were settled monthly had a 30% interest element according to analysis conduced by ProCredit Holding. *Thirty percent a month!* If the retailer could obtain a microfinance loan at ProCredit's rate of 4.5% a month at that time, and buy for cash rather than on consignment, the retailer would gain and physical and financial markets would be more efficient. Transaction costs are reduced and competitors may be induced to enter the market. As competition occurs, supported to some extent by credit, spreads diminish. The same effect occurs in microfinance markets. Competition reduces costs, which are passed on to clients in the form of lower interest rates[10] and a wider range of services (as described later).

These numbers are important in several ways. One is that countries with small, weak financial sectors are likely to fare less well than similar countries with more efficient financial sectors[11]. World Bank economists, using a broad cross-country sample, have discovered an even more exciting result:

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[10] "Economics focus: Small loans and big ambitions". *The Economist*. March 17, 2007. p. 84.

[11] Beck T., A. Demirgüç-Kunt and R. Levine, 2004, "Finance, Inequality and Poverty: Cross-Country Evidence", *Working Paper*, 10979, NBER, Cambridge MA.

> "Substantial research finds that financial development boosts overall economic growth, (and) we study whether financial development is pro-poor… Financial intermediary development reduces income inequality by disproportionately boosting the income of the poor and therefore reduces poverty. The result is robust to controlling for simultaneity bias and reverse causation".

Financial intermediaries such as competitive MFIs that create relatively larger financial sectors are pro-poor. Competition in commercial microfinance makes financial markets more efficient. By so doing, it assists society generally and is disproportionately pro-poor. The benefits go far beyond those immediately involved, making things slightly better for others who are not microfinance clients but who benefit as these multitudes of tiny changes slowly create more jobs, more opportunities and new horizons. This is the other side of the coin, a largely unseen side as an incredibly large popular, social and commercial step forward – creeping in in sandals. Financial development matters and appears generally to provide ethical benefits.

2.4 The case of the impatient Salvadoreña

Another positive feature is that the benefits of lower rates can be used to provide incentives. I once observed a client in a ProCredit Bank in El Salvador obtain a repeat loan, which she got in 20 minutes. It was larger, with a longer maturity and at a lower interest rate than her two previous loans. The first was for about $400 repayable in 6 months, the second for about $600 with a 9-month maturity. The interest rates were about 36%. She had paid each installment of these loans exactly on time. The loan that I saw being issued was for about $1000 at 32% with a maturity of one year.

This size of the new loan and the interest rate reduction were possible because she was a perfect borrower and also because there was sufficient flexibility to give her a lower rate. In an economically efficient market a 4% reduction in the interest rate would have been impossible, but an inefficient one provided space to offer a strategic incentive. This process, repeated many times in a competitive atmosphere, makes the market a bit more efficient. It is also the essence of financial development.

What more information would the lender need? She could walk out with $1000 in 20 minutes because of her perfect performance. I was amused because the client seemed impatient as she sat opposite the loan officer with the computer who was updating her file, authorising her loan and explaining why the reduction was possible and how it was calculated. I regarded her demeanor as a sign of empowerment.

In this case the loan applicant and the lender were willing to provide information to each other in order to establish trust. Each party had incentives to keep their contractual and implicit promises. The borrower had an incentive to repay in order to get another loan with better terms, and the lender had incentives to serve her well as a valuable client – a continuing source of income. The reduction in the interest rate provided an additional incentive to the borrower, further reducing the probability of default.

Microfinance has legitimised sustainable interest rates for the poor: "high" rates are now ethical in many societies – at least for certain purposes and groups in ways that are easily demonstrated. Better put, markets can work for the poor in ethical ways. The de facto standard does not compare their interest rate to that of a richer person, but that they can borrow at lower costs than would otherwise be possible.

2.5. Deconstructing informal finance

Some mysteries are embedded in informal rates – consider the 30% monthly interest rate. World Bank economists call these "anomalies", and research is underway to explore them. One situation common in many countries is illustrated by five-six in the Philippines. A poor woman with a basket goes to a stallholder early each business day and gets tomatoes on credit. The loan is for "5" in this case. She sells her tomatoes by the afternoon and returns to the stallholder, to whom she pays "6" – a 20% daily "interest rate". Similarly, a couple sell a variety of dried fish from a wooden cart. Every Monday morning they go to a wholesaler who gives them dried fish worth "1000", which they sell from their cart throughout the week. Every Saturday afternoon they return the cart to the wholesaler and give him "1200" – a 20% weekly "interest rate".

Clearly, part of the puzzle is missing. The wholesaler's compounded gain over a few years would exceed the GDP of the Philippines. Of course, the stallholders and the wholesalers have costs, too, but why would retailers not eventually become wholesalers? The question remains unanswered. One suspects that the cost or return in question consists of elements other than pure interest – the cost of money – and that this can be broken down or unbundled. But still, what barriers remain that inhibit these tiny businesses from growing?

3. THE ROLE OF SUBSIDY

Without subsidy there would be little microfinance as we know it today. Different types of microfinance institutions (MFIs) have different views of subsidy and its relation to sustainability. Broad generalisations about MFI types can be drawn from their different views on subsidy. These generalisations are stereotypical. From this perspective there are three types of MFIs. The first two are contrasted in Table 1.

Table 1. Stereotypical Varieties of Microfinance Institutions[12]

Characteristics	Type I MFIs	Type II MFIs
View of subsidy	Required for start-up, but eventual independence from subsidy is essential	Subsidies are essential for sustainability
Rationale for their view of subsidy	Subsidy is costly (donors impose transaction costs), fickle (fads change) and habit-forming (soft funds may dilute rigour, softening purpose)	Subsidy is required to alleviate poverty
Organisational form and objectives	Commercial, minimalist (providing financial services only), serves micro and small enterprises, regulated	Non-profit, political, focus on the poor. Maximalist (finance plus a social mission) to serve more clients and obtain more subsidies. Degree of financial regulation varies
Lending technology	Individual, variety of loan types, other financial services	Group lending, some savings, individual lending later
Mission priorities	Create more efficient financial markets. Build sustainable institutions. Serve the poor to justify subsidies and expand frontiers	Outreach to the poor. Keep poverty high on the public policy agenda. Fashion the MFI to attract subsidy for the social mission
Corporate form	Licensed financial institution	NGO, foundation
Ideal board	Investors with funds at risk who have a sense of social mission	Management, friends, contributors, and "representative members" who can provide access to (soft) funds

Cooperative financial institutions are a third type. They take subsidy when it is useful. Their core objective is affiliation, enlisting more members, creating more second tier institutions and offering more services. Coops are regulated under cooperative law. Their characteristics vary from the purely commercial to the non-commercial. Their lending technology is usually individual. Mission

[12] Von Pischke J.D., 2002, "Current Foundations of Microfinance Best Practices in Developing Countries", in James H. Carr and Zhong Yi Tong, eds., *Replicating Microfinance in the United States*, Baltimore and London: The Johns Hopkins University Press, pp. 97-112.

priorities are based on the belief that successful cooperation helps people and makes markets more efficient. Their corporate form is given by law. Their boards are elected by and from their membership, on a one-member-one-vote basis.

3.1 Is it ethical to continue to provide operating subsidies to large MFIs?

The distribution of subsidy for microfinance has sparked a debate that attracted considerable attention, not least in *The Economist*[13]. There are two parts to the argument. The first deals with start-up operating subsidies in the form of grants. Large, successful MFIs continue to obtain subsidies, while smaller and younger MFIs are less favoured.

Public and private sector donors provide grants in order to hasten the spread of MFIs' activities. Donors continue to provide initial subsidies to large MFIs because of their performance record and because of the importance of institution building, which is a long-term effort[14]. Institution building may be defined as efforts to ensure efficient staffing, good IT systems, adequate controls, and dynamic responses to market conditions and situations. Without strong institution building, donors and investors' investments are unnecessarily at risk. With institution building, expansion is more assured, providing more and better service for clients. Institution building is required to generate remunerative returns on investment, which in commercial microfinance appears to be a return on equity of at least 10% per year[15].

The rationale for subsidies is that certain aspects of microfinance development lie beyond the commercial realm. Specifically, staff training in some countries is arduous because local educational institutions are weak or inaccessible

13 "Time to take the credit", *The Economist*, March 17th-23rd 2007. p. 16.

14 Institution building is not a very strong term in English. During my time at the World Bank (1976-1995) in financial sector operations – assisting mostly state-owned and some private financial institutions – it typically included the provision of vehicles, IT equipment and English lessons, staffed often by relatively young officers in our client banks with attractive qualifications and often good English but without much clout. These efforts were treated entirely differently from the other conditions negotiated with the institutions borrowing from the World Bank Group. In contrast, I discovered that efforts at institution building provided by German development cooperation are comprehensive roadmaps that are taken very seriously. They include budgets, staffing plans, scheduling of many sorts and continual testing and monitoring. The difference is more than semantic, and from my perspective tends to rest in different treatment of the human element, especially getting the right people for the job.

15 Calculated using data gathered by Ohio State University researchers, led by Professor Claudio Gonzalez-Vega. I calculated an unweighted mean return on equity (RoE) of 14.6% from 1993 to 2006, for the four large MFIs, using December data. The annual range among MFIs was –2.2% to 34.8%.

for the majority of young people. This makes it difficult to recruit competent local staff because the skilled labour pool is relatively small. Expatriate staff are expensive, making it essential to employ qualified local staff in as many positions as possible. Local salaries may seem modest but productivity is often low, adding to the training burden. Recruitment and training impose relatively large up-front cost because basic training has to cover skills that in other countries with better education systems would be plentiful. These conditions also mean that staff turnover will be relatively high at both ends of the hiring spectrum.

At the other end, those who excel and become skilled are easily poached by other employers who face the same constraints, but with deeper pockets. This creates a bottleneck to expansion as growth has to be fueled by profits, which are likely to be thin or negative at the early stages of setting up a new commercial MFI. The capacity to expand and achieve scale requires good middle management. These managers are in charge of systems and of branches – essential for greater outreach. They serve as role models and become the source of higher management. Without robust middle management, outreach is constricted and the supply of microfinance is constrained.

An additional factor that increases start-up costs is the length of time required to obtain a banking or other financial service license. In at least one case, two years were required, in part because the local authorities needed "incentives" to provide approvals on a timely basis. Given the uncertainty, some expatriate and some local staff were kept in place, but no business could be conducted because the MFI refused to provide "incentives" to the banking regulators. Subsidies were exceedingly helpful in sustaining preparations and staff during the hiatus.

Given these constraints and their costs and implications, grants are often solicited. The highest priority is good local training and staffing, which could typically amount to between 20% and 30% of an institution-building grant to start a new commercial lending institution. The largest portion would be for a few expatriates, with the balance to premises, equipment for information and communication technology, and vehicles.

Break-even financial results for a new MFI may be targeted at between 18 and 36 months, contrasted with possibly four or five years for a new bank in the US. Full cost recovery often requires a period similar to the time it takes for a start–up to break even. In many cases grants are coordinated with ownership – grants and equity investment are provided by a single investor. Also, it would not be uncommon for a public sector grant-maker to provide funds along with a public sector investor. In effect, the institution-building grant leverages the investor's contribution, reducing the time required to reach break-even. But in such cases, each party has a long time horizon. The minimum commitment of the public sector investor would often be ten years or more.

To summarise: subsidies are vehicles for institution building, which includes an important human content. The subsidies help to overcome deficiencies in local educational structures and to accelerate the delivery of services to potential clients. The debate is whether mature MFIs, the large networks, should continue to receive subsidies for their expansion, or should the second tier of MFIs be the rightful recipients. In its argument, *The Economist* failed to mention institution building. From my perspective, subsidies and other funding for microfinance are already relatively plentiful for MFIs and are likely to grow. There is still a lot of space in some markets that could be claimed by smaller players that offer attractive possibilities.

3.2. Is it ethical for public sector investors to continue to lend to large MFIs?

The second part of the debate about continued assistance to large MFIs by public sector agencies centres on loans by IFIs (international financial institutions such as IFC, EBRD, MIF, etc.) and development banks such as KfW, FMO and BIO (also often included in the definition of IFIs). Through such owners, large MFIs have indirect access to capital markets. The gauntlet was thrown down by Julie Abrams and Damian von Stauffenberg in February 2007: "Role Reversal: Are Public Development Institutions Crowding Out Private Investment in Microfinance?"[16].

They note that IFIs have been increasingly active in investing in large MFIs, and indicate that in some cases these investments have led MFIs to prepay private debt, while in others the IFIs' terms and conditions were softer than those offered by private investors in MFIs, in effect crowding out private capital. This is an important issue because the IFIs' mandate is to be pioneers, investing where private investors would not, moving into uncharted territory and opening the way for private capital. The IFIs have performed this function well in microfinance. By the end of 2005, IFIs had invested USD 1.5 billion directly in IFIs, an 88% annual increase, and outstanding loans amounted to USD 1 billion.

Since about 2005 the number of deals has greatly accelerated, especially involving larger and better-performing MFIs (a number of which mobilise domestic deposits). MFIs with no IFI debt in 2004, for example, had an average RoE (return on equity) of 6% while those with some IFI debt averaged 17%. In 2005

16 Abrams J. and D. von Stauffenberg, 2007, "Role Reversal: Are Public Development Institutions Crowding Out Private Investment in Microfinance?", MicroRate: The Rating Agency for Microfinance. (Sponsored by Calmeadow).

these averages were 1% and 18%. The average increase in IFI debt between 2004 and 2005 was 88% for the 12 top rated MFIs and a negative 25% for the five with the lowest rates (on a four-step rating scale). Data for 2006 showed similar trends.

Abrams and von Stauffenberg do not present evidence that smaller MFIs with lower ratings could be turned into top rated institutions if only they received more funding. And, they do concede that the rapid emergence of microfinance loan deals might have simply grown in a spontaneous manner as breakthroughs gathered steam. It is not clear from their presentation the extent to which loan deals may have been parts of larger relationships or structures. The risks and transaction costs in dealing with the smaller and/or less-well performing MFIs are not explored. The differences in getting a deal to closure and in transaction costs among IFIs and private lenders is not discussed.

The study recommends five steps:

- Make IFI funding transparent
- Maximise commercial participation in innovative capital market transactions
- Seed the next generation of microfinance institutions
- Help develop mechanisms to cover foreign exchange risk
- Promote further private sector channels for microfinance and finance industry infrastructure

IFI staff members have for long wryly noted that their mandate was very tricky in the unforgiving world of high finance: If a pioneering deal failed, their critics said it showed their incompetence. If a pioneering deal succeeded, their critics would claim it was because they undercut the private sector. Rational exuberance seems to have gone into high gear in lending to MFIs.

4. THE PROBLEM OF MISSION DRIFT

Mission drift is considered unethical, a sell-out from the perspective of many microfinance practitioners. Mission drift is said to occur when MFIs go up-market, offering larger loans to less-poor borrowers, diluting the mission of microfinance. This charge is especially serious because microfinance is subsidised and targeted on the poor. However, subtleties are involved, along with business strategy and the normal course of enterprise growth.

4.1 Reasons to go up-market without abandoning your microfinance roots

Factors that lead lenders to expand up-market include: a) staying with upwardly-mobile clients, b) serving businesses that have never had access to formal finance, c) creating employment. These three factors demonstrate the multifunctional usefulness of finance at the small end of the market. The fourth, on the horizon, is the possibility of MFIs' retreating from markets in which consumer finance crowds out micro and small business finance as delivered by MFIs.

Retaining the investment in your clients: Commercial microlenders tend to issue larger loans as they gain experience. Successful clients' businesses are likely to grow, and a few microenterprises may become small businesses. The somewhat better off borrowers who have businesses and experience tend to make better economic use of their microenterprise loans because of their assets and skills[17]. They also usually started their businesses with informal credit from family and friends.

Loan sizes can safely increase because of the information that the lender accumulates through prompt repayment and adherence to other contractual expectations. Risk tends to decline because clients can be trusted to repay larger loans[18]. Why should lenders not make use of the information that they have gathered from their poor clients who are upwardly mobile? Client relationships are a microlender's largest investment and are costly to build – why not continue satisfactory ones?

Providing entry to formal financial services: Expanding financial markets in ways that are sustainable is generally welfare-enhancing and contributes to making financial markets more efficient. Small and medium-sized businesses are part of this process. If an MFI's target group is defined as businesses that have never before obtained credit from a formal source, many candidates are available, although the risks and style of interactions with these clients differ from those of the typical microentrepreneur. Small business loan interest rates are considerably below those of microfinance rates because of transaction cost economies and the broader range of services used. As a very broad generalisation, an institution offering a 32% rate on microloans might charge 22% on a small business loan. Collateral becomes a somewhat more important element in the relationship.

Employment creation: In the urban and semi-urban areas inhabited by the poor – the places where microfinance is concentrated – entrepreneurs are a minority. Most people work for someone else. As a generalisation, entrepreneurs are generally wealthier than workers in the informal sector. What can be done

17 Thomas Dichter, "Speaker's Corner". pp. 4-5.

18 Some lenders issue micro loans to small businesses that are new clients. This permits the lender to become familiar with the client and gain the confidence to issue larger and cheaper small business loans.

to improve the welfare of those who are not entrepreneurs? Employment creation is the logical remedy. Small businesses are sources of employment, which is good news for many poor households.

Consumer finance – "the never-never": In many middle-income countries consumer finance is easily obtained. Requirements consist of a domestic passport, a permanent address, a pay stub and possibly a relative or friend who also has a passport and permanent address and can serve as a witness. The borrower can obtain a loan equal to or larger than his or her monthly pay stub.

Commercial banks compete for this business, which is quite different from microfinance. Credit scoring models are used, based on statistical characteristics. Documentation is minimal and a loan is often obtained within a day. While commercial MFIs in these countries work quite hard to keep portfolio at risk (defined as amounts 30 days past due) below 5%, consumer finance tolerates much higher levels. Another concern is that microfinance at its best is transparent, while consumer finance is usually not. Fees are charged in addition to interest rates, which are sometimes zero – an advertising ploy.

Commercial microlenders know that their loans are not always used for the purpose stated on the loan application. However, commercial micro and small business lending processes are designed to ascertain debt capacity based on information specific to each client. This analysis of business and household income enables the lender to determine the debt capacity of the client, based on tangible and intangible criteria. These procedures are designed to avoid making loans that are too large, or terms that are too onerous. This tends to keep the relationship under control.

The qualitative differences between consumer lending and microlending in their pure forms are enormous. The micro loan is for a productive purpose that should give the borrower an opportunity to increase her wealth in a sustainable manner. The consumer loan is to accelerate consumption, often spending more too soon.

4.2 Three likely possibilities relating to mission drift

The engagement of larger, wealthier clients is sometimes considered a bait-and-switch tactic that diverts subsidised funds intended for the poor to those who are a bit better off. However, this objection is misplaced and should be put in context. Three possibilities arise[19]. The first is "mission stability" – the continued provision of a limited range of services only to the poor.

[19] This argument was first presented in my keynote speech at KfW's financial sector conference in Frankfurt in 2005.

"Mission enhancement", the second possibility, consists of new services offered and new target groups engaged, while the original target group continues to be served, often better. In other words, the original target group of microentrepreneurs is not abandoned, but rather are served more efficiently and in larger numbers.

Mission enhancement is consistent with the objective of serving those who have not had prior access to formal finance or to certain financial instruments. These additional opportunities are numerous and include small businesses and professionals as clients, payments – such as remittances – and savings facilities as services, and risk management tools such as insurance. This strategy is consistent with the mission of making financial sectors more efficient by continuing to engage those beyond the frontier of formal finance, such as women microentrepreneurs, and by catering to others not well served by mainstream finance, such as small businesses.

"Mission drift" is the third possibility: the institution that once served the poor moves up-market, abandoning the poor. This occurs most dramatically with a change in ownership of a financial institution that provides microfinance, but it can also happen slowly, creeping out of the small end of the market.

The important point is that mission enhancement should not be confused with mission drift. Enhancement is not drift – it is outreach and development, working at two levels. The first is doing more for good clients that have the capacity to expand their businesses. The MFI has gathered lots of information about such clients, providing the basis for good relationships and growth. Why not use valuable information that is costly to obtain? Why not provide incentives for continued productive relationships? Why not capitalise on good behaviour?

The second developmental effect is that mission enhancement makes financial sectors more efficient, as indicated by finer spreads, lower risk premia, new products, lower transaction costs, more participants, and services to an expanded array of clients. Accordingly, this three-part paradigm should be applied in the valuation of service to any target group. Some Type II institutions, characterised by group credit, are adding individual lending to their services, in part to offer new opportunities for their best-performing clients, and in part to join the competitive fray and the returns made possible by commercialisation.

Mission stability is unlikely to be a viable business strategy except in very small scale operations or in sluggish or stagnant markets. It will continue in ways that more closely resemble a club than a business.

5. PENSIONS FOR THE POOR OR POOR PENSIONS?

Microinsurance is a rapidly growing part of microfinance. Research by Stuart Rutherford in Bangladesh and elsewhere indicates that poor people are quite concerned about being able to care for themselves in old age[20]. Many informal organisations in the Subcontinent have traditionally provided long-term savings instruments, and Grameen Bank and others in Bangladesh offer very popular programmes. Africans also have similar concerns about poverty in old age, but with fewer institutional tools that provide finance for old age[21]. Within the international community, ILO has taken a lead in defining the issues and shaping the debate[22].

While long-term savings are incredibly important and a wonderful welfare enhancement, institutional means of securing this dream are dangerously weak – if history is a guide. Can financial markets and the governments that control them be trusted to provide value for money?

I recall seeing a Yugoslavian 10,000,000 note that could not buy lunch, a monochrome 50,000 Bolivano note that was printed on one side only, a beautiful Iranian 100,000 note picturing the Shah that was in common circulation, and many others. When Ghana decided to issue its own currency, the Cedi was worth US$ 1.40. *The Economist* opined that the Cedi would "have a life of its own". In mid-2007 Ghanaians exchanged their 10,000 Cedi notes for new, revalued one Cedi notes worth less than a Euro. At a conference in Brazil I received an honorarium in a paper bag about 50cm x 30cm x 20cm, filled with banknotes. I never counted them but I did buy two pairs of fine shoes and a kilo of coffee, with a few 10,000 notes left over as souvenirs. Investigation found that 17 zeros had been knocked off Brazilian notes during my lifetime to that date. And Zimbabwe, where the value of a university pension cannot buy a retiree lunch?

Of course, high interest rates can take the bite out of high rates of inflation, but in practice this is problematic. The diligent saver using financial institu-

20 Rutherford S., "Micropensions: old age security for the poor?" in Ingrid Matthäus-Maier and J.D. von Pischke, eds., *New Partnerships for Innovation in Finance*. Berlin: Springer Verlag.

21 Moulick M., C. Ngurukie, A. Mutua, M. Muwanguzi, M. Onesimo and G.A.N. Wright, "Cash, Children or Kind? Developing Old Age Security for Low-Income People in Africa", in Ingrid Matthäus-Maier and J.D. von Pischke, eds., *New Partnerships for Innovation in Finance*. Berlin: Springer Verlag.

22 Material on microinsurance and micropensions may be found on the websites of ILO, CGAP and the Micro Insurance Centre, among others.

tions to seek a comfortable pension in a typical country that is not part of the OECD can easily be devastated at least once in a lifetime[23].

Promoting long-term savings among the poor in non-OECD countries that issue their own currencies, with no measures in place to protect the value of these savings constitutes negligence.

How serious is this problem? To begin, research should be undertaken to review the historical record. Begin with an assumption that a working life lasts for 35 to 45 years. What would 100 deposited in a long-term account 35 or 45 years ago be worth today? What would 100 deposited annually in a long-term account 35 or 45 years ago be worth today? And what would be the results for all years in between? What benchmark interest rate series should be applied? These data are found in central bank bulletins, the IMF and other sources. The results of these analyses could ascertain magnitudes and provide a starting point for solutions.

One means of protection would be to convert pension accounts in domestic currencies into a basket of hard currencies: Euros, US dollars, Yen, Sterling, Swiss Francs and Canadian dollars, managed off-shore. This is the easiest arrangement, but some would protest that the funds should be available locally in non-OECD countries for development and related purposes.

At another level and invoking the New Development Finance, how could a global mechanism or mechanisms be structured to protect the long-term savings of the poor? Moral hazard could be a problem, as protection would soften the consequences for the government of its bad governance – but possibly beyond some devastating point there are no corrective incentives for bad behaviour. Riding out cycles would be important in order to discourage opportunism. For example, if situations deteriorated, incentives to seek protection would rise, creating a run to safety, while when things are going well there would be weaker incentives to buy protection. A lagged moving average might be considered for valuation and for disbursements from the fund to vested pensioners.

Other solutions are no doubt be available. In any event, exploration of this problem and possible institutional solutions to protect the savings of the poor globally should be placed on the table.

[23] The possibility of institutional failure is also a problem. I observed in Benin that the failure of cooperative financial institutions destroyed many members' savings – but with an exceedingly perverse twist. The poor did not save much anyway, and they knew how to survive poverty. They simply remained poor. The rich had taken their money out in different ways, reasonably well "protected". The middle class – the nurse, the teacher, the highway engineer – who dutifully made a deposit on each payday, suffered. In terms of nation-building, the toll is immense.

6. TRANSFORMATION OF COMPARTAMOS – FROM SUBSIDISED NGO TO MEGA WEALTH

Many MFIs began as NGOs, taking the form of a foundation or other not-for-profit, subsidised entity with relatively limited powers. Some of these have "transformed" into regulated financial institutions in order to expand their services, such as by offering deposit accounts for their clients. This provides convenience for clients while depositors' funds can be used to expand the loan portfolio. Foreign MFIs also benefit by being able to offset foreign exchange risk.

Commercial microfinance has benefited greatly from injections of equity and debt and through guarantees from public sector institutions such as IFIs. Private sector investors have also participated in these means of promoting microfinance. Grants have been plentiful for these purposes. These funds have enabled commercial MFIs to expand their outreach. Outreach in turn has attracted more funds, requiring professional management. With the increasing disaggregation of risk that characterises modern financial markets, the value of MFIs can be quantified more easily. This creates opportunities for owners to take capital gains through the sale of shares. But these investments are not for everyone because long time horizons are required. These gains take time to materialise in the form of cash – up to ten or more years in many cases.

Those who equate this type of financial market opportunity with "making money off the backs of the poor" would be appalled, if not outraged. Wealthy investors and others reap healthy gains from successful MFIs serving the poor. Those holding the opposite view are pleased with their gains and with the proof that microfinance has matured in the commercial realm, which offers even more opportunities for expanded outreach.

Compartamos, a Mexican MFI, began as a non-profit in 1990 serving two Mexican states. Expansion led to operations in more states in southern Mexico, reaching break-even in 1996. In 2001 Compartamos became a finance company (*financiera*) that could obtain funding from banks and by borrowing at home and abroad. In 2006 Compartamos became a bank, serving more than 600,000 clients, many of them women.

Compartamos has been extremely successful financially, with profit rates of more than 45% on operations, gross financial margins of about 90% and returns on assets of around 20%. Its return on assets was close to 20% for several years (2% is considered extremely good performance by commercial banks in developed countries). Its capital ratio is around 40%. From 2002 through 2006 its assets grew from about USD 75 million to about USD 300 million, in part through the sale of bonds. Simply put, Compartamos manages risk well and is extremely profitable and dynamic.

In 2007 Compartamos made a public (secondary) offering on the New York Stock Exchange and on the Mexican Bolsa, unloading 80% and 20% respectively. 26% of its shares were sold, at an offering price of about 12.6 times book value[24]. The total amount raised was more than USD 450 million, which went to share owners, not to Compartamos. The sellers included Compartamos A.C., the founding non-profit, a founding microfinance investment institution, an IFI and about 15 individuals who held about a third of the offering – none of whom held more than 10% of the sale. The average buyout of the 15 individual shareholders approximates more than USD 10 million each. The average "value" of each client at the time of the sale was about USD 3700 (number of clients divided by the value of total shares outstanding). Mexico's GDP per capita was about USD 10,600 at the time.

The share price at the April 23 offering was about 52 pesos. Through the end of May 2007 the market price remained above the issue price, rising to a high of about 64 pesos. Price/earning ratios approximated 41.

Compartamos will be a lightening rod in the debate about the ethics of commercial microfinance and its ownership structures. It will be applauded for its pioneering efforts and success in bringing microfinance onto centre stage, a clarion call for investors who want to expand the outreach of microfinance through investment. *¡Viva México! ¡Viva Compartamos!* Those holding the opposite reaction would feel that the reward for good performance was obscenely disproportionate, that money was indeed made on the backs of the clients.

Most probably forgotten in the celebrations and in the outrage are questions about the fact that in spite of all the signals sent by Compartamos, no credible competitor surfaced. A sad commentary on Mexican entrepreneurship generally.

Compartamos became sustainable relatively quickly, based on its high margins and lean operating style. Other commercial MFIs with more conventional operations are also moving towards continuing transformation. As venture capital (private equity) increasingly becomes involved, exit becomes a greater concern. Venture capitalists look for high gains in return for their risks as pioneers. These buyouts will not be so stunning as that of Compartamos, but large sums will be in play. In practically all cases, these commercial MFIs' operations got underway thanks in part to subsidies, which through these MFIs' own efforts were multiplied several times over, serving more people in new and different ways that have provided convenience at the least and empowerment as the norm.

[24] Data compiled and translated by Andreas Eichin at Frontier Finance International from Fitch, Reuters News Agency, and articles from the Mexican press.

In the meantime, some Americans pension funds have microfinance securities in their portfolios, and Dutch, French and other retail investors have several choices of this sort. "Making money on the backs of the poor", or just being "socially responsible"?

7. CONCLUDING OBSERVATIONS

Ethics become important to the extent that people have choices. Micro and small business finance provides choices, even entirely new vistas. Ethical problems arise whenever resources are in play, especially where money is involved. Ethical standards differ and compete, which is constructive. Finance is all about choice, and Gauss would not be surprised by the consequences. As a pragmatist he would probably ponder regulation, while Hayek might be especially doubtful concerning the "flexibility" in the application of laws in many poor countries. Yet financial markets are incredibly flexible and creative, even as demonstrated in the relatively small corner called micro and small business finance. As markets grow, it becomes possible to envisage new financial solutions that, among other things, will help to alleviate poverty.

Microfinance has many forms. Charitable ventures with broad constituencies outnumber commercial efforts. Widespread acceptance of microfinance interest rates in many countries constitutes a very positive opening in the thinking of critics who might otherwise condemn finance as being largely exploitive. This acceptance makes it possible to provide microfinance in a sustainable way, which is important because the poor want sustainable, dependable relationships that create and maintain trust. In this regard, microfinance institutions should promote transparency in financial behaviour and practice.

Properly conducted micro and small business finance has positive secondary effects, making financial markets and markets generally more efficient, adding a welcome dimension to the ethical debate.

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Résumé

Les efforts pour identifier un comportement étique peuvent amener a des résultats différents. Gandhi utilise comme référence la personne la plus malheureuse, Gauss souligne les tendances centrales et Hayek suggère que la spécialisation est essentielle pour une société productive. L'utilisation de la finance a toujours représenté un parafoudre pour le débat sur l'éthique.
La microfinance (MF) offre des services pour les pauvres entrepreneurs, et rend la frontière de la finance formelle un peu plus proche du standard de Gandhi. La MF qui opère de façon commerciale a aussi des effets positifs à travers les marchés financiers. La MF peut favoriser le premier accès à la finance formelle par les microentrepreneurs. La for-

malité favorise le pouvoir des contrats plutôt que celui de classe, tribu ou condition pour obtenir des transactions commerciales mutuellement rémunératrices. La diffusion du pouvoir est plus probable.
Les femmes peuvent bénéficier particulièrement de ces opportunités: la Banque Grameen au Bangladesh donne des crédits aux femmes qui auparavant n'avaient pas d'argent du tout; toutefois, l'épargne, non pas le crédit, est le moteur historique de l'entreprise. Peu de microentrepreneurs deviennent petits ou moyens entreprises, la compétition et la capacité tendent à préserver la dimension micro.
Les taux d'intérêt pour les micro et petites entreprises semblent élevés mais ils sont souvent les plus bas possibles. Les taux d'intérêt peuvent être considérés une abstraction mathématique – la préoccupation de l'entrepreneur est le montant du payement à faire et si le prêt était utile. La transparence, avec des règles uniformes de calcul, est la meilleure pratique.
La garantie réelle n'est pas tellement importante en MF quand les mécanismes d'encouragement sont dûment établis. Les prêts aux petites et moyennes entreprises sont normalement garantis parce que ces entrepreneurs ont plusieurs options et, donc, des flux de caisses plus complexes.
Les micro, petites et moyennes entreprises dans plusieurs pays opèrent dans des marchés financiers inefficaces. Les économistes de la Banque Mondiale ont trouvé que le développement du marché financier opère en faveur des pauvres parce qu'il favorise l'emploi et l'activité économique en général.
La MF est subventionnée, ce qui crée des ambiguïtés éthiques. Ces dernières se retrouvent dans les modèles de propriété et dans les rentes économiques est survivent avec les subventions.
Le changement de mission a lieu quand les services offerts s'étendent à d'autres groupes cibles que les originaires. Cela est généralement justifié par un désir de croissance de la clientèle, de fourniture d'accès aux services financiers formels et de création d'emploi. Le crédit à la consommation est souvent non transparent, coûteux et non productif et représente la plus grande menace pour la MF.
Les pensions perdent de valeur quand la monnaie s'effondre. Si l'histoire est un guide, les effondrements se produisent dans plusieurs pays au cours de la vie de travail d'une personne. Comment les épargnes de la classe moyenne qui est en train de se former et des pauvres qui travaillent peuvent être protégées s'il y a hyperinflation?
Pour conclure, Compartamos, une institution de MF mexicaine de grand succès, a fait une offre secondaire sur les marchés boursiers de New York et du Mexique en 2007. Les actionnaires individuels et institutionnels ont reporté des revenus extraordinaires. En même temps, Compartamos a atteint des taux de croissance très élevés, en servant de plus en plus de pauvres mexicains. La dimension de ses revenus a créé un grand scène pour le débat étique.