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PROPRIETARY FINANCING OF GLOBAL ECONOMIC DEVELOPMENT TO COMPLEMENT OFFICIAL DEVELOPMENT ASSISTANCE

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Something significant is happening in the world of global finance. A new socioeconomic development model has emerged, whereby, seed capital for small business start-ups is provided directly from shareholder-investors rather than multilateral aid or official development assistance (ODA). The new model co-opts the language of microfinance, the success of small lending programs for the poor, and the good-will associated with the notion of small business development to create a new microcredit financial industry and financial asset class. The phenomenon has the potential to alter our fundamental notion of global socioeconomic development. This article explores the proprietary nature of financing from wealthy investors such as family philanthropists, venture capitalists, private equity firms, insurers, and commercial banks. The rebranding of microfinance technology provides a useful case study to understand how proprietary financing works and what the changes portend for investors and people with low incomes trying to work their way out of poverty.

Key words: Microfinance technology, financial inclusion, economic development, banking the unbanked

INTRODUCTION

This paper examines an emerging form of financing socioeconomic development that is transforming the historical multilateral aid model designed in the 1940s by institutions such as the International Monetary Fund (IMF) and the World Bank in partnership with non-governmental aid organizations. Rather than relying primarily on government funds, official development assistance (ODA), and individual donations, the new model taps nontraditional private funds from wealthy financiers such as family philanthropists, venture capitalists, private equity firms, insurers, and commercial banks, collectively referred to as proprietary financiers.

The entry point for this new money is microfinance, that is, seed capital for new small businesses in locales where poverty is prevalent. The concept of microenterprise originated in Bangladesh in the 1970s when Muhammad Yunus started lending money to women with low incomes who wanted to own and operate their own businesses (Yunus, 2007). Microenterprise development earned Dr. Yunus and Grameen Bank the Nobel Peace Prize in 2006 and has since been replicated around the world (World Bank, 2014).

The growth and success of microfinance programs have attracted the attention of institutional investors over the past decade. Previously, microfinance had been off their radar because lending small amounts of money to people with no collateral who live in poverty is not a viable investment strategy. Today, however, financiers are capitalizing on the success and associated good-will of microfinance to turn it into a lucrative investment strategy. The emerging model involves new players, new financial instruments, a new socioeconomic development strategy, an expansion in the size and scope of microenterprise, and a rebranding of traditional microfinance, all of which is explored in this article.

The economic development literature heralds this new source of funding development and dismisses any critical analysis with the question: How is this not good news for the poor? (World Bank 2013, 2014, 2015). The

argument is that any money given to help poor people become economically self-sufficient is welcome “given low levels of domestic savings and limited access to private capital flows” (UN, 2012:2). This paper challenges such thinking in support of Muhammad Yunus and other development veterans who see problems with a privately-financed model dominating socioeconomic aid across the world (Hulme & Maitrot, 2014; Yunus, 2011a; Roy, 2011; Flynn, 2007). We all want to see quality of life improvements and reductions in poverty, thanks to development projects that are well-run, well-financed, and well-operated. However, the funding sources as well as the nature of investor-recipient transactions also matter and warrant careful analysis, not blind trust.

Why? Because since the financial meltdowns in the United States post-2007 and Europe post-2010, we have evidence of how financial risk from new sophisticated financial technologies can get wildly out of control when left in the hands of proprietary financiers whose investments are over-the-counter, part of the shadow banking system, and/or without public scrutiny. Proprietary trading in securitized assets led to tremendous losses of investor capital and human suffering over the past decade that demanded historic financial backstops by governments. The same could occur if this new proprietary economic development model falters.

Specifically, by shifting the financing of microfinance from the public sector (via multilateral government entities) to the burgeoning private for-profit global microfinance industry (via speculators and traders), we once again open the door to speculation in risky loans to people living in poverty, a new version of the subprime mortgage crisis in the U.S. and Europe. Perhaps an unapologetic look at the state of this new form of financing development with proprietary money would be valuable before it dominates the international aid arena.

Questions explored in this paper include the following: What is the difference between traditional microfinance and the new proprietary finance model? Who are the new economic players? What types of products are marketed? To whom are the products sold? How does proprietary financing work in developing and developed countries, including the U.S.? What are some of the implications of this new model for international aid? What do the trends portend for those living in poverty?

Because the new financing of microfinance is proprietary, we do not have primary data from which to answer these questions and adequately assess its practice. Therefore, secondary data and research from the frontlines are used to inform the discussion and move the topic onto our collective radar. In the future, it will be useful to ensure that proprietary data are released to the public in order to empirically track the impact of the proprietary financing of socioeconomic development and possible systemic risks.

Section one begins with an exploration into how traditional microfinance is being redefined. Section two articulates key characteristics that distinguish traditional microfinance from new investor-led financing of development activities. Section three identifies the new financiers and their clientele. Section four explores what recent changes in the financing of global socioeconomic development portend for lenders, borrowers, and investors and possible avenues to pursue moving forward.

REDEFINING MICROFINANCE

Traditional microfinance has its roots in the work of Nobel laureate, Muhammad Yunus, in the 1970s. As a young economist, Dr. Yunus was concerned with the well-being of Bangladeshi women living in dire poverty and aspiring for better living conditions. He came to understand the fundamental difficulties women had securing seed capital to work their way out of poverty through small business development. Thus, in 1974, Dr. Yunus gave a group of 42 weavers the equivalent of \$27 to pay off their high-interest loans from local lenders and start afresh. The money was repaid in full, and more women asked for start-up funds to establish microenterprises, resulting in the creation of Grameen Bank in 1976 (Yunus, 2007).

Within the first 10 years, Grameen Bank loaned \$40 million to Bangladeshi peasants through 241 branch banks. The money was dispensed for survival, “for a cow, a bullock cart, carpentry tools, wheat thrashers, sewing machines or light industrial equipment” (McCarthy, 1986). Loans ranged in size from \$1 to \$200 with the average being \$60, thus, the “micro” part of microenterprise. A remarkable 99% of the notes were repaid on time and in full.

Grameen Bank now serves 8.349 million borrowers in 81,379 villages across Bangladesh with a staff of 19,800 who process an average of \$1.5 million in weekly installments on microloans (Grameen Bank, 2016). Ninety-seven percent of the borrowers are women, and 97% of the loans are repaid. The model is replicated across the globe through the work of tens of thousands of microfinancial institutions, prompting development specialists to champion microfinance as democratizing capital, promoting financial inclusion, and offering a valuable development tool to help alleviate poverty.

Until recently, microfinance was off the radar of shareholder-investors who ignored the non-collateral poor with no assets upon which to secure bank loans. Microlending was not viewed as a lucrative business model. Even if the average default rate remained low (i.e., 1% to 3%), administrative costs were prohibitive. Moreover, private financiers did not want to establish and run in-country programs to organize women’s groups and teach them how to set-up new businesses. Economic development is a time consuming and expensive proposition that requires large staffs and significant operating costs. Thus, the provision of small loans to the poor had been perceived by financiers as having no commercial value.

The only way to make microfinance lucrative for lenders was to expand the number and types of services that borrowers secured. A microloan may initially cost the commercial lender more in human capital to administer than is received in interest payments and fees. However, the risk-return ratio changes when small borrowers become long-term consumers of financial firms that offer multiple products such as savings accounts, ATM cards, disability insurance, credit cards, home mortgages, mobile banking, plus fees for overdraft protection, ATM usage, and phone-in queries. Even more lucrative is the bundling of microloans and/or microinsurance policies into securitized assets (e.g., social investment bonds or development investment bonds) sold as investment-grade products.

The proprietary approach to microfinance is promoted today by the major multilateral aid organizations, private family philanthropies, and commercial lenders who welcome private investment dollars to grow microfinance institutions. The goal is to replicate microfinance but on a much larger scale and scope to make banking with poor people a lucrative endeavor for investors who supply seed capital. To attract new investors, the funds loaned for small business development often come with stringent performance conditions and sometimes guarantees (by government agencies or philanthropic foundations) that ensure that investors will be made whole if the loans do not yield expected returns.

The new model co-opts the language of microfinance, the success of small lending programs for the poor, and the good-will associated with the notion of small business development, to create a new microcredit financial industry and financial asset class. The new players are aiming high. The 2014 State of the Microcredit Summit Campaign’s two goals for the new proposed financial ecosystem are (1) to reach 175 million of the world’s poorest families and (2) to help 100 million families lift themselves out of extreme poverty (Reed, 2014). The World Bank reports that “some 50 countries have set formal targets and goals for financial inclusion” in their reform agenda to reach out to the 2.5 billion adults around the world without bank accounts (World Bank, 2014).

DISTINCTIONS BETWEEN THE OLD AND NEW MODELS

Below three key distinctions are presented to differentiate the emerging proprietary development model from the traditional microfinance model. The first is the consumer-orientation in contrast to microfinance's person-orientation. The second is a preference for selling financial products that maximize profits for distant investors rather than local communities. The third distinction is women's empowerment, a hallmark of traditional microfinance largely excluded from the privately-financed proprietary model.

Turning Persons into Consumers

The driver behind traditional microfinance is improving the quality of life for people who live in poverty. Microfinance projects created in 58 countries over the past three-plus decades were established to help families work their way out of subsistence through small business development. Maximizing financial returns for those donating the seed capital was not the goal.

While working in Africa in the early 1980s, I saw microfinance first-hand as an International Food and Nutrition Supervisor with Catholic Relief Services. CRS was one of the largest integrated aid programs worldwide with funding from the U.S. Agency for International Development (75%) and individual donors (25%). The program was designed by Rev. Carlo Capone, M.D., the CRS Medical Director in Sub-Saharan Africa. After a lifetime of working with the poor as a physician, Fr. Capone acknowledged that the etiology of poor health was poverty itself. So he created an economic development model that provided immediate food assistance to mothers with low-incomes while simultaneously teaching women ways to lift themselves out of poverty.

Begun in Africa in the 1950s, Dr. Capone's program provided food and nutrition services side-by-side with income-generating and educational programs for poor women with children under the age of five. The results were astounding. When food aid, education, and income-generating activities were offered in a single integrated program, children's health improved significantly for the majority of participants (The Hilton Record, 1968; Capone, 1980; Flynn, 1983).

Dr. Capone's linkage of social work and economics was breaking new ground in the field of international development. The CRS Food and Nutrition program directly altered the U.S. Department of Agriculture P.L. 480 surplus food program by adding an economic development dimension to international aid.

While socioeconomic development was transforming Africa, Muhammad Yunus was introducing a parallel effort in Bangladesh through the creation of new banking services to assist the rural poor. Small business loans—known as microcredit or Grameencredit—were availed to Bangladeshi women who wanted to work their way out of destitution. The focus was on group solidarity and community development to help alleviate poverty.

Fast-forward to 2016, and we see that the focus on integrated socioeconomic development through microfinance is lost on the newer proprietary-financed technologies where the primary concern is investor returns. The new money strives to turn microfinance programs into commercial enterprises that focus on profit maximization, cost minimization, efficiency, and shareholder returns.

To be successful, the lending institution must go beyond small loans and offer an array of banking products with high profit margins. Microloans induce millions of women living in poverty to engage in global finance at multiple levels. Securing small loans is just the entry point to a much larger banking system. The next step is to encourage the borrower to open a savings account, a service currently availed by half of the world's adult population (World Bank, 2015), leaving some 2.5 billion people as potential new customers to include an estimated 17 million adults in the United States (FDIC, 2012).

In cases where a household member is employed abroad, workers are encouraged to deposit remittances into the family's new savings account, accessible via ATMs for a fee. The World Bank (2015) reports that developing countries receive more than \$440 billion in remittances annually, often exceeding the dollar value of development aid. Heretofore, remittances have been commonly transferred through Money Service Businesses (MSB) established to facilitate money transfers for migrant workers. Under new proprietary-financed plans, MSBs may be squeezed out, leaving fewer remittance transfer providers.

The next product offered is mobile phone banking, whereby privately financed microfinance programs market mobile banking to borrowers to foster dependence on the lender and enable the aggregation of behavioral data, later used for credit-underwriting decisions.

Mobile banking allows for wide-spread money transfers around the world and addresses the distance problem reported by 20 percent of unbanked persons surveyed by the World Bank (2014) on why they do not have a bank account. The annual State of the Industry Report on Mobile Financial Services found that mobile money, mobile insurance, mobile savings, and mobile credit were provided by 255 registered mobile money services across 89 countries in 2014, reaching almost 300 million customers and is "transforming the way people access financial services, while offering new business opportunities for operators" (Scharwatt et al., 2015:5). On March 17, 2015, Facebook announced its entry into fintech (i.e., financial technology) by launching banking services on its instant-messaging app, following efforts by competitors Snap, Apple, and Google to bank the unbanked through mobile devices.

Microinsurance is another product offered by proprietary-financed development institutions, capitalizing on the popularity and success of microfinance. Once the poor have received a microloan from the lending institution and set-up a savings account accessible through mobile devices, customers are actively marketed to purchase microinsurance products advertised as "the protection of low-income people against specific perils in exchange for regular monetary payments (premiums) proportionate to the likelihood and cost of the risk involved" (Churchill, 2006). Examples of microinsurance products include disability insurance, health insurance, dental insurance, death insurance, funeral insurance, rainfall insurance, motorcycle insurance, crop insurance, and livestock insurance. Such products are sold across India, Asia, and Africa.

In some cases, insurance policies would seem to be potentially valuable especially for savvy customers who understands the intricacies of insurance and know how to manage their money and a business simultaneously. However, the idea of selling insurance policies also raises serious questions: How are illiterate persons to understand complex insurance policies that highly educated people sometimes find opaque? More fundamentally, why would a person living hand-to-mouth forgo basic human needs to pay insurance premiums to mitigate against tragedy? The poor live with tragedy daily with or without microinsurance.

Another question to consider is whether microinsurance will be voluntary or involuntary for customers who obtain microloans? Automatic bundling of insurance with microloans is becoming more commonplace (Allianz SE & GIZ, 2013). Can people with low-incomes afford to pay principal, interest, plus mandatory insurance on a loan? If so, what is the advantage of using microfinance institutions instead of traditional predatory lenders? Microinsurance may more realistically be insurance for the lenders, rather than for the poor.

The total package of financial services and products availed to those living in poverty by global financiers is promoted by the World Bank's Consultative Group to Assist the Poor (CGAP) on the grounds that "poor households need access to the full range of financial services to generate income, build assets, smooth consumption, and manage risk—financial services that a more limited microcredit model cannot provide" (CGAP, 2014). The success of this new model is evident in places like Bangladesh and India where people have more access to financial services provided by

microfinance institutions “than they have access to basic public services – health, security, education, electricity, water, roads, and information” (Rutherford, 2009).

Insurance and other financial products could be beneficial per se but not as currently tied to the new proprietary-financed model, which shifts the focus of socioeconomic development from helping an individual in need, to seeing the poor as consumers, a significant departure from our notion of helping those living in poverty through development programs.

Local to Transnational Stakeholders

A second fundamental difference between traditional microfinance and the newer proprietary model is the locus of beneficiaries. Microfinance has its roots in the local community where profits are reinvested as a public benefit. First and foremost, microfinance programs serve the program participants who are considered to be the clients.

In stark contrast, proprietary financiers serve a global constituency of investors. Financiers do not actually run the programs, rather, they give seed capital to local providers responsible for finding clients and executing lending activities. Profits are distributed to shareholders wherever they may live, which is not likely to be in the poorest communities.

The clients have thus morphed into the financial investors themselves, not the poor who seek financing. When Forbes compiled its first-ever Top Microfinancial Institution list in 2007, at a time when private investors had financed some \$2 billion in microfinance, the following six variables defined “top”: gross loan portfolio, operating expense, operating expense divided by the average number of active borrowers as a percentage of gross national income per capita, the outstanding balance of loans overdue by more than 30 days as a percent of gross loan portfolio, return on assets, and return on equity (Swibel, 2007). Notable is the absence of a single person-based or poverty-related indicator associated with successful microfinance investments.

Grounded in the reality of the local people, traditional microfinance organizations set themselves up with a social purpose in mind of helping to alleviate poverty. This is the primary concern built into microfinance institutions’ mission, operations, and governing documents. Large financial firms interested in microfinance are not in the business of poverty alleviation. Instead, they aim to sell financial products and maximize returns to shareholders.

Moreover, investors are not social entrepreneurs; they are business entrepreneurs. The process of creating a microfinance program that fosters social entrepreneurship is more complicated than simply giving loans to people who are unbanked. Success requires a strong presence on-the-ground coupled with deep knowledge of people and culture.

Empowerment to Profit

The third key difference between microfinance and propriety finance is the former’s coupling of monetary and non-monetary outcomes to produce positive socioeconomic outcomes in contrast to the newer programs’ focus on profit despite the development rhetoric. Commercial entities are very clear that their interest in funding the poor is a mechanism to generate profit by finding new customers around the globe. In contrast, locally-based microfinance groups focus not only on what money can do financially, but also how money can help empower people through education, training, community organizing, and small business development.

Although the initial focus of microfinance was women’s development, this has shifted as only 73 percent of borrowers are women, far below the 97 percent at the start of Grameen Bank (Women’s World Banking, 2013). As large commercial entities enter the microfinance arena, the percentage of women borrowers is dropping despite a

consensus that compared to men (a) women are better credit risks, (b) funds given to women are more likely to be used for poverty reduction, improved family living conditions and children's education, and (c) women need smaller loan amounts to achieve higher profitability.

Profit, not empowerment, is the focus of the new financing of microfinance programs. In order to make microcredit profitable for investors, increasing economies of scale are necessary. So the aim now is to sculpt nonprofit providers in the image of for-profits by leveraging the financial needs of local communities and moving away from the goal of empowering women with low-incomes.

The above three shifts—turning persons into consumers, focusing on global not local stakeholders, and valuing profits over empowerment—characterize proprietary microfinance portfolios in contrast to traditional microfinance programs. However, the distinction between these two models is not always made clear to prospective investors.

NEW PROPRIETARY PLAYERS

Privately-financed development activities are referred to variously as social investing, inclusive finance, banking the unbanked and underbanked, banking at the base of the pyramid, and impact investing. The idea is marketed as distinct from standard debt and equity investments in that investments are targeted to growth nations where there are large numbers of people with very low incomes. Sometimes these new investment vehicles are sold by for-profit non-bank financial institutions to investors who have a desire to be socially responsible with their money. Other times, savers in rich countries lend directly to borrowers in poor countries through peer-to-peer websites. Either way, the problem is that investors may not understand the difference between traditional microfinance programs and the new privately-financed initiatives.

To further confuse matters, some long-standing nonprofit microfinance entities have changed their business model to appeal to big donors. One example is FINCA International that has programs in 23 countries, staffed by more than 12,000 employees, providing loans to 1.8 million clients as part of an \$877 million loan portfolio (FINCA International, 2016).

To appease potential donors, in 2010, FINCA created FINCA Microfinance Holding (FMH), a for-profit limited liability corporation that enables FINCA to receive funds from non-traditional sources, convert international FINCA subsidiaries into commercial for-profit businesses, and expand financial products such as mortgages, remittance transfers, and microinsurance. Thus far, the new strategy has been successful, according to FINCA's Director of Transformations, Equity, and Mergers & Acquisitions, Chikako Kuno, who indicated that a second infusion of \$74 million from investors in 2012 would "help fund the planned growth of our Subsidiaries around the world and enable our existing Subsidiaries in 22 countries to continue to transform into licensed deposit-taking institutions" (FINCA, 2013). Microfinance holding companies, like FINCA's FMH, comprise an estimated 10% of the \$22.1 billion microfinance investment business (Hummels and Röntgen, 2013).

FINCA, thus, has a new clientele: private investors who want to invest in the poor in return for above-market rates of return. No longer are poor women who come to FINCA for help starting small businesses the primary beneficiaries of their programs. Financial investors have become FINCA's primary clientele.

The largest microfinance institution, ACCION International, has also actively moved from traditional microfinance (begun in 1972) to the new proprietary-financing model. In 2012, Bamboo Finance, a Luxembourg-based private equity firm, bought the Boston-based ACCION Investment Fund for \$105 million. Bamboo Finance's interest in financing the poor has since expanded into Mongolia, Kyrgyzstan, India, and Southeast Asia given attractive

returns on investment of up to 20 percent for their clients who include Dutch pension fund ABP, Abu Dhabi's Aabar Investments, and high net worth individuals and families.

Bamboo Finance's chief investment officer, Xavier Pierluca, estimated that "about \$72 billion of assets around the world are being invested in microfinance right now, having grown significantly over the last 10 years" (Steger, 2012). Pierluca believes that part of the growth is because some traditional microfinance institutions are accumulating assets of up to \$1 billion, making them "relevant for the large private-equity funds." This estimated \$72 billion in new money from proprietary financiers of microenterprise development significantly adds to the \$160 billion a year in official development aid from the World Bank, the United Nations, and the Global Fund for grants, loans, and expertise advice (World Bank, 2016).

Firms such as the venture capitalist Sequoia and private equity Legatum are also investing equity in microfinance institutions with short-term potential for initial public offerings modeled on the experiences of Banco Compartamos in Mexico and Equity Bank in Kenya. The Swiss bank, UBS, joined the movement based on "the potential of impact investing, with its dual social and financial goals, to appeal to mainstream private investors . . . Banks, with their expertise as intermediaries between capital and investment opportunities, clearly have a role in deploying capital effectively for social aims" (UBS, 2014).

The once obscure, small-scale microfinance industry has become a mature industry and one that welcomes commercial lenders and stakeholder-investors, thus promoting a new model of economic development by rebranding traditional microfinance technology.

TRENDS IN MICROFINANCE TECHNOLOGY

Proprietary funding of socioeconomic development is in an experimental phase. Tensions exist between traditional microfinance institutions and the newer entrants viewed as competitors. In fact, after receiving the Nobel Peace Prize in 2006, Yunus himself was forced to resign from his role of Managing Director of Grameen Bank by the Bangladesh Bank who stripped Grameen Bank from the power to appoint its own board of directors and transferred authority to the central bank. All this transpired upon the release of a World Bank report empirically documenting the success of Grameen Bank in Bangladesh as evident in increases in household spending, labor force participation, and school enrollment among participants (Khandker & Samad, 2014).

Tension stems from Yunus' questioning proprietary financiers who are turning microfinance programs into commercial, for-profit enterprises:

"Commercialisation has been a terrible wrong turn for microfinance, and it indicates a worrying "mission drift" in the motivation of those lending to the poor. Poverty should be eradicated, not seen as a money-making opportunity. There are serious practical problems with treating microcredit as an ordinary profit-maximising business. Instead of creating wholesale funds dedicated to lending money to microfinance institutions, as Bangladesh has done, these commercial organisations raise larger sums in volatile international financial markets, and then transmit financial risks to the poor.

Furthermore, it means that commercial microcredit institutions are subject to demands for ever-increasing profits, which can only come in the form of higher interest rates charged to the poor, defeating the very purpose of the loans . . . The community needs to reaffirm the original definition of microcredit, abandon commercialization and turn back to serving the poor" (Yunus, 2011a).

The head of microfinance investments at Triodos Bank, Marilou van Golstein Brouwers, commented on the influx of private capital into these newer institutions, “If the mission ... is only to maximize profit, then the social goal of helping people out of poverty is not reached. The problem is that a lot of the new private investors in the sector see it mainly as a way of making a lot of money” (Evans, 2010).

This new form of financing the poor portends significant changes in our notion of socioeconomic development. Consider the definition of small or micro. Commercial banks define microfinance institutions as those with up to \$50 million in deposits, well-beyond “micro” for a community living in poverty. As the number of microcredit financiers increases, so does competition to gain a foot-hold into new geographic locations. As a result, microfinance institutions are exerting tremendous pressure on front-line staff members to increase small loan volume because the for-profit business model imposes bottom line quarterly earnings growth to justify new loans. As a result, staff members must become earnest salespersons and aggressive loan collectors to keep their jobs. The focus on “small” business development is lost to an economies of scale business model.

Moreover, as new and larger financial players enter the microfinance arena, the supply of money available for microloans has rapidly increased to some \$72 billion. Among the biggest investors are the Bill and Melinda Gates Foundation, Michael and Susan Dell Foundation, McGraw-Hill Publishers, Omidyar Networks, MasterCard, Visa, Deutsche Bank, Citi Microfinance, Moody’s Analytics, and NYSE Euronet. The sheer scale of these funds risks crowding-out quality. Some lenders have reported a drop in loan portfolio quality and an erosion of lending discipline (Viada and Gaul, 2012). These changes have put pressure on microfinance institutions (MFIs) that were once small enough to ensure high-quality operations. But now, according to the Microfinance CEO Working Group, “Due to high growth, the MFI’s systems are overstretched, and the controls appropriate to a smaller MFI are no longer sufficient” (Firth, 2014:3).

Financiers are willing to provide financial capital for poverty programs, moreover, only with strict conditions (i.e., measurable impact) and often implicit guarantees. Such are the conditions on social impact bonds (SIB) and development impact bonds (DIB), which are recently-introduced experiments in funding aid programs with money from institutional and retail investors. To encourage such investments, governments in several countries actually guarantee that investors will earn a portion of the promised returns even if the goals are not met (U.S. National Advisory Board on Impact Investing, 2014).

The first social impact bond was issued in England in 2010, followed by the United States in 2012. One of the lead investors in the U.S. was Goldman Sachs, which secured a guarantee of repayment from Bloomberg Philanthropies in an effort to encourage other financiers to invest in this new microfinance asset class. Development impact bonds are available through the U.S. Agency for International Development’s Development Credit Authority and the Overseas Private Investment Corporation and are offered with a backstop for financiers entering the small business arena to insure capital is not lost if programs fail to deliver expected rates of return. This is a key feature of the new proprietary microfinance model in need of careful research and analysis (see UBS, 2014).

Last, it is not clear what happens on the frontlines if outcomes (or impacts) are not achieved. With traditional microfinance programs, funds would not necessarily be pulled if participants failed in their endeavors. Programs are equipped to deal with failure through counseling and training programs that help participants learn from their mistakes and remain engaged in the effort. Commercial investors are not engaged for the long-term.

Charity Washing

Global financiers and philanthropists are marketing new financial technologies associated with microcredit as a form of financial inclusion to help disadvantaged people become part of the global economy. United Nations Special Advocate for Inclusive Finance for Development, Queen Máxima, notes that “financial inclusion enables and

accelerated progress toward numerous national priorities such as job creating, equitable growth, poverty alleviation, health, education, food security, and more” (UNSGSA, 2014).

However, new proprietary financing models are not necessarily charitable in nature as marketed. With returns exceeding 20 percent, Wall Street and Silicon Valley are now microfinance creditors because microfinance is profitable.

While proprietary financial investment vehicles are new, the rhetoric is familiar and suggests that we may be seeing a new form of “charity washing” in the making. The risk is that new products will be mistaken as benevolence. Bankers and financiers are not in the business of charity. They are wed to the bottom line of generating sufficient profits to stay in business.

At the opening of the gala of the United Nations 2005 International Year of Microcredit, Secretary-General Kofi Annan reminded the group that “microfinance is not charity but a way to extend the same rights and services to low-income households that are available to everyone else” (UN, 2005). Ten years later, researchers Hulme and Maitrot add that “peddling a false account of the ‘magic of microfinance’ in developing countries, and the enthusiasm and good intentions of Western banks and billionaires to support this magic, is a key component of the public relations strategy of mainstream finance . . . The belief, and vested interest, in the microfinance narrative in the rich world are so strong that microfinance can avoid the growing evidence of its dark side” (2014:4, 6).

In the ever-expanding reach of global capitalism, financial technology aims to align traditional microcredit for poor women with mainstream market capitalism.

SOLUTIONS TO CONSIDER

One of the ways to mitigate against charity washing is for nonprofit entities to help guide the process of moving from small-scale microenterprise development to the new proprietary model in order to maintain some basic premises to protect the poor. The offer made to nonprofits to partner with for-profit financial institutions is seductive at a time when U.S. nonprofits are modeling themselves on for-profits to raise revenues generated from fee income, estimated to be almost 50 percent of annual budgets (Salamon, 2012). To maintain their unique role, nonprofit financial institutions may want to stay true to their charitable, tax-exempt purpose by serving as an intermediary between households and commercial institutions entering the microfinance arena.

Nonprofits could also work with governments that will be called upon to develop codes of conduct to regulate this rapidly growing financial sector, including establishing a microcredit regulatory authority in each country, capping the maximum interest rate on microloans, establishing provisioning policies that limit the number of loans per customer, overseeing money wires from transfer centers, and addressing taxation issues.

A closer examination of these newer forms of “banking the unbanked” and “financial inclusion” apply equally to developing and developed countries, including the U.S. given that microfinance is no longer a Third World issue. In 2013, Walmart and American Express jointly introduced the Bluebird Card that offers direct deposit, ATM, bill payment, check-writing, and sub-savings account capabilities. Bluebird is a way for Walmart’s Money Center™ to provide financial services to their customers in the U.S. in the aftermath of a rejection by the Federal Deposit Insurance Corporation of its application to open an industrial bank in Utah to service its low-income customers (Barbaro, 2005; Walmart, 2014). Walmart has demonstrated how commercial institutions can meet the banking needs of the growing underclass in the U.S. Will the next step be to issue small business loans to the poor?

If the introduction of microfinance has no educational or community building component, customers may not have the capacity to read the fine print on a microloan, credit card, or microinsurance applications. They may not understand compounded interest calculations and the impact on the bottom line. Individuals may not have the ability to renegotiate with a bank, credit card issuer, or mortgage firm if they get in over their heads (see Servon, 2017).

Moreover, evidence of microfinance impacts in Latin America and India indicates that some heavily indebted individuals who cannot meet interest rate payments in excess of 20 percent and/or who do not see a way out of their indebtedness, commit suicide in high numbers (AP, 2012; Biswas, 2010). In the Arabian Gulf, migrant workers have succumbed to over-borrowing through credit cards in order to send more money home. Many end up in Arab debtor's prison for non-payment. The New York Times describes the process as follows: "Technically, debtors go to jail for bouncing 'security checks' they must sign when accepting a card. If borrowers fail to pay, banks can deposit the checks for the sum owed, and bouncing a check is a crime" (DeParle, 2011). The Philippine Embassy in the United Arab Emirates has made debt reduction a part of a financial literacy campaign to improve conditions for migrants.

In South Africa, the African Bank raised money from global financiers to meet demand from its 2.4 million customers for loans to buy middle-class lifestyles. Borrowers were disproportionately poor and put up no collateral. When one-third of the loans went into arrears, African Bank had to turn to the central bank for a bailout.

Such adverse effects of commercial microfinance practices beg the question as to what kind of expectations society has for citizens who do not fare well economically or become financially vulnerable as a result of products that aim to bank the unbanked. Societies have always assumed there would be a group of people not able to make "correct" economic choices, and hence, programs and policies were established to mitigate the damage created by poor decision making.

It is interesting to note that on the heels of the World Bank's Global Financial Development Report 2014, which actively promoted financial inclusion strategies, the World Development Report 2015 deployed behavioral economics to argue for socially-engineered policies tied to financial loans to the poor because "people do not always make deliberative, independent decisions based on careful self-interested calculations" (World Bank, 2015). The report provides the rationale for private global financiers to embed strict outcome targets (or financial incentives) to force participants to deliver as envisioned and, thereby, yielding the expected rates of return on investment for financiers.

It seems as if global capitalism treats all people as if they have the innate capacity to make "good" choices. But when people do not, who is held accountable, the lender or borrower? Central banks could play a role here to insure that microfinance institutions be financially transparent and transmit buyer beware messages to prospective borrowers as well as shareholder-investors.

Over-indebtedness was the focus of a 2014 study conducted by the Microfinance CEO Working Group comprised of the leaders of eight dominant microfinance organizations that have a collective reach of 250 microfinance institutions in 70 countries, representing over 40 million clients (Firth, 2014). The group's recommendations to mitigate against over-indebtedness included mandatory reporting by MFIs, stronger borrower screening, avoidance of micro-competitive hotspots, and a limit on the number of loans per borrower.

Another fundamental question is what will happen to all the small loans being issued under the guise of poverty alleviation? Will these debt instruments be bundled and sold as investment-grade notes as we saw with mortgage-backed securities in the 2000s and today's rental-backed securities? Who will determine if a small loan is a worthy investment-grade asset?

To address critical human needs through burgeoning privately-financed technologies, all three sectors of the economy—business, nonprofits, and government—have a role to play as articulated by IMF Managing Director Christine Lagarde at the June 2014 International Forum for Financial Inclusion: "I see promoting financial inclusion as a collective responsibility. It is a task for both the government and the private sector. Each has a role to play—the private sector in harnessing technology and adapting to consumer needs, the government in creating an enabling environment for greater financial inclusion. Civil society also has a role to play, of course, by providing informal support and oversight" (Lagarde, 2014).

CONCLUSIONS

The entry of large commercial financial institutions and private financiers into the business of small-scale banking and credit services in growth markets is a game changer for multilateral economic development. The nascent interest builds upon a history of successful microenterprise development, defined as making small amounts of capital available to women with low-incomes to work their way out of poverty. Microenterprise began as a charitable effort to help people who live in poverty earn small sums of money to feed their children. Seed money is offered as either a non-collateralized loan (with a below market interest rate) or a grant (that creates no future financial obligations).

The newer proprietary model, discussed above, brings the commercial profit maximization/cost-minimization business model to poor communities by banking the unbanked and aggressively promoting the inclusion of new customers into the commercial banking system, initially through microloans but eventually as full-fledged banking consumers with credit cards and insurance policies. If indeed the goal of these new microfinance financiers is to treat the poor as any other customer, why the guise of presenting the operations as charitable or socially-oriented?

There appears to be a certain degree of overconfidence among business people who enter the world of socioeconomic development. Because of financial successes in the world of transnational business, they believe they have the requisite knowledge to be successful in social spheres. Actually, understanding the reality of living in poverty is quite complex. When some of these newer business models are superimposed on growth economies, risk of failure on a large scale is introduced. Can we find ways that wealthy people can feel good about investing money while respecting development professionals? Perhaps this is a place for further discussion.

Microfinance is a powerful financial technology that provides access to capital, community, and training that transforms the quality of life of the poor and working class. In the years to come, commercial investing that rebrands microfinance, may prove to be a sound technology for savvy individuals who need investment capital and other banking services. Others, however, who obtain easy money through credit may not do as well due to a lack of education or self-restraint as we saw with emerging market governments that received windfall loans in the 1990s and the millions of Americans who ended up with underwater mortgages in the 2000s.

What will happen if large numbers of individuals become overextended on credit cards or default on loans on a global scale? What cultural, legal, and social institutions will be needed to ensure that the newest financial technologies benefit society in the short and long term? To answer these questions, full disclosure of the extent and nature of proprietary financing of small business development is needed in order to conduct rigorous, verifiable, and quantitative analysis of this new form of financing global socioeconomic development, which has the potential to impact hundreds of millions of people across the globe.

While the benefits of microfinance programs have been widely recognized, Dr. Yunus cautions that "There are always people eager to take advantage of the vulnerable. But credit programmes that seek to profit from the suffering of the poor should not be described as "microcredit," and investors who own such programmes should not be allowed to benefit from the trust that microcredit banks have rightly earned" (Yunus, 2011b). On the topic of

proprietary financing of microfinance, Yunus recently noted, "If you're inviting investment from the market, they are looking for their return. That's the wrong message. Microcredit should not be presented to investors as a ground for making a lot of money out of the poor people – that's a shame" (Militzer, 2014). Yunus and coworkers at Grameen are working on reclaiming the microfinance brand.

Perhaps by more accurately identifying the commercial nature and motives of the new proprietary financing of microenterprise development and securing proprietary data on such practices, we can clarify any obfuscations moving forward for the benefit of borrowers, lenders, and investors.

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