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To whom should we be fair? Ethical issues in Balancing Stakeholder Interests from Banco Compartamos Case Study

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In the world of microfinance, interest rate ethics is an important issue, thrown into the limelight by the Initial Public Offering of Compartamos which resulted in millions of dollars of gains, some of which found their way into private pockets. These high gains were based on high interest rates, raising ethical questions. The paper then uses a stakeholder analysis to explain the interests of different stakeholders in this case and present that fairness to one group of stakeholders is often at the expense of another group. We take the position that in this case, specifically, the firm objectives could have been met without such ethical trade-offs. The specifics of the case are then generalised to all NGOs participating in for-profit firms.

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Title: To whom should we be fair? Ethical issues in Balancing Stakeholder Interests from Banco Compartamos Case Study

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Abstract

In the world of microfinance, interest rate ethics is an important issue, thrown into the limelight by the Initial Public Offering of Compartamos which resulted in millions of dollars of gains, some of which found their way into private pockets. These high gains were based on high interest rates, raising ethical questions. The paper then uses a stakeholder analysis to explain the interests of different stakeholders in this case and present that fairness to one group of stakeholders is often at the expense of another group. We take the position that in this case, specifically, the firm objectives could have been met without such ethical trade-offs. The specifics of the case are then generalised to all NGOs participating in for-profit firms.

Keywords

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1. Introduction

Microfinance is today a well-known instrument in development policies. With between $800 million and $1 billion to microfinance of subsidies per year (2004) and more than $5 billion of assets under management at the end of 2007 mainly through socially-driven investment funds (CGAP, 2008), donors and social investors contribute to the boom of the sector. Microfinance institutions (MFIs) have reached more than 130 millions clients, most of them previously excluded from the traditional financial sector[1] (Daley-Harris, 2008). The Mexican MFI named *Banco Compartamos* is one of its most famous and controversial leaders.

At the end of 2005, Compartamos was charging high interest rates of 86% p.a., net of taxes on its loans to the poor[2] (Rosenberg, 2007). This strategy led to high profitability and a booming book value of the shares that reached 21 times the paid-in-capital by December 2006. The Return on Equity was higher than 50% p.a., much more than the Mexican banking sector and that of most MFIs in the rest of the world, causing the growth rate in outreach to double from 24% per year in the 1996-2000 period to 46% in the 2000-2006 period.

In April 2007, *Compartamos* issued shares in a secondary offering IPO. 30% of existing shares were sold at 12 times their book value to new investors, providing existing shareholders a net profit of about 460 million dollars. The selling investors included NGOs such as Compartamos AC and ACCION, as well as IFC, the private lending arm of the World Bank group. Private individuals, who held a minority of shares, captured over $150 million from the sale. The backlash to the issue was a lot of accusations that poor people paying very high interest rates were sacrificed for rich investors. For instance, immediately after the IPO, Lewis (2007), wondered if the IPO is "a warning that microfinance is going awry". On the other hand, the Compartamos IPO has served to bring a massive private sector infusion of investment to alleviate poverty (Rhyne & Guimon, 2007).

This paper will discuss some ethical questions related to *Compartamos* strategy. We will argue that *Compartamos* strategy favored some stakeholders, primarily the shareholders and to a lesser extent the staff and the potential borrowers who could benefit from the expansion of the MFI. Nevertheless, this strategy was endured at the expense of another key stakeholder, their current clientele. The IPO principally contributed to the shareholders interest rather than the potential borrower since it did not lead to a capital increase but only the sale of existing shares.

These ethical issues stem from governance problems, which are thorny in the best of times, and the paper will zoom in upon conflicts between different types of shareholders with diverging missions, which make the resolution of stakeholder problems more difficult. This paper is not directly dealing with problems of ethics in money per se (ethics of making money, ethics of using money, etc.). Nor is it directly dealing with the ethics of for-profit, capitalist, banks making profits by selling finance to poor people at the bottom of the pyramid. We will argue that Banco Compartamos story is a much more complicated case since it is governed and primarily owned by not-for-profit NGOs or developmental institutes. Hence, it raises ethical questions on the role and the missions of non-profit or socially-oriented associations and enterprises. In this paper, we will focus on the history of Compartamos before and just after the 2007 IPO. The IPO launched a controversy that affected the whole microfinance sector and forced the managers to decrease interest rates afterwards.

The paper is structured as follows. Section 2 briefly presents the facts of the Compartamos case up to the IPO in April 2007. Section 3 will address the ethical questions of choosing between stakeholders implicit in Compartamos' interest rates and their profitability. Broadening the debate to the whole non-profit sector, Section 4 will present some ethical issues raised in the governance of microfinance institutions in particular and NGOs in general when shareholders have diverging motives between themselves. Finally, Section 5 will draw some conclusions.

2. Compartamos history until April 2007

Compartamos AC was an NGO established in 1990 as a not-for-profit institution to provide microcredit to poor people. During the period 1990-2000, this NGO received donor funds of $6.3 million. Donors included the CGAP[3], a consortium of public and private donors hosted by the World Bank as well as other international donors, as well as the NGO ACCION International, which was financed by the American development agency USAID. Thus, donor agencies were the principals and Compartamos AC was the agent whose mission was to aid the poor by offering them credit.

In 2000, a for-profit finance company named *Financiera Compartamos* was formed with a paid-in capital of $6 million. The goal was to make the management more professional and aggressive to reach its targeted outreach to ensure financial sustainability thorough economies of scale. The shareholders of *Financiera Compartamos* included the NGO, Compartamos AC, as well as the equity investment fund Profund, ACCION International and IFC, the private lending arm of the World Bank group. Together, these agencies with development missions had 68% of the shares in the for-profit *Financiera Compartamos*. These agencies are themselves agents for donors or for tax-payers (Mersland, 2008). The rest of the shares were predominantly with directors and managers with some outside private holding.

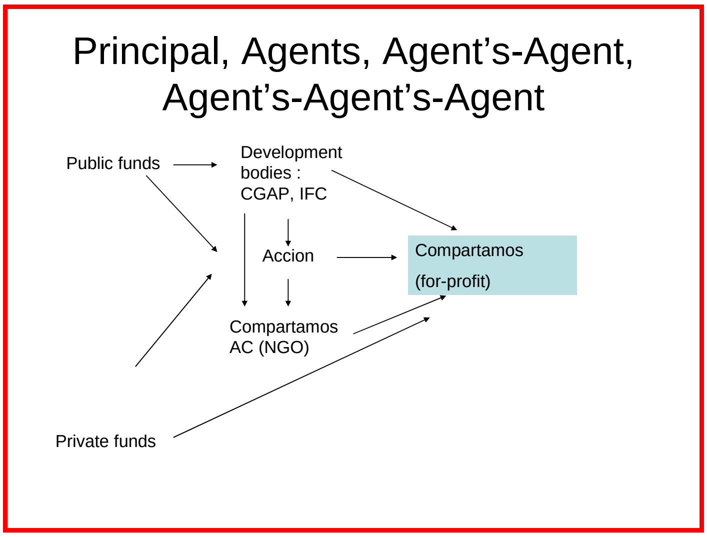


Figure 1: Principal-agent representation of Compartamos

Thus, we can resume that public funds given to agencies were given to an NGO, who in turn invested it in a for-profit agent. As such, the finance company was a for-profit agent of a line of not-for-profit principals, as summarised in Figure 1. Although this itself raises some governance issues, it must be reminded that many public agencies sub-contract a good part of their mission to private companies. Here, the mission of the development agencies was to raise the standard of the poor. The mission of the Mexican NGO was to raise the standard of the poor by aiding them to get credit. The mission of the for-profit was to give credit to the poor in a financially sustainable manner. The idea was to attain independence from the vagaries of donor financing.

The for-profit *Financiera Compartamos* really made high profits, primarily from high interest rates. It charged high interest rates of 86% p.a., net of taxes on its loans to the poor. With VAT, this was almost 100 % p.a. The high interest rates led to high profitability. *Financiera Compartamos* ' ROE of 55% p.a. is higher than that of most MFIs in the rest of the world (average ROE of 7.5%) and higher that those of most MFIs and consumer lenders in Mexico. At the same time, the operating costs remained lower that those of comparable MFIs and consumer lending institutions. The high profitability financed outreach, causing the growth rate to double from 24% per year in the 1996-2000 period to 46% in the 2000-2006 period. At end-2006, the book value of the initial paid-up shares of $ 6 million had reached $ 126 million, an increase of 21 times! Outreach extended to over 600,000 clients. The average loan size in 2006 was about $ 450, about 6% of Mexican per capita income, suggesting that Compartamos aims at poorer people than do many Microcredit and consumer finance institutions[4].

In 2006, the company obtained a banking licence and transformed itself into *Banco Compartamos,* in order to be able to raise deposits. In 2007, an IPO was made by *Banco Compartamos* in which existing investors sold 30% of existing stock. No new stock was issued. They received $ 470 million (12 times the book value!). This means original investors got 100% per year compounded for 8 years. The IPO was 13 times oversubscribed and considered a huge success by any financial market standard. Pent-up demand caused the share price to surge 32% in the first day of trading.

Mainstream international fund managers and other truly commercial investors - not socially responsible investors - bought most of the shares. Roughly 6,000 new shareholders, including about 160 institutional investors, in Banco Compartamos own 30% of the stock. The rest was retained by existing shareholders. Who got the money? Two thirds of proceeds went to the three NGOs and development agencies. One third of the proceeds, around $ 150 million, went to private individuals.

The World Bank has been under criticism from academics and social workers from all sides saying that their donor funds do not go far enough to foster real growth and development. Ironically, in this Compartamos case, where the IPO was evidently a huge success with perfect execution, they found themselves being criticised for having initiated too much growth and profits!

Within two months, CGAP (through Rosenberg (2007)) and ACCION (Rhyne & Guimon, 2007) published papers in defence of the Banco Compartamos IPO. Compartamos AC also listed arguments in this line on its website.

3. Fair prices: a stakeholder approach to Compartamos' policy

This section will debate Compartamos' pricing policy considering the diverse stakeholders involved in its activity. After a brief historical and comparative introduction to the fairness issues in interest rates, we will present the key stakeholders. Freeman and Reed (1983) distinguish between a wide definition of stakeholders and a narrow definition. In the wide definition they include "any identifiable group or individual who can affect the achievement of an organization's objectives or who are affected by the achievement of an organization's objectives". In a narrower definition they include "any identifiable group or individual on which the organization is dependent for its continued survival". In this paper, we use the narrow definition. However, alongside the five traditional stakeholders of financial institutions, employees, shareholders, current borrowers, donors and regulators, a sixth one is at the core of this debate on interest rates: the potential borrower[5]. We will show that Compartamos' justification of its pricing strategy appeals to two stakeholders: the shareholders and the potential borrowers, at the expense of existing borrowers.

Stakeholder analysis has now been applied in a number of papers in diverse industries and functional areas such as retailing (Whysall, 2000), intercollegiate athletics (Wolfe & Putler, 2002), R & D (Elias, Cavana, & Jackson, 2002; Nystrom & Poon-asawasombat, 2003), charitable contributions (Brammer & Millington, 2004) and political issues (Bryson, Cunningham, & Lokkesmoe, 2002; Drori & Weizmann, 2007). In most of these analyses, some common steps are present: a set of stakeholders is first defined, then their interests are indicated, and then a discussion is made of the conflict of interests and the relative power of each stakeholder[6]. The issues chosen are often presented in terms of ethical concerns. For example, in the retailing industry, Whysall (2000) looks at ethical issues such as low pay of retail workshop required for low prices to customers, selling products made in sweatshops in low cost countries, offensive advertising, development of out-of-town outlets, and copy-cat branding. All of these require balancing interests of some of the stakeholders.

All these papers indicate that the Stakeholder Analysis concept is not perfect, but it helps understand the business process, despite some limitations. One limitation is that Stakeholder analysis assumes homogenous preferences within each stakeholder group and this is not always the case (Wolfe & Putler, 2002). A different formulation of this critique is that role based shareholders may not have the same interests, especially if self-interest is not the primary motivator (Wolfe & Putler, 2002). In fact, in our own study there are different shareholders with different interests and different donors with different interests. However, this limitation can be answered easily by simply increasing the number of stakeholders in the analysis. A second limitation is that the same stakeholder's interests may be homogenous or heterogeneous for different decisions (Wolfe & Putler, 2002). In our case, we are mainly looking at issues related to the price and clientele, so we don't face this problem. A third limitation is that stakeholder analysis is too superficial and that to really understand social organizations we need to go deeper and perform an Archetypal Social Systems Analysis (Mitroff, 1983). However, in our experience managers would suffer from time constraints and bonded rationality to study what is happening in the mind of each and every individual. Therefore, some kind of superficiality and aggregation is necessary for management decision making.

Nevertheless, despite these limitations, all these studies have opted to adopt stakeholder analysis because of the advantages it provides. On the one hand, by looking beyond shareholders, stakeholder analysis takes in multi-party interests involved in the success or failure of the firm (Freeman & Reed, 1983). At the other extreme, it simplifies the analysis by grouping interested parties in a few manageable slots (Wolfe & Putler, 2002). This then allows noting the interests of these groups and the inherent risks in ignoring any group (Bryson et al., 2002), especially those who control resources that may be critical to the network (Drori & Weizmann, 2007). The advantages of such analysis increase in complex markets, different stakeholder backgrounds, large investments and perceived risky products (Nystrom & Poon-asawasombat, 2003) and risky environments (Wolfe & Putler, 2002).

Fair interest rates: History and comparison

Debates on fair prices have a long historical background, starting with Aristotle's denunciation of interest as the unnatural fruit of a barren parent. More recently, the fair trade movement started to lobby for a fair remuneration for the low-income countries' workers. Even if they are often praised by activists or the civil society, fair prices theory have been relatively little discussed in the recent ethics literature[7]. Microfinance offers a new and particularly challenging field to analyse pricing policies since it includes sometimes conflicting interests of stakeholders[8].

The question of high interest rates is a very controversial one[9] so that the debate is not restricted to Compartamos. Smith and Epstein (2007) indicate that annual interest rates paid by poor borrowers in Mexico range from 50% to 120%, compared to a worldwide average of 31%. This corroborates with Woodworth (2000) who reports interest rates (APR) of 16% for Grameen Bank (Bangladesh), 54% for Banco Sol (Bolivia) and 30% for Enterprise Mentors (Philippines, Mexico, Guatemala). Although inflation rates and market structures may explain some of the variation there is a strong case, based on these figures, that interest rate ethics could be culturally dependent[10].

The question of interest rates can be framed in terms of "fairness" of prices to clients. What is the difference between MFIs and predatory lenders? At what point does an MFI become a predatory lender? The answers may again be culturally dependent. At a time where the Western world has slowly been taking away anti-usury laws, so as to allow lenders to take the risk of giving credit to "poor" borrowers, who is to decide the morality of 100% interest rates: the society (government) or commercial investors? De Sousa Shields (2008) considers that any limit would be arbitrary. In many cases, it anyway entails some political considerations. The Economist (Aug 19, 2006) reports that Indian government officials considered interest rates of 21.5% charged by SHARE, an Indian MFI to be too high and forced it to reduce them by 4%. This is in a context where the average moneylender was charging more than twice as much.

In France, Attuel-Mendes and Ashta (2008) find that the lifting of usury ceilings has neither increased interest rates nor increased bank micro-lending. Thus, if micro-credit in Mexico is booming at 100% interest rates, why don't banks in France succeed in lending at these rates? Are ethics and practices being influenced by local culture? Another example of cultural connotations of lending to the poor is Wal-Mart which charges 86% on consumer financing loans in Mexico (Smith & Epstein, 2007), an interest rate which would shock Americans.

A brief comparative analysis based on the Microbanking Bulleting (MBB) can help us to identify some explanatory factors for Compartamos interest rate[11]. In order to assess if Compartamos rates are normal according to its specificities, we compared the spread in each cluster. The results of this analysis are mixed. On one hand, based on the comparison with the relevant peer groups in the MBB, the geographic provenance, the size of the institution and the business model (for-profit) do not significantly explain the high interest rates. On the other hand, some factors explaining the level of interest rate are probably the village banking methodology that they have adopted and the size of the loan. In comparison with other MFIs offering the same methodology, their operational expenses of 36.4% in 2005 remain high[12]. Moreover, compared to the sector, Compartamos offers particularly small loans in relation to per capita gross national income[13]. Fixed transaction costs (such as searching for customers and processing the application) are spread over a lower loan size, driving up interest rates.

The following stakeholder analysis must be viewed in the background of such comparative and cultural differences.

A stakeholder analysis of microfinance activities

In following the classical stakeholder analysis methodology (Bryson et al., 2002; Elias et al., 2002; Whysall, 2000; Wolfe & Putler, 2002), we start by presenting the different stakeholders, then analyse their different interests or stakes, and finally create a power versus interest grid. The discussion comments on this.

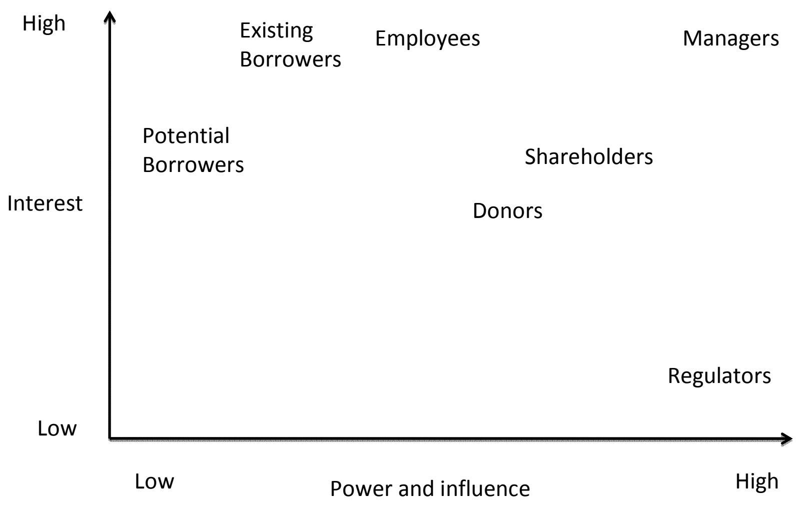
There are six different stakeholders prominent in the debate on interest rates sparked by Compartamos. These include shareholders, donors, regulators, employees, existing borrowers and potential borrowers. In Table 1, we summarise the objectives of each stakeholder group and, more specifically, what could be expected from each stakeholder as objective with respect to interest rates[14]. We note that shareholders and employees are primarily interested in high interest rates compatible with financial sustainability and growth and that borrowers (both existing and potential), donors and regulators are primarily interested in low interest rates compatible with outreach and impact.

Table 1: Objectives of the Stakeholders

Stakeholder	Overall objectives	Expected interest rate desired
Existing Borrowers	Availability, Impact	Low interest rates
Potential Borrowers	Availablility, Impact	Mixed: High if it enables outreach but Low as future borrower
Donors	Outreach, impact (but also sustainability)	Mainly low interest rates?
Employees	Profit, growth, job stability, (but some may have social objectives)	Mainly high interest rates?
Regulators	Client protection (Outreach, impact, employment?)	Not related to interest rate (Low interest rates?)
Shareholders	Profit, growth (but 2/3 also have development goals)	High interest rates (some may want lower interest rates)

In Figure 2, we present a power versus interest grid. As can be seen, the regulator is powerful, but not primarily interested in Compartamos per se since at this stage it did not have any savings. Donors are more interested in Compartamos than regulators since they have provided funds, but it may be just one of their portfolio of donees. However, once having given their funds, their power diminishes unless the donations are recurrent. Potential borrowers are certainly interested since Compartamos could lend them cheaper funds than moneylenders, but one could argue that Compartamos is one among the potential future players. As opposed to them, existing borrowers are far more affected by Compartamos. At the same time, existing borrowers could impact Compartamos by unionising and refusing to pay (as recent events in Nicaragua show[15]). We have divided employees into workers and managers. Workers have all their earnings coming from Compartamos, but their power is limited to union activities (including protests) and resigning. Significant decision making power and interest lies with the managers. In Compartamos case, Shareholders are also powerful, even more since some of them couple their relationship as donors or managers.

Figure 2: Power versus Interest Grid of Compartamos stakeholders



We will now look at the divergent interests of each of these stakeholders and indicate the compromises which require to be made.

The **first** and maybe most obvious stakeholders are the current clients[16] of the MFI. We have already highlighted the high interest rates charged by Compartamos. Interest rates charged by MFIs are usually superior to the traditional banks because of the heavy transaction costs of the tiny loans they offer. Worldwide, these, interest rates often range between 25 and 50%. Compartamos is thus one of the most expensive MFI in the world.

As argued by Armendariz and Morduch (2005), Compartamos' seems to be somewhat inefficient compared to the other leading MFIs. Since Compartamos charge higher interest rates, clients end up paying for the inefficiency of the institution. Thus there is a trade-off between employee comforts and existing borrowers.

The small loan size partly, but only partly, explains the pricing strategy. For instance, according to Rosenberg's (2007) analysis, Compartamos could have reduced its interest rate to the range of 65 to 70% while maintaining a level of profitability compared to other banks (e.g., return on equity of 15%). Thus, a second compromise was the question of shareholders' interest versus those of existing borrowers.

Historically, Compartamos' interest rates increased during the Mexican financial crisis in 1995, in order to cover additional expenses related to the devaluation and inflation. They however never decreased afterwards when the economic conditions were stabilised. Managers and shareholders were probably very cautious to cover all potential risks that the institution may face, even after the crisis was over but this would then be "at the expense" of the current clients.

Even if the exact impact of these high interest rates is still much debated in the microfinance community, one can anyway say that they restrict the activities that the borrowers can start or develop to the ones with very high returns. The argument that "poor people would not take such high interest rates loans if they were not making even higher profit" is not completely sound. Loans are taken before the event. While the average borrower may have borrowed on the basis of high expectations, there is no evidence to show that she did indeed meet those high expectations. It is equally possible that she got deep in debt and any repeat loans may be to repay the losses from the failed enterprise. The question is not only whether poor people (existing borrowers) made some profits, but also whether they could not have made more profits and the financing would have had a greater impact on these existing borrowers.

Nevertheless, these high interest rates are still most often far below what the informal lenders offer. These rates would thus be cheaper than the second best solutions that borrowers would get otherwise, therefore considered fair by many managers of MFIs. If we make a parallel with debates on wages in developing countries, this justification would be similar to the managers arguing that their low wages would be more than the inexistent social benefits unemployed workers get or, wages other workers may get in another sector or another company. A very low wage (or a high interest rate) would be justified if no better alternative exists.

When the markets are not competitive, the sustainability of the institution also matters for the current borrowers since a bankruptcy of the MFI may mean that the sole source of funds could be the even more expensive moneylenders. This financial sustainability is required both for borrowers to want to return money (if they think the MFI is not going to last, they will not repay and the MFI will indeed not last) and for commercial financing of the MFI. This argument, thus puts a lower limit on what would be an ethically sound interest rate, indicating that an interest rate below break-even point (estimated at 62% by Rosenberg (2007)), would go against the interest of the existing borrowers, unless subsidized donor funds for long periods are available.

Both the borrowers and the commercial investors know that donor aid is subject to fads (Rosenberg, 2007) and to herd mentality and, therefore, MFIs need to get commercial backing and be sustainable. However, this is countered by Lewis (2008) who remarks that commercial finance is also subject to herd mentality. Nevertheless, we could say that a diversified mix of the two would reduce vagaries.

A trade-off appears between the additional burden represented by the high interest on the debt to existing borrowers and the long term risk of bankruptcy. The same logic might be introduced for any event that would affect the institution sustainability and therefore justify high prices. It is thus used to defend their high profit margins. At the same time, existing borrowers could impact Compartamos by unionising and refusing to pay (as recent events in Nicaragua show[17]).

Another argument defending high interest rates will lead us to our second stakeholders: profits would enable the impressive growth of the MFI and thus be fair to potential clients.

The **second** stakeholders are thus the vast amount of poor who are untapped by the traditional banks and the MFIs, the future or prospective borrowers. A main defence to Compartamos strategy is that the profits the MFI obtained from its existing borrowers has enabled it to reach potential borrowers faster. In Microfinance jargon, the impact on existing borrowers was sacrificed to increase outreach and possible impact on new borrowers.

In line with this, Rosenberg (2007) argues that the retained earnings were essential for financing outreach because alternatives didn’t really exist. Borrowing from debt was not really feasible. They could have taken private socially responsible equity earlier, but preferred to wait to take commercial equity. This is because, with only a few large private investors, the existing NGOs would have lost control. And donors could change their mind, their capital would thus subject to fads. Thus, the high interest rates and correspondingly lower impact on existing borrowers were necessary to get outreach to new borrowers.

In this sense, potential clients might prefer higher interests since the profit margins would enable growth. However, as soon as they would become borrowers, they would prefer lower interest rates. There is thus a clear trade-off between their interests. Moreover, the argument that outreach to new borrowers and impact on existing borrowers would be intrinsically incompatible holds no water. Zeller and Meyer (2002) consider that outreach, impact and financial stability form a triangle. The argument goes that helping the poor (impact) requires reaching them (outreach). However, impact is difficult to measure (Armendariz & Morduch, 2005). This may explain why MFIs focus on giving information on financial sustainability and outreach to attract investors. Irrespective of whether impact is measurable or not, a teleological question is raised: are outreach and sustainability by themselves worthwhile goals for donors, NGOs and development agencies, if there is no impact. In other words, without impact on the poor, what is the purpose of reaching them and why bother to sustain the NGO? To apply the question to the present case, and this is the part most people have chosen to focus on: if interest rates had been lower, the impact on the poor would have been more. This relative way of looking at impact obviates the need to measure it. True, some limited impact may have occurred if they were borrowing, but the impact may also have been much greater if the interest rates were lower or if they had been partners in shareholding.

A stronger argument can be taken from credit cooperatives, where the borrowers are members of the organisation and participate in the distribution of the overall surplus. When a MFI is registered or organised as a cooperative, with members as shareholders, if the borrower pays high interest rates, and the cooperative makes high profits, a part of the earnings from high interest rates could be distributed back to the existing borrower-members. Of course, it is still possible in any form of MFI but the borrower would not take part in the decision process. Alternatively, if the firm needs cash-flows to finance growth, the high profits can be kept as retained earnings, but a part still belongs to the borrower-member. In the Compartamos case, a part of the profits from high interest rates could have been re-distributed to existing borrowers in one of two ways. First, a part of the high cash inflows could have been earmarked for investment in share capital, and only the balance (lower amount) would have been considered interest. Thus profits would have been lower for Compartamos, share-capital would have been higher, but the total cash inflows required for future expansion would have been the same. Alternatively, Compartamos could have retained the high interest rates and the high profits and high retained earnings, but converted part of the retained earnings into share capital and distributed these new shares to the borrowers for free. The end result would be the same, if there are no taxes[18]. In either case, cash inflow would have remained as high (or higher) than what Compartamos in fact realised, but retained earnings would have been converted into paid-in share capital. In this case, at the time of the IPO, the existing borrowers could have participated in the high capital gains, instead of original shareholders pocketing all the gains. In fact by distributing free shares to borrowers, no cash outflow is created, but profits are transferred from a few private investors to thousands of poor borrowers. Total equity remains the same, but reserves and surplus are converted to share capital for new share owners. All these new (poor) shareholders therefore share in the profitable growth of the MFI. Thus impact can go hand in hand with outreach.

When Compartamos decided to offer issued shares in a secondary offering IPO, it entails that only existing shares are traded and the profits get to the shareholders selling the shares, instead of a capital increase where new shares are offered. A capital increase would have diluted the power of the historical shareholders but would enable to attract some additional fund to finance the growth of the MFI. This choice is therefore incoherent with the outreach arguments of high interest rates.

Another argument related to the potential client is that they would be “left” to moneylenders unless a MFI offers them a microcredit. Comportamos’ managers recognize that their interest rate is high but they are still a lot cheaper than the informal lenders and would thus be fair to prospective clients[19]. Getting back to the parallel with fair wage, the managers would argue that potential workers in less developed countries may be able to perform the same tasks at a better price than what the current employees in advanced countries get. This argument, often used in globalised sectors facing new competition from emerging countries, is less powerful in an uncompetitive environment. Similarly to the case of wages, the question however remains if, or to what extent, the existence of potential clients or potential workers in the case of wage should impact the fairness of a transaction to existing borrowers or to existing workers in developed countries who lose their jobs. The question may even be more pertinent when an institution, such as Compartamos, receives some socially-oriented funding, whether from publicly-funded NGOs (Accion in this case), or public investors (World Bank through the IFC) that entail some social responsibility towards all stakeholders.

Informal lenders are indeed more expensive in Mexico[20], as in most countries. Moreover, moneylenders are still very controversial actors everywhere (Guerin, 2006). On one hand, they have been repeatedly denounced for years as exploitative because of their very high interest rates (Armendariz and Morduch, 2005) and many countries have tried to regulate them one way or another to avoid usurious practices. Even if the methodology clearly differs from informal lenders, Yunus has also accused Compartamos to be in the "moneylending business" because of their interest rate practices (RESULTS, 2006). On the other hand, holding their pricing policy apart, moneylenders' flexibility has been recently distinguished. While microfinance institutions often prove to be inflexible offering rigid and standardized products, moneylenders could more easily adapt their loan to the clients' needs. Hence, some researchers suggest they could remain present even when microfinance expands. They would be complementary rather than mutually exclusive to other sources of funds due to the flexibility of their financial services[21]. In addition to the price of the loan, other elements of the product-mix would be considered and appreciated by the clients. Similarly, in microfinance, many scholars argue that the most important is not the price of the loan but the access (Rosenberg, 2000). Additionally, drawing a parallel to the moneylenders offering flexible and door to door products, Compartamos argues that it offers credit with non-financial services to its customers (Danel & Labarthe, 2008), and offers some free life insurance (Rhyne & Guimon, 2007). As a result, the free (non-)financial services drive up the cost of the loans.

This last argument is not credible for many reasons. First, a major difference between a moneylenders' business model from that of microfinance institutions is that the former never request any form of subsidies or socially-responsible funds. As a result, they do not profess socially benign motives, as opposed to donor-funded MFIs which do.

Secondly, while flexibility is one intrinsic feature of a loan, non-financial services could be easily separated from financial services. Compartamos' managers would be probably less criticised if they would let clients choose between cheaper loans with financial services and the "full package". In fact, many donors often advise managers to separate financial and non-financial departments of their MFI or rather use a partner NGO to provide non-financial services. This does not mean that non-financial services are useless. On the contrary, they may be very valuable for the clients and empower them (Holvoet, 2005). But it is not sufficient for socially-responsible managers that the MFI offers these services to justify their support. If a donor has to choose between MFI A offering loans without additional service and MFI B offering similar loans but with non-financial services and three times more expensive, it will often be judicious to select the first institution and ask another NGO specialised in non-financial services to do the additional job.

Third, this does not seem to be credible according to the analysis of Compartamos profit margins which are high[22]. This leads us to the third stakeholders, the shareholders and the role they played in Compartamos' development.

As in any financial institution, the shareholders are a key stakeholder, the **third** one we examine. While clients have paid a high price to Compartamos, shareholders have booked significant Returns On Equity during the last years, compared not only to the microfinance industry, but also to the traditional banking standards in Mexico and Latin America. As is regularly the case in microfinance boards, Compartamos managers may have disagreed with other board members on their profit expectations. The complexity of the shareholders' structure with for-profit, non-profit and public institutional investors is a difficult issue to manage in microfinance (Labie, 2001). Most, if not all, shareholders would pursue a double bottom line of financial and social impact. Nevertheless, some investors may favour financial returns after two to three years while others may be more willing to obtain lower returns to maximize the social impact of the institution. This conflict is likely to acerbate after the IPO since some commercially-oriented hedge funds have entered the board. Commercial investors were interested in the high ROE booked by Compartamos and probably expected similar figures after the IPO. Of course, donors or socially-oriented investors did not know who would buy the shares offered during the IPO. They could have however selected or refrained from offering shares to some categories of investors[23].

Similarly, donors or socially-responsible investors did not restrain the managers on their interest rate policy and let them maintain very high prices until the IPO. No condition in a covenant or other pressure on the level of interest rates was put by socially-minded shareholders to have impacted the pricing policy. It is likely that most of them wrongly assumed that the interest rates would automatically decrease with time and competition. As we know, interest rates did not dramatically decrease. International experience indeed show that interest rates do not naturally decrease but only in some circumstances, such as the contrary cases of Bolivia and Bangladesh suggest (Porteous, 2006).

Another key aspect related to the shareholders concern their relationships with the management team. In Compartamos' case, the relationship is particularly cumbersome since the founding and still current directors and managers directly held 23.7% of the shares at the time of the IPO. This triggers the question: Alignment of principal agent at the expense of the others stakeholders? Here we are just highlighting the conflict of interest between two groups of stakeholders: shareholders and managers. The conflict within the different categories of shareholders will be examined in the next section.

Directly related to the shareholders in this case are the donors, the **fourth** stakeholders. Part of the debate may indeed be due to the lack of clear distinction between the shareholders and donors. A donor such as World Bank or a NGO, ACCION, probably invested in shares rather than grants either to retain some control on the MFI or to show that microfinance can be profitable. Other donors offer grants, for instance for capacity building, without taking a seat in the board of directors.

Some donors favored Compartamos as a key example of sustainable institution able to attract private money and grow at a rapid pace. Nevertheless, Compartamos' evolution sheds light on the complexity of their role and more specifically their exit strategies. Compartamos was presented as an example of a success story, a leader in the industry. Many publications of donors include Compartamos as an example before its IPO, even if sometimes it acknowledged its debatable pricing policy. For instance, CGAP 2001 Annual Report states that "as a finance company, it can now raise funds for expansion in the commercial market. Its orientation and its success are having a major demonstration effect in Mexico". Similarly, the 19th case study on "Donor good practices" published by CGAP in 2005 used Compartamos as an example with as subtitle "donors succeed by making themselves obsolete". The case study explains that Compartamos became a self-sufficient, regulated finan-cial institution in 2001 "with the help of donors such as the US Agency for International Development (USAID), the Inter-American Development Bank (IDB), the Consultative Group to Assist the Poor (CGAP), and several Mexican business-men" (Dugan and Goodwin-Groen, 2005).

The kind of performance indicators set by the donors to Compartamos may affect the policy of Compartamos. For instance, in 1996, CGAP gave a US $2 million, three-year grant based on performance indicators: (1) an arrears rate below 10 percent, (2) client growth of at least 25 percent annually, and (3) a specific annual target for return on assets for each of the three years (Dugan and Goodwin-Groen, 2005). No performance indicator was set on the interest rate. These indicators of fast outreach and profitability certainly reinforced Compartamos in his policy orientations. Compartamos reached the profitability objectives within six months of signing the convention!

Regulators, **a fifth stakeholder**, may also have favored Compartamos directly or indirectly by protecting its leadership through a defensive legislation. In 2007, Mexico was only ranked as the ninth Latin American country by The Economist for its regulatory framework since the “regulatory framework has been in considerable flux in the current decade, with the confusing co-existence of competing juridical vehicles and the long and several times delayed implementation process of promising reforms adopted five years ago” [24]. The license allowing mobilisation of savings accorded to Compartamos in 2006 was also very difficult to get. It is likely that the inefficient regulatory framework favored the early mover or leader in the market: Compartamos. One would then talk about a traditional problem of “regulatory capture” where the "capture" or "interest group" impacts the formation of public policy.

Nevertheless, Compartamos also refused some free training or grant offered by local political bodies to remain independent. It is however not the sole institution to fear local governments. Interference by local politicians, such as in Benin, India or Nicaragua, is increasingly feared by microfinance practitioners and makes them reluctant to accept any support forcing them to partly depend on them (CGAP, 2004). Nevertheless, the refusal of support or grant is not ethically neutral. Taken to the extreme, we come up to the case of a MFI refusing all donation or subsidised credit line from socially-responsible investors. In order to cover the costs that these donations could cover, the institutions can either implement a very cost-effective management or increase its interest rates.

The **sixth** and last stakeholders we will present are the employees. Employees include workers and managers. Personnel expenses are a major cost driver in microfinance. Some MFIs are able to offer very cheap credits because of the low salary that they offer to the largest group of their staff, the credit officer. In Compartamos’ case, their high administrative costs have been highlighted a few times (Armendariz and Morduch, 2005). An easy explanation would then be that they have offered good salaries to their staff at the expense of the borrowers. If this analysis is correct, we could infer that the staff was one of the favoured stakeholders. Hence, the pricing policy would be fair to the employees.

Nevertheless, two lines of arguments can be opposed to this statement. First, the relatively poor clientele of the institution and the time-consuming loan methodology may explain part of these expenses and dismiss the argument of fair salary. Second, the turn-over of the employees and the internal debates on the wage policy, for instance when Compartamos wanted to open some more urban branches (Schlefer & Stuart, 2005) are indications that things are more complicated. Moreover, without additional information on the wage differential between the different levels of management, it is impossible to draw strong conclusions on the salaries. Kneiding and Rosenberg (2008), for instance, report the comparatively high costs of qualified labor in Mexico.

In short, the relatively high administrative costs are a sign that staff could have been a favored stakeholder but it is difficult to draw some strong conclusions without a deeper analysis. High operating expenses could well be due to some management decisions related to incentives, salaries or training but also somewhat to some external elements such as the competition to get some skilled staff.

Ethical conclusions based on the stakeholder analysis

After the presentation of the six key stakeholders, let's get back to our original discussion on the fairness of their interest rates and summarize the key elements. The high profit margins obtained by Compartamos or, to a lesser extent his national competitors; show that the Mexican microfinance market is very profitable. Hence, the discussion can, to a large extent, be reframed in the more traditional debate on the surplus repartition between the stakeholders of a firm.

Compartamos' management argues that their growth rate enable them to reach potential borrower. Moreover, they consider that they are fair to their current borrower since their clientele has very high margins and thus benefit from the service anyway.

Two issues are at stake: the growth rate and the strategy to finance growth objectives through high interest rates. First, the growth aspiration of Compartamos managers or shareholders is not specific to this institution. The whole microfinance sector is booming, not only through the creation of Greenfield microfinance institutions but also through the impressive growth of the major MFIs. Ambitious growth objectives are regularly set by the microfinance sector in major meetings such as the Microcredit Summit Campaign. At the core of this growth is the laudable decrease of financial exclusion and thus the potential borrowers. One could however question if poor clients could be the ones bearing the burdens of expansion financed by the high profit margins made on their backs. If growth must be partly at the expense of current borrowers, it must be carefully managed. In some difficult situations where no other financing strategies are possible, a more gradual growth would be less controversial.

The second issue concerns the financing strategies. Many surveys confirm that the largest MFIs can now access cheap funds from commercial or semi-commercial investors. In Compartamos case, other financing strategies may probably have been developed. Compartamos had access to the international financial market, as suggested by its successful bonds issue. Managers could have relied on local or international commercial funds or on socially-responsible investment funds largely interested in microfinance and most often without interest rates restriction. In short, their financing strategy was not socially neutral.

Erroneously assuming that the market would undeniably force them to decrease rapidly their rates, donors or regulators did not directly intervene in this repartition of the surplus, for instance through a covenant in their contract on the interest rates. Moreover, by restricting competition with a very defensive regulatory framework, regulators may have favoured the "rent" of Compartamos managers and shareholders. Similarly, donors may well have believed too much in the emergence of competitors or the willingness of the managers to decrease interest rates.

Shareholders ended up being favoured by the interest rate policy. The portfolio growth has enabled to serve new clients but also to make Compartamos more attractive to commercial investors and thus increase the benefits of the shareholders. Rosenberg (2007) argued that « All other things being equal, if Compartamos profits had been two-thirds less (still at a robust level around 20% annual return on initial equity), one would expect the IPO shares to have sold for a price two-thirds lower".

This leads us to the main element in the stakeholder analysis which is related to the type of IPO. Compartamos IPO was not a capital increase, enabling it to finance its growth, but the sale of existing shares where the returns go directly to the shareholders. On the one hand, since the money is not reinvested to finance new activities of Compartamos, it has some very limited impact on existing or potential client, or for employees. While potential borrowers may have directly benefited from a capital increase if the profits had been reallocated to investment and new lending, it is clearly not the case with a sale of existing shares.

On the other hand, the sale of shares benefits the historical shareholders of Compartamos and might even negatively impact existing borrowers with the entry of more commercial shareholders such as the hedge funds. We will address the conflict between the various shareholders in the next section.

4. **Ethical issues raised in the governance of microfinance institutions in particular and NGOs in general when shareholders have different missions**

In this section, we are studying the case but often we are going beyond the case to broader questions of ethics and governance. Governance has different definitions, but in the microfinance context, it generally includes issues such as mission, boards, donors, regulation, apex associations, competition, mismatch in liability/assets and the influence of local communities and regulators (Hartarska, 2005; Labie, 2001, 2003; Mersland, 2008). As we can see, this is a complicated case involving complex governance issues. The principal agency problems were highlighted in Figure 1. There are a number of principal agency relationships, including sub-agents. However, this fact alone does not raise ethical questions, except that, at each stage, the questions posed can be different. Before addressing these issues, we will first question the mission of some non-profit or socially-oriented institutions offering financial services.

Ethical issues related to missions of NGOs

Ethical problems relating to the mission of microcredit NGOs have been discussed for some time (Copestake, 2007; Mersland & Strom, 2008; Morduch, 1999) recognize different kinds of mission drifts. They examine one of them: is the size of average loan increasing, implying a drift to not-so-poor borrowers? They find no evidence of this. Mersland (2008) points out that this question keeps repeating itself in history by examining the history of savings banks in the 19th century. Savings banks sought out wealthier clients but this did not detract them from serving the poor. However, in this sub-section we are going into much broader questions of missions for all NGOs: is the objective of an NGO, by definition usually a not-for-profit, to make profits while serving the poor? Thus, we are talking about the mission conflict of social entreprises.

A **first** problem, within the field of deontological ethics rather than teleological ethics is related to mission conflict: whether NGOs should create for-profit entities. As pointed out earlier, NGOs use contractual relationships with for-profits all the time. However, this is an arms-length relation. In this case, the NGO had created a controllable for-profit organization. Thus, the ethical issues are not the same because the principal-agency relationship is different. It may be noticed that this is exactly the inverse problem to the one being debated in Corporate Social Responsibility where Friedman (1970) feels that the managers are misappropriating funds by distributing them as donations: if shareholders wanted to give donations, they could do so from the dividends they receive. This issue also has reverberations in the Grameen Danone case (Yunus & Weber, 2007): Muhammad Yunus wants to create social businesses in which the investors get a zero return. However, Danone wants to be careful to get at least a 1 to 3% return, to show that it is balancing economic and social goals at the same time.[25] As such, the debate is wider than the narrow debate of whether NGOs can start for-profits. It encompasses all cases where an organisation with one mission is attempting to create another organization with a different mission. A related problem is at what level of profits should a double bottom line institution operate? What amount of profits should be sacrificed for social motives? For instance, based on deontological arguments on the fragility of the clients, Muhammad Yunus considers that MFIs charging higher rates than the costs of funds plus a 15% margin should be considered as imitating money-lending activity (RESULTS, 2006)[26]. Are there cases which justify grants to for-profits? Who should decide this?

Stemming from the above questions, the **second** question is whether NGOs should provide the seed capital of private enterprise. If the role of NGO's is not-for-profit, should this seed capital be only in the form of grants or interest-subsidized loans?

The **third** question is related to the profit level that is appropriate for a non-profit organisation: If the answer to the first question is in the affirmative, that is a not-for-profit can make profits, a subsidiary question leads to further debate: how much profit should a not-for-profit make before it is considered exploitative of the poor. According to Yunus and Weber

(2007), a social enterprise in not entitled to any profit. However, social investors say that an interest rate of 1 to 3% to cover inflation and perhaps a minimal amount of administrative costs would be reasonable. They argue that this makes borrowing MFIs more responsible rather than giving them free gifts. Finally, socially responsible investors feel that near market rates are quite acceptable but the notion of market rates can be controversial. If other operators are charging 150%, and Compartamos charges 100% in a similar context, would these market interest rates be ethical?

Related to this is the use of microcredit banner by Compartamos[27]. Essentially, if Banco Compartamos had never used the microcredit label and had taken the same growth rate, it may not have been criticised as vociferously. However, at a time when the public image of microcredit as an instrument to alleviate poverty was crowned by the giving of a Nobel prize to Grameen Bank and its founder, M. Yunus, it was greeted by criticism as being unethical (Lewis, 2008). Thus, the context also shapes ethics. A related contextual question would be whether the attention given to this bank would have been the same had it not made profits, but losses. There are a number of ventures supported by IFC and ACCION, but they are not the issue of serious ethical discussion.

Fourth, the Compartamos case raises the question of the end or exit strategy of public donors investing in socially-responsible or social enterprises. While it is increasingly recognized that governments should not take private initiatives because of high entrenchment costs, the question comes: can successful social enterprises ever be terminated? If social enterprises go awry, what controls is there that their managers or founders would be placed under legislative or self-imposed restrictions? A possible solution could be to recognize that not-for-profit or social enterprises can make surpluses but they are required not to distribute these surpluses. Nevertheless, the question of consistent non-distributed surpluses raises the question of who (which stakeholder) these surpluses belong to? The entry of hedge funds with the IPO in the shareholding structure is likely to acerbate the tensions between the stakeholders.

Entry of hedge funds and very commercial players into non-profit or socially-oriented MFIs: Which board do you want?

A second group of ethical problems stems from the different kinds of shareholders present in this particular case. This relates to the motivation of minority for-profit shareholders, founder shareholders, majority NGO shareholders and employee shareholders. For-profit shareholders may not necessarily have a double bottom line of social and financial goals. More specifically, the Compartamos case raises two questions on the shareholding structure. First, how to manage co-existence of more socially-minded shareholders (an NGO or a donor) and profit-minded ones? Second, should donors or NGOs (funded by public money or general audience) sell their share to commercial players (rather than Socially Responsible Investors, for instance) and thus indirectly use some previously public money to finance future commercial goals.

In order to better analyse the board dynamics, we will thus analyse the problems or challenges caused by each of these four groups of shareholders, indicated above.

<u>First, we take the case of minority private shareholders:</u> a main challenge for an institution facing an overlapping of deontological and teleological ethics is created by the presence of minority private shareholders. If all the shareholders had been not-for-profits, the problem of capital gains would not have arisen because all the gains should have gone back for developmental objectives. However, if minority private shareholders gain, the question comes in whether the minority wasn't, in fact, controlling the majority to ensure that impact on poor people was sacrificed so that the majority NGOs could have peace of mind through viability. Private shareholders would also gain from the ultimate capital gains (increase in book value AND increase in market value). Thus, what is being questioned is the end result "did private shareholders gain?" Nevertheless, this teleological question would not have been posed if there were no NGOs involved. So, the question is deontological: "did private shareholders unduly benefit from the distribution of public funds"?

An alternative question is why an NGO included minority shareholders to start with. The NGO itself is a piece of paper, managed by real people. What is the relationship of these directors of the NGO with the outside shareholders?

There is a lot of literature, legislation and court decisions on minority interests and rights. These rights have a semiotic correspondence to duties of majority shareholders to preserve values for minority. In this legislative and cultural context, could the NGO majority shareholders have done otherwise than to maximise profits for the minority private holders? Would it have been ethical for NGOs to sacrifice the profits of the minority private shareholders just to ensure its own mission? Thus, existing laws in other fields (minority interests in for-profit organizations) may make NGOs respect rights of minorities even when those minorities have come in knowing fully well the social objectives of the venture.

Second, we look at the problems created by the presence of founder shareholders: this problem concerns a specific type of shareholder who could be in majority or in minority, the founder of a company. It is recognized that at some stage, in a for-profit context, that founders need to exit to make room for more suitable managers in view of the growth stage of the firm. These founding shareholders would exit through a sale of their shares. ACCION (Rhyne & Guimon, 2007) raises the question of the compensation to founding members of an NGO as such institutions increasingly turn to becoming for-profit. This question had already been raised in the Consensus Statement of the Council of Microfinance Equity Funds who considers that, while it is legitimate that founders benefit for value created, "appropriate mechanisms for compensation are complicated by the non-profit structure of the NGO and the presence on the balance sheet of donated funds" (CMEF, 2005). This view bifurcates NGO MFI founder-shareholders in two parts: individuals and non-profits. If the NGO MFI had been started uniquely by individuals, and if a commercial enterprise offered to buy out the founders, it is obvious that the founders should have the right to sell and the right to capture the increase in value. After all, why should all the increase in value go to the commercial enterprise who is taking over?

However, when the invested money belongs to not-for-profits, do they have the right to make a profit? The question goes back, as CGAP put it, to the time when the not-for-profit entered the MFI. As such, we go back to the initial question above of whether a not-for-profit should invest in shares at all? Does the not-for-profit have the right to make money on its portfolio? Can it maintain the value of portfolios by investing in shares and, if not, can it invest in bonds? If so, does maintaining value include participating in governance of the targeted companies? How about participating in managements? Thus, the ethics of pension fund governance of for-profit firms also needs to be examined.

Third, the case is complicated by NGO majority shareholders: in preceding sections, we have already talked about the difficulty of NGO shareholders using the principal-agency framework. However, what complicates these issues is that not all the NGO shareholders have the same mission. Thus the mission of the IFC is to invest in private enterprise. The mission of ACCION who received USAID funds is to develop microcredit and impact the poor. Thus within two NGOs, there is a conflict on interest where the mission of the IFC is closer to shareholder interest and the mission of ACCION and Compartamos AG (the NGO) would be more aligned with the interests of borrowers.. Before the IPO, ACCION held 18.1%, IFC had 10.6% and Compartamos AG (the NGO) held 39.2%. Since no one NGO had majority control, the final decision would be based on horse-trading and political wrangling, including obtaining support of private minority shareholders who held the balance 32.2%. In such a situtation, the private minority shareholders may get de facto control and could subvert the mission of each of the NGO shareholders.

<u>Finally, we examine employee shareholders:</u> Another problem is the problem of incentives through employee shareholding, particularly with the managers. Employee shareholding with directors and managers is one of the favourite tools of private equity to boost performance. However, in a setting of NGO missions to aid the poor, the objective of the employees (agents) gets aligned with profits and shareholder "value", not shareholder "values", where the latter concerns the professed value of the majority NGO shareholders. Again, it is the deontological misalignment which is being questioned.

5. Conclusion

The normal critique of the Compartamos case is framed in a deontological-teleological framework. If we adopt a Friedman (1962, 1970) based governance principle where the only objective of a profit making Compartamos would be to make profits while respecting laws, it is evident that the consequence of Compartamos behaviour is clearly meritorious. If, however, we enlarge the governance dimension to include ethical and discretionary dimensions (Carroll, 1979), then the social consciousness based deontology opens the debate as to whether profits justify exploiting the poorest.

The ripples of this case extend beyond the narrow stakeholder analysis we have adopted. Had we used the wider definition (for example, Freeman & Reed, 1983), we could have included the entire microfinance sector as a stakeholder, since it is affected by the behaviour of

Compartamos. Compartamos IPO has severally affected the legitimacy of the microfinance sector according to many observers. This paper has raised future agendas for thought raised by the Banco Compartamos IPO. We have argued that while potential borrowers could have directly benefited from a capital increase if the profits had been reallocated to investment and new lending, it is clearly not the case with an exclusive sale of existing shares. This choice has favoured other stakeholders, mainly the (private) shareholders. Exorbitant returns followed by the sale of shares might attract new investors, such as the hedge funds or other commercial investors, but this will likely be at the price of the loss of the social identity of microfinance. Other strategies of financing can be adopted such as the bonds, or the use of CSR funds expecting lower returns. Other stakeholders, such as the staff, may have been favored.

In the paper we mentioned that ethics shape laws, but are also shaped by existing laws and beliefs. We gave an example of the latter concerning minority interests and rights. The heated debate on the Compartamos IPO has culminated in a first step taken: On April 21-23 2008, some leading microfinance personalities signed "The Pocantico Declaration" at the Microfinance Leaders Retreat. This is a step toward a self imposed voluntary code of deontology. So, the experience and the ethical debate have led to new lessons and some action based on these. It is still doubtful today to say that this level of self regulation will be sufficient to address the various challenges raised in the paper.

Many of the key questions of governance go beyond microfinance to all institutions dealing with social justice. The paper also has not gone into the reverse area: should for-profit businesses invest in not-for-profits? The ethical issues are the same as summarised in corporate social responsibility and corporate philanthropy: what are the ethics of managers (who are the agents) who decide to put their firm's money into not-for-profit channels?

It raises ethical questions and is a bonanza for future research to reply to these questions. We believe the raising of these questions, explicitly and clearly, is necessary for this debate and for further regulation of microcredit in particular and NGOs in general.

[1] For examples of recent contributions related to microfinance (Ashta, 2009 forthcoming; Copestake, 2007; Cull, Demirguc-Kunt, & Morduch, 2007; Hermes & Lensink, 2007; Hermes, Lensink, & Mehrteab, 2005; Hudon, 2009; Mersland, 2008).

[2] When we include VAT, clients ended up paying around 100% p.a.

[3] The Consultative Group to Assist the Poor (CGAP) includes 11 multilateral donors like the World Bank, IFC, EBRD; 4 private donors (Ford, Dell, Gates, Omidyar) and the rest are bilateral donors (essentially from OECD governments).

[4] All facts and figures in this paragraph are taken from Rosenberg (2007) or Rhyne and Guimon (2007).

[5] Next to these six stakeholders, the whole microfinance sector could be considered as another stakeholder in a wide definition of stakeholder. As already explained, we will however focus on a narrower definition of stakeholder.

[6] Individual studies have their own specific steps too depending on the objectives of the study.

[7] Exceptions include Graddy and Robertson (1999) on the racial discrimination in the pricing of fast-food restaurants, Hudon (2007) on fair interest rates for institutions lending to the poor, Mews and Abraham (2007) on usury and just compensation or Zwolinski (2008) on ethical issues surrounding price gauging.

[8] In line with the seminal work of Freeman and Reed (1983), we will consider stakeholders persons or groups with legitimate interests in procedural and/or substantive aspects of corporate activity (Donaldson & Preston, 1995).

[9] On the history of the debate on what constitutes usury, see Mews and Abraham (2007)).

[10] On the uneven development of microfinance, see Vanroose (forthcoming)

[11] The Microbanking Bulleting (MBB) provides the average interest rate by clusters of institutions, such as the size of the institution or the legal structure. In 2005, the average nominal yield in the MBB was 32%. In a recent publication, Kneiding and Rosenberg (2008) report an average nominal yield of 35% with a larger database.

[12] The comparison with the peer group of MFIs using the village banking methodology, with an average of 28%, reveals that their management is still inefficient. Similarly, the peer group of MFIs offering the smallest loans has an average operating expense of 23%. Rosenberg (2007) however nuanced these results arguing that the gross operating expense ratio ignores the impact of Compartamos' low loan sizes.

[13] At the end of 2006, the average loan size was 440 USD, which make them in the smallest group according the Mix Market methodology. When the loan size is divided by the GNI per capita, results are similar. The average loan size is an often used measured of the outreach and poverty incidence of an MFI's activity. The rationale is that the smaller the loan, the greater the depth of outreach towards the poorest.

[14] When the objectives of a stakeholder are not entirely clear or straightforward, we include question marks.

[15] See Latin American Herald Tribune (15 Jan 2009): "3 Injured, 160 Arrested in Protests Over Micro-Loans in Nicaragua", http://www.laht.com/article.asp?ArticleId=325400&CategoryId=23558 last accessed on February 8, 2009. The article indicates that thousands of protestors demand moratorium on debt repayments to microlenders.

[16] MFIs sometimes offer savings products alongside the traditional microcredits, that can further complicate matters. Nevertheless, as Comportamos did not provide savings facilities at the time of its IPO, we will consider that the clients are solely the borrowers of the credit products offered by Compartamos.

[17] See Latin American Herald Tribune (15 Jan 2009): "3 Injured, 160 Arrested in Protests Over Micro-Loans in Nicaragua", http://www.laht.com/article.asp?ArticleId=325400&CategoryId=23558 last accessed on February 8, 2009. The article indicates that thousands of protestors demand moratorium on debt repayments to microlenders.

[18] With taxes, the first solution would be better.

[19] On this kind of justification of interest rates, see Hudon (2007) second representation of fair interest rates.

[20] See Rosenberg (2007) analysis of Compartamos competitors.

[21] For a description of some of the private lenders and moneylenders, see Servet (2006)

[22] But perhaps the break-even point could be reduced below the estimated 62% if no free non-financial services were provided. With the same total margin, interest rates would then come down.

[23] Although this is only a short term formal solution: once the market is created, anyone can buy the shares in the open market.

[24] Economist Intelligence Unit (2007), Microscope on the Microfinance Business Environment in Latin America 2007, The Economist, Washington D.C.

[25] However, neither Yunus nor Danone executives have really got the point: its not the level of dividends which is important because the price of the shares will capture any growth component which will also lead to capital gains.

[26] RESULTS (2006), A Conversation with Muhammad Yunus, November 14, 2006, available at

http://www.results.org/website/article.asp?id=2476

[27] This issue has been raised a few times by M. Yunus in this case, calling Compartamos ‘exploitative’ or active in the ‘moneylending business’.

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