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# Micro-lending: An Effective Union of Ethics and Profits

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**Micro-financing** within the United States is gaining recognition and is on the cusp of entering the mainstream banking community. The introduction of micro-lending into our contemporary economy is following an evolutionary path through the business community. The combination of globalization and recent scandals involving large international businesses has resulted in society evaluating business practices and how businesses can operate in ways that positively influence society. This paper proposes that one way for the banking industry to have such impact is micro-financing.

## **Evolution of Ethical Business Practices**

Our national economy was built on the assumption that the sole purpose of business is to generate profits. Many believe a business that is genuinely working to the benefit of its shareholders will naturally practice business in a generally ethical manner. Many in our society feel that this is a dangerous presumption. Dalla Costa (1998) states, "It is illogical to assume that the business model of selfish advancement can attend to the people that the economy itself has disadvantaged" (p. 18). Ethics is about values and what one *ought* to do. Dalla Costa (1998) summarizes the difficulty in using ethics as a guide for general business practices: "The authority and acceptability of 'ought' is a conundrum for the global economy and global society. So far, cultural, social and spiritual variances, so pronounced in our fragmented world, have made it virtually impossible

to formulate a coherent, unified 'ought'" (p. 24). For society, however, the goal of ethical business practices has endured. The goal is lofty, but for ethical values to result in ethical business practices, they must be translated into ethical behaviors. Long ago Aristotle made the point that "Wisdom is only wisdom if it is of practical use" (as cited in Dalla Costa, 1998, p. 9).

One method to encourage ethical business practices is measuring Corporate Social Responsibility (CSR). It may be less difficult for a business to examine its impact on society in specific arenas than to determine ethical behaviors. One aspect of CSR is the concept of sustainability. Sustainable business development is defined as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (Edwards, 2005, p. 4). Not only can sustainability as a business notion guide positive business actions, it also iterates the evolutionary process of change. Edwards (2005) states the move toward sustainability will "involve three distinct phases: genesis, critical mass and diffusion" (p. 3). Edwards, citing the Brundtland report, says that "sustainable businesses are 'evaluating any proposed initiative with reference to the interaction of three fundamental criteria: ecology/environment, economy/employment, and equity/equality,' now the Three Es" (2005, p. 17). The model of the Three Es has influenced further refinement in the attempt to make ethical business goals practical resulting in triple bottom line accounting (3BL).

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3BL mimics the model of the Three Es in that “Sustainable business will be required to take into account the triple bottom line of people, profits, and the planet” (Banham, 2004, p. 3). The three prongs of the model coincide with the Three Es: people to equity, profits to economy, and the planet to ecology. This represents a shift from seeing business solely as a means to profit, to seeing business as a *social enterprise*, which “like any other regular business, must be profitable for it to be sustainable” (Rubio, 2005, p. 6). Thus, 3BL is perhaps one of the first bridges from the world of moral behavior to the realm of practical business strategy. Advocates of 3BL claim that attending to the broader impact businesses inevitably have on communities and alleviating *social deficits* is actually sound financial strategy because losses of social capital tend to require financial capital and significant political and social attention (Norman and MacDonald, 2003). With terminology based in accounting and measurement, the business world can begin to learn how to change its behavior. Norman and MacDonald (2003) explain, “The idea behind the 3BL paradigm is that a corporation’s ultimate success or health can and should be measured not just by the traditional financial bottom line, but also by its social/ethical and environmental performance” (p. 1). It seems as if this method of incorporating ethics into business has been effective because many organizations, including AT&T, Dow Chemicals, Shell, and British Telecom, now measure their 3BL.

### **Ethical Financial Industry**

The manifestation of The Three Es and 3BL in the financial industry is the practice of micro-financing, which is making small loans to micro-entrepreneurs designed to enable them to grow beyond self-sufficiency to positively impact the economy. As the general business community has attempted to establish methods and terminology to infuse the economy with ethical activity, so too has the world of investments. In 2002, the World Summit on Sustainable Development “decided to investigate the possibility of establishing a socially responsible investment (SRI) index” (Gilmour, 2004, p. 75). Gilmour (2004) states the goal of SRI is that, “Over time, the index could be used as an initial screen for all potential investors—a kind of aspirational benchmark” (p. 77).

The growing demand for ethical business practices has resulted in individuals deciding how they spend their money; more and more people attempt to demonstrate their values with their bank accounts. Freundlich (n.d.) notes that in the complicated world of investing it has

become increasingly difficult to know exactly what one’s money is doing. He says, “It is exactly this *disconnect* that has been fueling the growth of Community Investing, perhaps the least well-known sector of SRI” (Freundlich, n.d., ¶ 1). SRI mirrors the inclusion modeled by the Three Es and 3BL explains Baue (2005), “SRI addresses not just financial but also social and environmental performance” (¶ 2). Baue (2005) quotes Coro Strandberg, a consultant responsible for a 2005 study entitled *The Future of Socially Responsible Investment*, as predicting, “a gradual shift from SRI as an instrument of moral philosophy for moral investors to SRI as an instrument for mainstream investors who are not interested in morality itself but recognize that immoral behavior of companies will hurt their investments” (¶ 4). In fact, SRI has grown as reported in *The Journal of Investing*, “We now see socially responsible mutual funds (SRMF) that impose major socially conscious constraints on their investment practices” (Shank, Manullang, & Hill, 2005, p. 83). Strandberg’s prediction appears to be on target since “Fifty percent of the investment houses around the world offer a socially responsible investment option” (Banham, 2004, p. 2). Further evidence is that “the average SRMF performed better on average than its conventional rivals” (Shank et al., 2005, p. 83). By investing in organizations that provide micro-financing our economy reaps additional benefits. John Bryant (2001) points out that when micro entrepreneurs are provided the means to grow their business, “not only do states get back the employment taxes, but they get business taxes as well” (p. 24). Micro financing appears to be a win-win situation with individual entrepreneurs, investors, and the economy and community benefiting. The big picture looks good, but what exactly is micro financing and how is it functioning in the United States?

### **History of Micro-financing**

Micro-financing is the practice of lending small amounts of money to individuals who don’t qualify to access capital through traditional lending channels. The goal is to alleviate poverty. The movement toward micro-lending has mirrored the overarching evolution toward more ethical business practices; it was initially an altruistic response to a social crisis. While most view micro-lending as a novel enterprise, this concept was utilized 100 years ago in response to the calamitous earthquake in San Francisco. Most businesses in the city were destroyed, and many did not have the financial capacity to access traditional lending channels. The Bank of Italy, now known as the Bank of America, moved into the niche market and began

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providing small loans to poor entrepreneurs enabling them to begin rebuilding the city. Thus, there is a precedent for micro-lending in the United States through traditional banking institutions.

Micro-lenders strive to serve populations that traditional banking organizations do not serve. These are the people who have no collateral, nonexistent or negative credit history, or who experience other barriers such as racism or sexism. Regarding traditional banks, Rachel Myrow (2006) explains that few banks actually seek out the poor. Micro-lending of amounts as low as \$50.00 to the poor with very low interest rates allows them to build their business and establish a positive credit history. As they grow, they establish the credit worthiness that traditional banks find more palatable. Micro-lending has proven so successful in developing nations that the “United Nations considers the movement a critical tool to fight world poverty” (MacDonald, 2000, p. 1).

The most well known institution providing micro loans today is the Grameen Bank in India, founded by Muhammad Yunus as a response to the debilitating poverty in his country. Yunus’ creation of today’s micro-lending model has “challenged basic assumptions about poverty and the means to escape it” and “turned the conventional wisdom of traditional financial institutions on its head” (as cited in Phillips, 1996, p. 1). One assumption challenged is that philanthropic giving in the form of charitable donations best helps the poor. The fallacy of this assumption, as well as the appropriateness of the practice of micro-lending as the means to alleviate poverty, will be examined further later in this paper. It is sufficient at this point to quote Phillips’ (1996) article again “The results speak volumes: Grameen Bank is estimated to have lifted half a million families out of poverty” (p. 1).

In addition to the consistent mission of micro-lending, the practice Yunus established of lending to groups of entrepreneurs rather than to individuals has also remained consistent. While this is not the case for all micro-loans in the United States, it is perhaps the most innovative aspect of the practice. Freundlich (n.d.) reports many programs “use a peer-lending model that binds individuals together in a supportive group of borrowers whose access to loan capital is dependent upon the success of all its members” (§ 2). This model is a further demonstration of sustainable business practices, which encourage a shift toward social business enterprise and strengthening communities. Rogers and Ryan (2001) summarize, “Sustainable development can only occur with a massive move away from individualism, with a renewed

emphasis on community and a shared responsibility for our well-being and our environment” (p. 282).

### **Micro-lending in the United States**

Micro-lending has been quite successful in developing countries, where an amount as low as \$50.00 can make a real impact for an entrepreneur. The practice of micro-lending in the United States must be able to address the realities of our economy. MacDonald (2000) states “The nascent micro-enterprise industry faces difficult challenges in meeting the needs of American micro-entrepreneurs. In the Third World, \$100 can make a dream come true; here, it won’t last” (p. 3). However, Donna Fabiana, the U.S. director of The Foundation for International Community Assistance, stresses “While third world poverty looks different, the obstacles that the poor face are often very similar to those felt here” (as cited in Burstyn, 1995, p. 1). Organizations providing micro-loans in America have adjusted certain aspects of the practice, but the core purpose of alleviating poverty is intact. As Norton (2003) explains “Yunus’ basic trickle-up principle remains essentially the same in urban America as it was in rural Bangladesh, striving to build a self-sufficient workforce out of financial untouchables that banks cannot or will not support” (p. 1). Who are the untouchables in America? They are the poor, and minority and women business owners. Adapting the practice to the United States is becoming more necessary as many individuals struggle to succeed in our economy. Families are finding it harder and harder to survive, much less thrive, and poor entrepreneurs or those who are affected by discriminatory lending practices are falling behind. Jon Wainwright, economist and affirmative action expert, said “The magnitude of the racial difference in small business loan approval rates is substantial. For example, approximately 24% of loan applications by White business owners are denied; compare this to the loan denial rates for minority business owners: 62% for Blacks, 47% for Asians, and 54% for Hispanics. It is important to note that these disparities persist even when variables such as education, experience, age, etc. are held constant. Unfortunately, minorities and especially Blacks continue to be discriminated against in the market for credit. This is an important market failure. (personal communication, May 1, 2006)

### **Domestic Micro-financing Organizations**

Today organizations providing micro-loans in America are working to address a social inequity, the initial step in Edward’s (2005) diffusion phase. Examples

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are increasingly abundant but this paper will be limited to three organizations, ShoreBank, Operation Hope, and ACCIONUSA. ShoreBank, operates in Illinois, Michigan, Oregon, and Washington D.C.; its motto is *Let's change the world*. ShoreBank focuses on 3BL, stating "Unlike conventional banks, ShoreBank strives to meet three objectives simultaneously: to build wealth for all in economically integrated communities; to promote a healthier environment; and to operate profitably" (ShoreBank, 2005a, ¶ 1). It also responded to social inequity by addressing "officially sanctioned discrimination on the basis of race and income" (ShoreBank, 2005b, ¶ 2). Operation Hope, founded by John Hope Bryant and based in Los Angeles, operates under the motto, *No loans denied*. As the Bank of Italy responded to crisis, so too the creation of Operation Hope was an effort to rebuild and repair a damaged community. Operation Hope was "founded immediately following the civil unrest of April 29, 1992 in Los Angeles" (Operation Hope, n.d., ¶ 1). True to form, this organization is responding in a moral fashion to a social inequity. Its founders feel that "America has suffered far too long with two Americas; one served, bustling with economic, educational and social opportunity, utilizing all of the tools of a capitalist society, and one grossly underserved, overly dependent, and historically neglected by the private sector" (Operation Hope, n.d., ¶ 3). ACCION USA is now "the largest micro-lending network in the country" having loaned "more than \$90 million to more than 10,000 low-income entrepreneurs" in America (ACCION International, 2006a, ¶ 2). Its impetus was concern "about growing income inequality and unemployment in the U.S." (ACCION International, 2006a, ¶ 1). These organizations were born of altruistic intentions, but are they working?

### **Financial Performance of Micro-lending**

Research indicates that micro-lending is financially successful. Operation Hope reports that in 14 years of providing micro-loans they have not had one default (Myrow, 2006). ACCION boasts a loan repayment rate of 97 percent, which has "shattered the myth that the poor were bad credit risks" (ACCION International, 2006b, ¶ 3). Burrus (n.d.) reports that, "With just two micro-loans each, 203 ACCION clients increased their business assets by an average of 51 percent, business revenue by 37 percent and take-home income by 40 percent over a two-year period" (p. 4). This illustrates that serving populations historically viewed as untouchable can, in reality, positively impact the whole economy by increasing individual income, assuaging unemployment, and expanding the tax base.

Independent research supports the numbers these organizations report. Burstyn (1995), citing a study conducted by the Aspen Institute that reported that 78% of the entrepreneurs obtaining micro-loans were still operating in their third year, notes "That in itself is an enormous achievement, as the typical survival rate for small businesses in the U.S. is only 50 percent" (p. 1). Bill Edwards, executive director of the Association for Enterprise Opportunity, states, "Our studies indicate that micro-enterprise returns \$4 for every \$1 of public money" (as cited in MacDonald, 2000, p. 2). Kimball (1997) performed an extensive study comparing the performance of specialized micro-lending institutions to conventional banking organizations, which he calls diversified peers. He found that "In addition to higher returns, the micro-lenders clearly outperformed the diversified peers in terms of growth" (Kimball, 1997, p. 51). Kimball (1997) states that micro-lenders compared to the diversified peers had "a net interest margin at 4.89%, 4.60% at the diversified peers; Net revenue at 6.69% of assets, 5.42% at the diversified peers; Higher average returns on equity at 16.23%, at 12.69% at the diversified peers; and Higher asset growth at 11.86% per year, at 8.43% for the diversified peers" (p. 51).

Traditional banking institutions should take note of these findings that document an overall financial health. Remarking on the performance of micro-lending institutions, Prahalad (2005) states, "Their success has shown that poor people can be valuable clients of specially designed financial services" (p. 293).

There is additional potential in micro-lending that could attract conventional lenders into the arena. MacDonald (2000) reports that "there are an estimated 13.1 million micro-entrepreneurs in this country" (p. 2). This is a huge market, and it is growing. Baue (2004) reports that the Grameen Foundation-USA "identifies a ripe market for microfinance, which is projected to grow from a \$2.5 billion market today to a \$25 to \$50 billion market in the future" (¶ 2). If micro-lending practices expand to serve this large population in the United States, our economy will be positively impacted by increased business and income taxes as well as increased individual income facilitating a higher level of spending. Prahalad (2005), whose term for the untouchables is "people at the bottom of the pyramid" (BOP), says "To convert the BOP into a consumer market, we have to create the capacity to consume" (p. 16).

### **Involvement of Conventional Banking Institutions**

Some traditional banking institutions are paying attention to the positive financial performance exhibited

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by the micro-lending movement. Tefft (1995) reports an important shift at the World Bank, one that may serve to further legitimize the micro-financing industry. She states, “The World Bank, which traditionally lends to governments, launched a \$200 million micro-financing initiative through private organizations and special banks for the poor” (Tefft, 1995, p. 1). The role of conventional banking institutions in the micro-lending industry at this point is primarily in funding the specialized institutions, which have been performing the service. The Global Commercial Microfinance Consortium links conventional banking organizations to those with micro-financing experience. “Its \$75 million fund is supported by financial institutions all over the world, including Merrill Lynch” (Baue, 2005, p. 2). Reporting on funding, ACCION USA President Burrus (n.d.) wrote that “More than 30 banks have made loan capital available to ACCION USA, led nationally by Wells Fargo, Citibank, Chase, Bank of America” (p. 2).

One expectation held by conventional institutions that provide capital to these specialized organizations is that as those clients become successful, they will eventually be in a financial position to utilize traditional banking services. The traditional institutions are beginning to build a relationship with potential future customers. Burrus (n.d.) at ACCION USA notes that participating institutions believe that “Partnering helps raise a bank’s profile in communities where it may have had little presence or even a negative image” (p. 3). As they enter into the new industry, traditional banks are practicing sound business strategy with these partnerships while at the same time bolstering sustainable development.

### **Creating Community Stakeholders**

If sustainable development through micro-financing positively impacts individuals, communities, and economies, then there will be an evolution from charity to self-sufficiency. The welfare and charitable-giving

paradigms have not alleviated poverty in the United States. Prahalad (2005) points out that “Charity might feel good, but it rarely solves the problem in a scalable and sustainable fashion” (p. 16). Indeed, many feel that these methods of *helping* actually hinder, creating dependency and hopelessness, as well as fostering a disconnect between the *haves* and the *have nots* in our society that often manifests in destructive actions. Operation HOPE reminds us that “Over 3000 structures were burned or vandalized during the civil unrest of April, 1992 in Los Angeles, yet not one of those structures was a home” (Operation HOPE, n.d., ¶ 4). John Bryant (2005) points out that, “You do not burn that which is your own” (¶ 13). Illustrating the value of community stakeholders the site offers this connection: the home ownership rate in South Central L.A. was 35% and the voter turnout rate was 38% (Bryant, 2005, ¶ 13). Those who perceive themselves as valuable members of society engage in productive social and economic activities.

Micro-lending is a proven means to creating stakeholders in our communities. Burrus (n.d.) states “The power of micro-lending, as banks are discovering, is that it isn’t charity. Instead of creating dependency, it fosters initiative” (p. 4). Micro-financing is an ethical response to social inequity that has established a record of providing profitability as well as benefit to multiple stakeholders in a variety of arenas. It benefits the individual entrepreneurs by enabling them to grow their business and increase their income. It benefits state and federal economies by creating additional tax income. It benefits investors by providing profitable returns. It benefits all members of society by creating engaged stakeholders acting responsibly in their communities. Micro-lending is a potent tool for sustainable community development. Freundlich (n.d.) summarizes this convergence of ethical intention and profitable practices stating “Community investment demonstrates a sustainable partnership between capital and humanism that cuts across partisan lines” (¶ 18).

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