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When Small Loans Make A Big Difference

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Nearly everyone told Matt and Jessica Flannery that their idea--a Web site where people could make micro loans to individual borrowers in the developing world--wouldn't work.

Venture capitalists couldn't see how anyone could make big money on loans as small as a few hundred dollars. And foundations, for their part, wouldn't support something that they saw as commerce, not charity. "We were in this weird social entrepreneurship space, trying to fight perceptions," Matt Flannery recalled.

One lawyer friend even told Flannery the Web site would be illegal. "He said, 'You can't just send money to someone in Uganda and have [him or her] send it back and have it be OK. If you do that, someone's going to care. Someone's going to show up at your door,'" Flannery said. "I read all the policy and case law on it, and I couldn't find anything that said it was illegal. So we just started doing it."

That decision proved prescient. Today, the Web site the Flannerys created--Kiva.org--is one of the hottest and hippest on the Web. One online commentator compared it to an online dating service, and even former U.S. president Bill Clinton has praised its virtues. Kiva's 270,000 lenders--people who typically hand over their money, via credit card, in $25 increments--have funded borrowers in places as far flung as Tanzania and Tajikistan. So far, they have assisted about 40,000 borrowers in 40 countries and provided a total of about $27 million in funding. A wave of international attention came to the practice of micro lending when Muhammad Yunus and his Grameen Bank won the 2006 Nobel Peace Prize for pioneering work in the field.

Kiva, founded in 2005, has been so successful that it has already spawned imitators: Last year, eBay launched a lending site called MicroPlace. Flannery, Kiva's chief executive, and Premal Shah, its president, spoke about the business and its evolution at the University of Pennsylvania Microfinance Conference.

A Cross Between Google And Bono
Kiva mixes the entrepreneurial daring of Google with the do-gooder ethos of Bono, lead singer of the rock band U2. And with it, the Flannerys have managed to merge two recent socio-economic trends--social networking and microfinance. Microfinance tries to improve the economic condition of people in the developing world by giving them very small loans instead of donations. It tries to marry the discipline of markets with the charitable spirit of old-style foreign aid.

Like a social networking site, Kiva posts profiles of potential borrowers. Lenders then peruse the profiles and make loans to people whom they find appealing. They can sort potential borrowers by nationality, gender, business type or level of need. African widows tend to draw significant interest, while Central American men--and butchers--tend to attract far less. (Lenders can also post their profiles, and Kiva highlights individual lenders and the loans that they have made.)

Once a lender makes a loan, Kiva sends the money to a microfinance institution in the borrower's home country. The MFI--Kiva has relationships with about 100 of them--disburses the funds and works with the borrower to ensure timely repayment. In the language of the banking industry, the MFI services the loan.

Kiva's lenders aren't allowed to charge interest on their loans, and Kiva doesn't charge interest to the MFIs. But the MFIs do charge their developing-world borrowers. This arrangement creates a low-cost funding source for the MFIs while also allowing them to generate money to cover their operational costs. Ideally, a Kiva lender will re-loan his or her money when it's repaid, creating a virtuous circle. According to Shah, "Ninety-seven percent of our active loans are [paid] on time, and our default rate is less than 1%."

Unfortunately, lenders haven't caught on to the second step in the process. "We have a challenge right now, because the people who are getting paid back aren't reloaning," Flannery noted. "They are just keeping the money in their [Kiva] account. Maybe they didn't know it was a loan. Maybe they thought it was a donation. So we have about $3 million right now in the bank just getting float." Kiva's challenge is to prompt them, through e-mail and notices on its site, to lend again.

Kiva, organized as a nonprofit, makes the money to sustain itself through, in Flannery's words, "tips." Specifically, it asks its lenders to give a voluntary contribution to Kiva each time that they make a loan. "We get about 8%," Flannery said. "So if our lenders lend a million dollars, then we get $80,000 to pay our engineers and programmers." Today, Kiva has a staff of about 25 at its San Francisco headquarters.

The Importance Of Good Press

Early on, the Flannerys and Shah bootstrapped the Web site, paying start-up costs out of their own pockets. At the time, Matt Flannery wrote computer programs for TiVo and Shah worked for eBay. They ended up not needing to raise outside money, because Kiva began to get mentions in the media. That brought potential lenders flocking to the site.

First, blogs like Daily Kos picked up on it. Then the print media and PBS followed, and finally, Oprah devoted a segment to it. "*Frontline* on PBS, that brought us to a 10-X level of growth overnight," Flannery said. "And Oprah, that was maybe 10-X again overnight."

One writer, *New York Times* columnist Nicholas Kristof, even went to the trouble of making loans and then traveling to Afghanistan to meet two of his borrowers--a baker and a TV repairman. "Web sites like Kiva are useful partly because they connect the donor directly to the beneficiary, without going through a bureaucratic and expensive layer of aid groups in between," Kristof wrote.

In fact, the demand from potential lenders has been so great that, in December, Kiva had to turn some away. All of the available loans had been funded. "It was very stressful," Flannery recalled. "People had heard about us on television or the Internet, and yet we had to refuse their money."

The dilemma underscores one of Kiva's behind-the-scenes operational challenges. It won't take just any potential borrower in the developing world; a boot maker in Bolivia can't post his information directly on the site. Kiva only takes borrowers brought to it by MFIs that it has carefully vetted, and it will suspend loans to MFIs whose borrowers have high rates of delinquency or whose operations seem shaky. In evaluating MFIs, Kiva considers data submitted by the organizations themselves and by independent third parties, Shah said. Kiva has devised a five-star rating system for the MFIs and shows the ratings, along with profiles, on its site.

"We want to increase the transparency of the process," Shah noted. "We want to give more information on the social performance of the loans and more information on the MFIs." Eventually, as Kiva collects reams of data about MFIs and borrowers worldwide, it could come to serve as something like a credit bureau for the microfinance industry, he said. In theory, its data on each MFI's performance could be valuable, not just to its lenders, but to big backers of micro loans, like large foundations, governments and nongovernmental organizations.

In the future, Kiva hopes to track, in addition to repayment patterns, the social impact of its loans. Shah spoke of creating a scorecard for which Kiva could develop a short survey assessing whether a loan had improved a borrower's social and economic situation. "We could ask 10 or 15 questions like, 'Do you have a tin roof--yes or no? Do you have a pressure cooker--yes or no?'" Today, Kiva gathers that sort of information in an ad hoc fashion. It sends volunteer fellows into the field to work with the MFIs. The fellows report back to the home office and also blog about their experiences on the Kiva Web site.

The fellows program is, in some ways, rooted in Matt and Jessica Flannery's own travels in the developing world. "We went to Africa together right before she went to business school," Flannery said. "We were working in Uganda, and we had this idea to start lending over the Internet." Jessica, now Kiva's chief marketing officer, had worked as a consultant to microfinance lenders in Uganda and Kenya. "My wife got really excited about living in Africa, and I was really excited about living in San Francisco. So we had this marriage dilemma. We solved the problem by forming a Web-based startup in San Francisco that works in Africa. So my marriage was the real motivator for Kiva.

"At first, we had all of these naysayers. Experts said, 'That's an interesting idea for advertising, but that can't scale. How can thousands of people from Uganda, Cambodia and Tanzania--random places where the Internet doesn't work so well--post their pictures and get people to lend to them?' The idea did seem crazy," Flannery noted. "But we weren't thinking it was going to be a multimillion-dollar business. We were thinking it would be our side project. We would see if it worked in Uganda. If it worked there, where there was an Internet café, why might it not work in other places as well?"