

# innovations

TECHNOLOGY | GOVERNANCE | GLOBALIZATION

*Special Edition for the Skoll World Forum 2009*

## Social Entrepreneurship: Shifting Power Dynamics

### *Lead Essays*

President Jimmy Carter The Hope of Our Future World

Paul Farmer Three Stories, Three Paradigms, and a Critique

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### *Cases Authored by Innovators*

Matt Flannery Kiva at Four

Mark Plotkin Changing the Landscape of Power

Karen Tse From Fear to Hope  
*commentary by Kenneth Neil Cukier*

Bunker Roy Empowering the Rural Poor to Develop Themselves  
*commentaries by John Elkington; Martha Stone Wiske*

Martin Fisher Income is Development  
*commentaries by Paul Polak; Julia Novy-Hildesley; Eric Simanis & Stuart Hart*

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### *Analytic and Policy Articles*

Brian Trelstad Simple Measures for Social Enterprise

Alex Nicholls Learning to Walk

J. Gregory Dees Philanthropy and Enterprise

**FEATURING SKOLL SOCIAL ENTREPRENEURS**

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## **Organization of the Journal**

Each issue of *Innovations* consists of four sections:

- 1. Lead essay.** An authoritative figure addresses an issue relating to innovation, emphasizing interactions between technology and governance in a global context.
- 2. Cases authored by innovators.** Case narratives of innovations are authored either by, or in collaboration with, the innovators themselves. Each includes discussion of motivations, challenges, strategies, outcomes, and unintended consequences. Following each case narrative, we present commentary by an academic discussant. The discussant highlights the aspects of the innovation that are analytically most interesting, have the most significant implications for policy, and/or best illustrate reciprocal relationships between technology and governance.
- 3. Analysis.** Accessible, policy-relevant research articles emphasize links between practice and policy—alternately, micro and macro scales of analysis. The development of meaningful indicators of the impact of innovations is an area of editorial emphasis.
- 4. Perspectives on policy.** Analyses of innovations by large scale public actors—national governments and transnational organizations—address both success and failure of policy, informed by both empirical evidence and the experience of policy innovators. The development of improved modes of governance to facilitate and support innovations is an area of editorial focus.

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Matt Flannery

## Kiva at Four

*Innovations Case Narrative:*  
Kiva

*This essay is a sequel to the case titled “Kiva and the Birth of Person-to-Person Microfinance,” published by the author in Innovations (Winter/Spring 2007). Started by the author, Jessica Jackley Flannery and Moses Onyango in 2005, Kiva is an online lending platform that allows individuals in the developed world to loan to small businesspeople in the developing world. Kiva operates in the microfinance space and works with a growing network of microfinance institutions (MFIs) in more than 40 countries.*

*In the original case, Matt Flannery looked back on the seeds of Kiva’s extraordinary success over a mere two years. He also looked ahead at some of the challenges facing microfinance at that time and explored the risks and opportunities associated with Kiva’s continued growth. In this second installment of the Kiva story he describes some of the pitfalls that materialized and how Kiva dealt with them. He also takes another look ahead, now from the perspective of a changed organization operating in a different financial climate.*

*This sequel was written for, and appears first in, the Innovations special edition for the Skoll World Forum 2009.*

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It has been two years since I wrote the first Kiva case for *Innovations*. That essay was an attempt to chronicle Kiva’s early days and give the reader a sense of what lay ahead. At the time, it felt like the end of the beginning. I’m not so sure anymore. What I realize now is just how long the beginning can be. Long stories have long beginnings, and I can now tell that we are in for one long story.

It is an amazing story and I feel lucky to be playing a part. In the last two years, Kiva’s staff has tripled and our impact has multiplied more than tenfold. We’ve traveled all over the world and made friends most everywhere. We’ve witnessed an alarming amount of poverty. We’ve also seen a universal work ethic, and the cre-

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*Matt Flannery is the co-founder and CEO of Kiva.org. He is a Draper Richards Fellow and a featured blogger on the Skoll Foundation’s Social Edge website.*

*Matt Flannery and Premal Shah, President of Kiva, are 2008 recipients of the Skoll Award for Social Entrepreneurship.*

## Where are the Kiva Entrepreneurs?

110+ MFIs from 40+ countries



### Out of Africa and Into the World.

activity and entrepreneurialism that reside in the world's working poor. It is that spirit that has made our business possible.

Because of the efforts of thousands, we've managed to stay financially healthy and to build a great team in the process. We've grown a service that serves people in over 40 far-off countries like Mongolia, Togo, and Paraguay. It still feels like a dream.

We've also been able to make it through more than a few rainy days. Every great story has its rough patches. In the past two years, we've had our share. We've been overworked and we've been betrayed. We've taken some hits and fought back hard. At points, I didn't know if we were going to make it through. However, we managed to come out stronger with each setback. It was much too early for the story to end.

So, this paper is a brief recap of the past two years, what we have learned, and what we are up against now. It is a picture of an organization making its way through adolescence: shedding some childish ways while trying to retain the essence of what made it special in the first place. Enjoy.

### THE DEMAND-SUPPLY SEESAW

Since I wrote the initial paper two years ago, our cumulative volume has grown from \$6 million to over \$60 million. As we've grown, we've been riding the seesaw

Special Note from Kiva

Thanks Kiva Lenders!



**You've funded EVERY business on the site!!**

Our website is experiencing record traffic from [recent press](#) we've received, and because generous lenders like you are supporting small business entrepreneurs in the developing world this season of giving.

Please check back again soon. (Press Ctrl-D to bookmark the website.) Kiva Field Partners around the globe are approving new loan applications and posting new businesses on the site each day. We hope that you'll soon find an entrepreneur you'd like to lend to.

Donate to Kiva.org's operating expenses

**Media Event Spike, Potential Lenders Take Hike.**

of supply and demand. At many points during these two years, we've had no loans to offer—lenders had snapped up everything we put out. Media events like our appearance on the Oprah Winfrey Show caused enormous spikes in user lending, and each holiday season causes a much more predictable and dramatic spike. But low-income entrepreneurs and MFIs in the developing world don't necessarily time their work according to network TV schedules or U.S. gift-giving patterns. Because of this, our site was sold out after Oprah and for a few days over the 2008 holiday season.

For much of 2008, however, this wasn't the norm. Especially over the summer, our site had hundreds and sometimes thousands of loans on offer at a given time. A few of them even "expired" after they were listed for 30 days and did not get fully funded. When loans expire on Kiva, we return the funds to our users who then re-lend those funds elsewhere on the site or withdraw them.

Expirations carry a certain amount of risk, in both business and moral terms. MFIs come to expect a certain level of funding and plan their portfolio growth around it. If the funding they actually get differs significantly from their projections, they run the risk of having a liquidity crisis. Although this hasn't yet hap-

pened to any of our partners, it is a real risk. To mitigate the likelihood of such a crisis, Kiva actively limits the extent to which any given MFI can rely on Kiva funding. Specifically, we do not allow an MFI to fund more than 30 percent of its portfolio through us.

Kiva's model can be scaled up; that is no longer controversial. But by exactly how much? That question is up for debate. Personally, I believe that we are nowhere close to our upper limits, for either lenders or borrowers. By Kiva lenders, we mean those individuals who lend money on the site; borrowers are the entrepreneurs who receive users' loans channeled through our field partners. Field partners are local micro-finance institutions (MFIs) that Kiva enrolls throughout the developing world.

The main constraint to our growth is user lending. I've often observed that when our lender base grows, our partner base responds by putting more loans up on the site. This effect is not immediate: it can take us quite a while to enroll an adequate number of partners and perform the necessary due diligence and training to get their loans posted on the site. But once the low-cost debt capital is there, borrowing follows. And when there is an abundance of lending, Kiva earns revenue; in turn, that provides us with resources we can use to support our field partners. When the lending side grows, everybody wins.

A second barrier to growth is currency risk, because exchange rates fluctuate so much. Through Kiva, MFIs borrow in U.S. dollars; then they disburse local currency to the entrepreneurs on our site. But when it's time to repay the lenders, Kiva asks for dollars. In the interim, the MFI bears the risk of currency fluctuation. In late 2008, the dollar appreciated sharply against most currencies—and several MFIs had to pay more than they had anticipated.

Currency fluctuation threatens our ability to expand indefinitely because it presents a large and unquantifiable risk to our field partners. To mitigate this risk, we plan to launch a feature that will allow MFIs to offload their currency risk to our lenders. Our lenders can then make a choice: whether or not to make loans through field partners that do not cover currency risk. It will be interesting to see how this affects our marketplace. Many lenders may not understand the feature. Others may simply detest it.

### THE 3 AM PHONE CALL

When we started Kiva, a mentor warned me about trust. It is extremely hard to pursue a legal case in most developing countries. All we had to stand on to enforce repayment was trust. Sure, we could trust our first partners, who were referred to us by friends. But once we got outside of our circle of close contacts, we would run into trouble. This advice, however thoughtful, proved to be the opposite of what we experienced.

Through 2005 and early 2006, Kiva consisted of just a few employees, mostly unpaid, enrolling MFIs based on trust. Our non-existent budget made it hard to do onsite due diligence. In addition, our focus at that time was almost exclusively

on Africa, which has proven to be a more difficult place to work than the other regions.

In 2007 and 2008, we watched as several of our early field partners unraveled. Many of them had been introduced through close contacts, people we felt we could trust. But without a budget, we could not visit them before we initiated the partnerships. We learned the hard way from these cases that “feeling we could trust” was not enough to prevent fraud.

Fraud, as Kiva defines it, occurs when a field partner knowingly does not deliver some amount of the funding to the end borrower on the site. When we detect fraud, we end the relationship and evaluate our options for recovering the debt. Sometimes we can work out a plan with the MFI’s leaders to repay our users. Other times, a legal situation arises.

We have worked with about 110 field partners in our three-year history. With six, we have encountered serious fraud, leading us to dissolve a partnership. Behind each of these breakups is a story. Usually, it is of a patriarchal figure who viewed his organization as an extension of himself. The abridged stories get sent out to our user base in emails and are posted on the field partner pages of our website. The unabridged stories live on in my mind.

In this sense, Kiva is quite unique in the world of philanthropy. We proactively send out bad news as well as good news. For us, the integrity of the data is most important. Our users crave feedback. Negative feedback, while hardly a joy to receive, is still a useful contribution to the ongoing conversation about microfinance and international development. Such news comes at the strangest times, often in the middle of the night.

In the summer of 2007, just after we published our first article in *Innovations*, we hit a particularly hard point. A 24-year-old Kiva Fellow, Shelby Clark, was stationed in Uganda. He discovered, through weeks of detective work, that the leaders of a particular field partner, the Women’s Initiative to Eradicate Poverty (WITEP) were stealing some of the money that was intended for the borrowers whose descriptions were on the site. In addition, the organization’s board of directors did not really exist and most of the staff members were using fake names.

It turned out that WITEP was illegally constructed as a shell to funnel a percentage of the Kiva money to one of Kiva’s founders—Moses Onyango—whom we had featured prominently in the original article. In 2006, we asked Moses to expand his role beyond simply lending to his community in Tororo and Soroti. Moses, who had little background in microfinance, quickly embarked on a business development journey that took him all over East Africa. He helped us enroll a number of partners in that region. One of them, apparently, didn’t really exist and was constructed by Moses himself.

Shelby called when he discovered two sets of loan agreements: one real and the other falsified. This was the smoking gun. My next move was to alert the board. Our board member Geoff Davis challenged me to take action, and within a few days I was on a flight to Kampala. I spent two weeks organizing a clean-up operation. We hired accountants and lawyers. I spent hours with Moses, trying to figure



out exactly what happened. He was very apologetic, but our conversations didn't go anywhere. The money had vanished into a series of bad investments and a new house. Moses had a growing family. His new son was named for me: Matthew Flannery Onyango.

Those two weeks in Uganda were devastating. In the ensuing two years, we've pursued a legal case that has yet to bear any fruit—especially because we refuse to offer bribes.

### TRANSPARENCY AS A HABIT

In total, Kiva lenders sent about \$250 thousand to WITEP; about half of it made it to the WITEP borrowers portrayed on the site. Kiva was just passing the \$10 million mark for cumulative loan volume, but we had less than \$1 million in fully repaid loans. A sudden default of all WITEP loans would take our default rate to 25 percent. Our cornerstone value is transparency. Were we ready to swallow this poison?

Well, yes. After weeks of debate, we decided the debt was, at least in the short term, unrecoverable, and we owed it to our users to tell them the news. On “Black Wednesday” (August 22, 2007), we alerted our users that not all of their funds made it to the intended recipients. Furthermore, we issued a refund for the full amount of the WITEP loss. Thankfully, by that time we had reserved enough cash to cover the full amount of the refund.

The reaction from our user base was telling. Overwhelmingly, they thanked us for our honesty and poured their refunds back into loans to other MFIs on the site. They reinforced an important lesson: whenever possible, be completely transparent. Transparency pays huge long-term dividends.

Since the WITEP debacle, we've had five other situations involving severe fraud. We signed up all of these MFIs early in our history before we had the budget to travel and work with auditing firms. In Cote D'Ivoire, an MFI gave out \$300 loans but posted \$1200 loans to the site. In Kenya, an executive director passed away and her husband diverted funds to pay off other debts. Also in Kenya, two other fraudulent MFIs embezzled money intended for borrowers who never saw a penny. In Ecuador, a startup inflated loan sizes by 30 percent and used the extra income to fund its operational costs.

In some of these cases, we were able to recover funds; in others we were not. In some, legal situations continue. As time has passed, we've learned to be increasingly detailed and timely in our communications to lenders. Our user base, above anything, desires information.

If you are running an organization and are considering withholding valuable information from your customers, just don't. There are a million reasons to withhold information. Lawyers will warn you about liabilities. Marketing people will preach about tarnishing the brand. Investors will encourage you to look bigger and better than you are. Most of this is just tired and outdated thinking.

Operating transparently is a great way to keep an organization accountable for

Kenya > Supporting Enterprises for Economic Development (SEED Development Group)



**Special Notice on SEED Development Group from Kiva Staff -- April 23, 2008**

During an audit, Kiva discovered that the SEED Development Group was not providing entrepreneurs with the full amount of their loans raised on Kiva. This violates Kiva's policies, so we have **terminated our relationship with SEED Development Group. In**

**addition, SEED has defaulted on its entire loan portfolio, and all active loans have been defaulted.** Please see the FAQs below for more information.

**FAQs:**

**Q. What is SEED Development Group and how are they related to Kiva?**

A. Kiva does not lend directly to any entrepreneurs. Instead, the loans on the Kiva website are administered by independent Field Partners, which are organizations that lend to the poor for poverty alleviation. The role of a Field Partner is to screen each

**About the Field Partner**

<b>Field Partner:</b>	<a href="#">Supporting Enterprises for Economic Development Group</a>
<b>Field Partner Risk Rating:</b>	<b>CLOSED</b> (Learn more)
<b>Time On Kiva:</b>	24 months
<b>Kiva Entrepreneurs:</b>	262
<b>Total Loans:</b>	\$74,550
<b>Delinquency Rate:</b>	N/A - No Active Loans
<b>Default Rate:</b>	18.73%

[See all loans from this field partner >>](#)

**Kiva Fundraising Status**

**Fundraising Status:** Closed

[See all fundraising loans from this field partner](#)  
[RSS](#)

**Portion of FAQ section reporting fraud and describing Kiva's response.**

its actions. Before you act, ask yourself: would you be OK doing this if you had to tell your entire user base about it? Would you be proud if your actions were described on the front page of the *New York Times*? These are great tests that I often use to vet a decision.

At Kiva, almost everything we do is open for public view. We are willing to share anything, as long it meets two criteria. First, the information must be verified and cannot fall into the realm of gossip or speculation. Second, the information cannot violate a particular individual's personal right to privacy. Beyond these two criteria, all of our information is fair game.

**DUE DILIGENCE: RISK AND REPAIR**

Our problems with field partners relate mostly to those we enrolled in 2005 and 2006. Since then, our problems with MFIs have become less frequent and less severe—largely because we have built a professional due diligence operation. In the process, Kiva was transformed from a pure web startup into a hybrid Internet/international development organization. These efforts let us confront and contain the specter of fraud in the field, which threatened our viability in 2007.

Kiva's early employees had absolutely no background in due diligence. We were, and are, by nature more focused on the user experience. It required a significant cultural shift within the organization to get good at due diligence. We weren't

the right people to do it, so we brought people in from outside. Since late 2007, we have been building our microfinance team; of our total current staff of about 35, roughly 15 are focused on selecting and monitoring our partners.

We now employ microfinance specialists in San Francisco and abroad. In San Francisco, we have partnership managers who each manage around 15 MFI relationships and are segmented according to region. In four regions, we have hired local staff to provide the first layer of due diligence, training, and monitoring in the field. The local staff members send data to our investment committee in San Francisco. The committee approves MFI applications based on a perception of social impact and financial health.

In addition to this in-house due diligence, we rely on the expertise of outside firms. For two years now, we have partnered with Ernst & Young to perform many of our visits to borrowers. In 2008, after a year of a normal paying relationship, Ernst & Young pledged over \$1 million in donated services to Kiva so that we could quickly expand the number of visits per year. This is an example of a synergistic partnership between a nonprofit and a corporation.

The microfinance world is colorful, scattered, bulging and full of promise. Banking services are spreading to poor people in the most remote places on earth. Thousands of MFIs are out there within our reach. That said, few of them are ready for truly commercial capital—and those that are commercially viable have been soaking in debt offers over the past few years. Kiva is trying to change that game by creating a transparent, Internet-based marketplace for MFIs of different shapes and sizes to reach out to the world of online lenders to raise capital for their borrowers. We have helped about 110 such organizations expand their reach. As the Moses story shows, doing so can mean walking a bumpy road.

It is a challenge to deal with small and large partners on the same platform, and risk is a key reason. The greatest determinant of risk is the characteristics of the lender MFI, not those of the individual borrower. In general, a loan that is processed by a small field partner is far more risky than one processed by a mature MFI. In order to represent this reality to our users, in 2007 we created a risk rating system that categorizes our field partners on a spectrum of one to five stars. MFIs that have one star are generally much more risky than MFIs that have five. And those with one star may raise far less money—by an order of magnitude—than MFIs that have five. The risk rating system helps us make sure that our loan volume is well balanced between riskier and safer field partners. Lenders who are less risk averse and want to assist smaller, often newer MFIs can choose loans services by one-star partners. Lenders more sensitive to risk can go with five-star loans. In this way, the rating system gives lenders the ability to adjust to their own tolerance.

The efforts I've described here—at due diligence, diversification, and a star-rating system—are among the reasons why our default rate is currently below 3 percent. But uncertainty is a key element of Kiva's product vision, so you can be sure that this rate will fluctuate as Kiva lenders confront the realities of international development work.

## **Interest Rates Revisited**

In 2005, we took the advice of an informal contact at the SEC and launched the site without interest rates. That is, we decided to offer zero percent interest to our lenders and allow our field partners to retain the interest rates they charged the borrowers as long as they disclosed them to our users. That turned out to be one of the wisest (or luckiest) moves we've made.

I repeatedly tried to get the interest rates back on the site. I felt that interest rates were important to the long-term growth of our project and that they conveyed a sense of dignity between lender and borrower in a relationship based on business, not charity. To me, taking the rates off the site was an accident and I was determined to undo that temporary concession. For two years I bugged any lawyer who would listen. Certainly, I argued, if sites like Prosper and Lending Club could do it, Kiva could too.

All the while, our popularity was soaring. Our user base was growing faster than we expected and we saw little evidence that our users wanted to earn interest on their loans. In fact, many considered themselves donors. Only a small percentage would withdraw their cash from the system once it was repaid. Still, I busied myself with this legal scavenger hunt and, in the process, became quite a knowledgeable (if amateur) securities lawyer.

But for all my sleuthing, I couldn't find a legal team that would give us permission to pay interest to our lenders. After two years of trying, we effectively gave up. Our user base didn't want the interest and there was no airtight legal argument to justify offering it.

In 2008, our "decision" to stay at zero percent started to look brilliant. In the U.S., the SEC began to regulate the world of person-to-person (P2P) lending. LendingClub registered as a securities broker and so did Prosper—under a cease-and-desist order from the SEC. The securities model changed the P2P space, and dramatically. It significantly changed the type of borrowing and reduced the personal touch of a product that is supposed to be very personal. If we were to use it, we could not pursue our mission. So, instead of becoming an investment company, we decided to continue as a nonprofit offering zero percent loans to the public.

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### AN ONGOING EXPERIMENT IN SUSTAINABILITY

We have developed two key formulas for measuring Kiva's sustainability and impact: Operational Self-Sufficiency (OSS) and the Leverage Ratio.

First let's look at OSS, which we define as the percentage of our total costs covered by operational revenue. This tells us how much of our operating costs we can cover through our core business. The choice to use OSS creates an organization-wide incentive to increase online lending. When the loan volume spikes, so does

OSS. Then Kiva earns revenue that it can use to build its infrastructure to prepare for even greater levels of lending.

Creating an emphasis on OSS has helped us avoid a trap that snags many nonprofits: measuring overall success based on fundraising. Fundraising can often be quite disconnected from getting stuff done, but it is absolutely necessary and quite difficult. Many nonprofits spend the majority of their time concerned about the next big grant instead of executing their mission. The two activities usually occur in different mindsets and locations.

OSS lets us see what percentage of our total costs is covered by operational revenue—revenue we earn through online transactions. Thus our pursuit of greater operational revenue is directly tied to the pursuit of our mission: “connecting people through lending to alleviate poverty.” Currently, we get operational revenue from three sources: optional transaction fees, the float, and gift certificates that expire.

First let’s look at the optional transaction fee. These fees are the donations that our users choose to send to Kiva when they make a loan. If you use our site to make a loan, you will see that the site “pitches” you for a donation of 10% on top of the loan purchase. So, if you choose to make a \$25 loan to a tailor in Ghana, you will be asked whether you are willing to donate \$2.50 to Kiva on top of your loan. If you agree, your total transaction comes to \$27.50. We send the \$25.00 to the field partner and keep the \$2.50 to help cover our expenses.

Two years ago, about seven out of ten users decided to pay us the ten percent and on a typical day we processed \$50K in loan volume. On such a day, Kiva would make about \$3,500 from optional lender fees. Today, about five out of ten users decide to pay the 10 percent and on a typical day, we process about \$100 thousand in loan volume. Thus, as I write this we are bringing in about \$5 thousand a day in optional fees. The percentage of users who donate has fallen because now more of our loans are “re-loans” as opposed to new ones. But the absolute daily revenue from optional lender fees has increased, to about \$2 million in 2008.

The second source of operational revenue is the float: the revenue from the interest accruing in our bank account. On a daily basis we receive and send funds to our users and to our field partners. As our loan volume grows, the amount of money that sits in our account on a daily basis has grown. Since most of our users do not withdraw their funds, this amount will probably keep growing. In 2008, this account yielded approximately 3 percent; we have invested that income in a money market fund, which has earned us about \$400 thousand.

The third source is gift certificates that expire. In late 2007 we implemented a policy on them. We had noticed earlier that year that a percentage of our gift certificate recipients would not take the time to use their gift certificate, no matter how many times we reminded them. Meanwhile, the funds behind those certificates were lingering, unused, in a restricted bank account. Kiva had no right to ever use these funds for any purpose, given that we never issued a contract to the purchasers. To this day, these funds linger. Starting in late 2007, we implemented an expiration policy for gift certificates issued after that point.



**From a staff of ten in 2007 to 35 today... and counting.**

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We took a state-by-state approach to conform to the individual state regulations for using gift certificates. Each state is different. In the states where expiration is legal, we allowed unused gift certificates to expire after 12 months of neglect and several reminder emails. In 2008, we recognized the first expirations as donation revenue. Approximately \$300 thousand in gift certificates expired and became donations to Kiva. This amounted to about 15 percent of the total purchases from the year before.

Through these three conduits, Kiva's operational revenue for 2008 came to approximately \$2.7 million. Our expenses for the same year totaled approximately \$4.1 million. Hence, our OSS for 2008 came in at about 67 percent. When I wrote the first article, Kiva's OSS was 100 percent. At that point, we were approximately ten people and we conducted little onsite due diligence. Today, we employ 35 people and conduct hands-on due diligence in over 40 countries.

Thanks to the generosity of several foundations, we were able to grow faster than our operational revenue allowed. This funding has allowed us both the freedom and the ability to grow up fast. Without the help of foundations, our due diligence operation would have taken many more years to assemble—and meanwhile the Kiva brand and user experience would have suffered. Certainly, we would not be where we are today without the partnership of foundations that were willing to take risky bets on Kiva.

However, grants can be a volatile source of income. Over-dependence on them can be dangerous. Our board constantly wrestles with this issue. How grant-dependent should we become? How low should we allow our OSS to drop? Should we set a date in the future for OSS to be 100 percent? Or, should we embrace the idea that a certain percentage of our budget will always be supported by grants? Would Kiva refuse grant funding if it could become OSS positive? These are difficult questions with no clear answers. Our board will continue to try and strike the right balance.

In addition to OSS, the other formula we devised to measure our sustainability and impact is the leverage ratio; it measures the amount of money we send to low-income entrepreneurs as a factor of our costs. It is our answer to the “percentage overhead” statistic that came into vogue in the past two decades as a key way

to measure nonprofit efficiency.

As I mentioned above, in 2008, we spent about \$4.1 million to make Kiva work and our users sent about \$36 million to low-income entrepreneurs. Thus, for every dollar we spent on expenses, we sent almost \$9 to the end recipients. Throughout our history, we have kept this ratio above \$8. I am proud of this, because it means that a donation to Kiva's operational expenses generates real returns in the form of dollars being sent to the poor. In the decade to come, I believe that we can expand the leverage ratio astronomically, and thus become one of the most high-leverage philanthropic opportunities in all of history.

Although we need to be creative in finding metrics to measure our sustainability, ultimately our financial model—in fact our mission—is driven by the stories generated thousands of miles away.

### THE STORY FACTORY

As a quick look at my first article will show, Moses is good at telling stories. Moses lit up early Kiva with true tales of fish mongering, goat herding, and clothes reselling. Our family and friends loved it. The stories spread through the blogosphere and adorned the biggest publications in the world. Moses was featured in print all over Africa, North America, and Europe. But as Kiva spread, Moses began telling taller tales involving fake borrowers. It worked. Throughout the process, Moses learned a key lesson: stories are worth something. In fact, they are worth a lot. You can make a pretty penny; all you have to do is tell a good story.

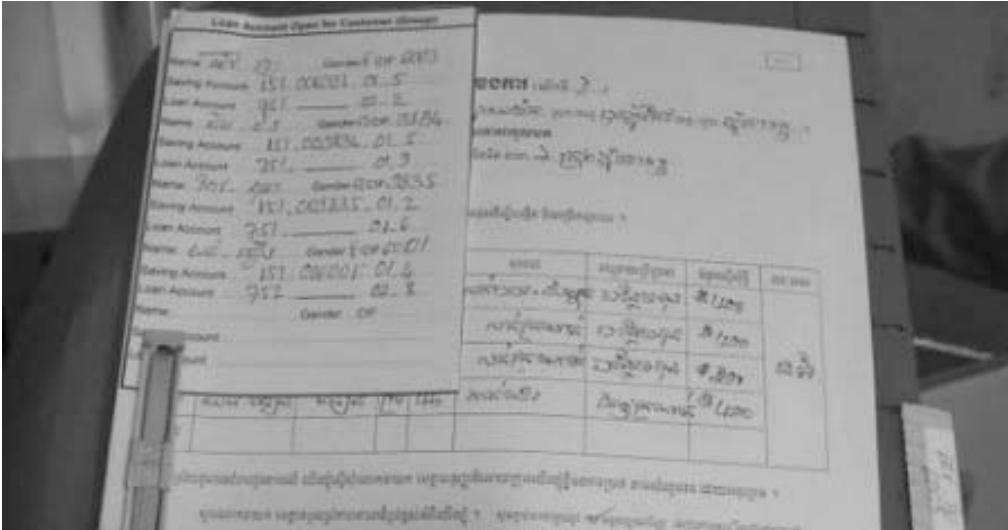
In our first year, the Kiva user experience was filled with feedback. When we had under 50 loans on the site, this was easy enough. Moses had a small office in Soroti that employed three staff members. They would post pictures and business plans directly to the little site we had built. They would also keep tabs on the borrowers every month and write frequent journal updates on each one. The stories detailed business progress: profit margins, total sales, supply chain management, and much more. Waking up every day to new stories was addictive and kept us going through many long days with little rest. The Kiva lenders weren't making a profit, but they were getting paid in a different way: in stories.

Things have changed since the age of Moses, who is now wandering in his own personal desert.

In the ensuing years, things accelerated quickly. The Kiva office in Uganda couldn't handle the load, so we signed up partners worldwide. Annual loan volume went from \$500 thousand, to \$2 million, to \$17 million to \$36 million. For each loan on the site, we were able to get a picture and a story. This was no small feat.

We were expanding our reach and answering the critics who said Kiva couldn't scale. They asked us how we could get all those photos and stories on the site, one at a time. It seemed so inefficient. The trick is that we weren't the ones doing it. We offloaded the task to hundreds of individuals around the globe.

For the collective, it was reasonably efficient. Taking pictures and telling stories does add cost to the operations of an MFI. But those costs are minimal relative to



**Signed Cambodian Loan Application in Khmer.**

the benefit; they boil down to information gathering and uploading. Field partners have overcome the greatest odds, struggling with unstable electric power, narrow bandwidth and sub-par equipment to get pictures and stories on the site. Why? Simply put, it makes financial sense.

Out in Cambodia, I got to watch firsthand how a sophisticated MFI gets content on the site. It is quite an operation. The MFI headquarters is in Phnom Penh, but many of the clients live in provinces hours away. They have branches scattered about the provinces. Loan officers in the branches have been trained on how to gather Kiva information.

In the field, loan officers carry Kiva questionnaires along with a host of other loan documents. When they visit a village, they gather women and tell them about the opportunity to apply for a loan. If a woman decides to apply, the loan officer takes down information on paper—some for the Kiva site and some for other business purposes. The Kiva questionnaire asks for information that interests lenders. For instance, how many children do you have? And how will the loan make an impact on your family? This is all done in the local language—Khmer. They also take photos of the applicants.

Returning to the branch, the loan officer enters the data into a computer and sends the information—via Yahoo! Messenger—to the Kiva coordinators at the headquarters in a major city. Kiva coordinators are typically young, Internet-savvy males who get paid a few thousand dollars a year. It is a desirable job and about ten of them are now working in Phnom Penh. We train them in the art of synthesizing the Kiva questionnaire into a readable narrative; then they spend their days writing stories and uploading pictures. Once live on the Kiva site, the average loan is fully funded in 39 hours.

During the Moses days, each lender would get several journal updates



throughout the course of a loan. Journal updates are essentially progress reports. This is no longer the case. Journaling about a loan requires about as much work as posting a new loan. In the days when we couldn't get enough loans on the site, we got lax about enforcing our journal policy. The number of journals on the site dropped steadily. Today, about one in five loans on the site returns a journal entry after the loan is made. I view this as a temporary product concession that we need to correct. The best way to correct this, in my opinion, is to provide a financial incentive for writing journals. In the coming year, we will try to resuscitate the journaling feature.

Kiva's product vision—and my early views of poverty in Africa—were influenced by the practice of child sponsorship. As a kid, I would write letters to children a few years younger than me in Africa and South America. I imagined my letters being delivered to a thatched-roof hut halfway around the planet. It sparked my imagination and gave me a sense of connectedness. Through Kiva, we can provide some of that to a new generation of kids.

Looking back now, I imagine that the transaction wasn't as simple as I had thought. A lot of intermediaries were involved, lending a certain production quality to the experience. Plus, it was expensive. Delivering the child sponsorship experience was often as expensive as the child sponsorship itself. At Kiva, it's not as simple as it seems, either, as described above. It's also a pretty incomplete picture. The stories provide only a small window into what life is like in Cambodia or Uganda. But it's a start.

## ENERGY IN CROWDS

Kiva runs on a combination of software automation and bite-sized contributions from humans on all seven continents. Even Antarctica is a proven source of energy for Kiva. If you look under the hood, you will see that it takes hundreds of volunteers to make this thing work.

Our first energy source powers translation. As Kiva enrolled partners all over the world, we ran into language barriers. Most executive directors of internationally known MFIs speak English. But the English usually stops there. Loan officers in Senegal speak French and Wolof. Mozambique MFI staff members conduct operations in Portuguese. In Haiti, it's Creole. Spanish is the most common language among our MFIs.

It's pretty far-fetched to think that Kiva could force a system-wide switch to English on its site. So, in 2007 we began to experiment with letting field partner staff post their entries in their own languages. Soon we got an outpouring of emails from people volunteering to translate the text.

Stealing a page from the Wikipedia playbook, we built an interface that translators could use to add an English version to the non-English postings. Through a combination of recruitment and serendipity, hundreds of users are now voluntarily doing translations each month. Most of them live in the U.S., but many live in the very countries where the entrepreneurs are borrowing.

Our next source of people power is the Kiva Fellows. Every four months, they provide a huge injection of energy into the Kiva engine. Fellows are volunteers, with a wide age range, who work with our field partners for periods of ten or more weeks. Three times a year, Kiva sends out a platoon of around 30 such fellows. To date, we've sent out over 100.

Kiva Fellows facilitate connections between lenders and the entrepreneurs they support. They write many of the stories you see on our website, upload videos, and blog about their experiences. In addition, they assist with communications and bridge the cultural gulf between Kiva and the field partners. They help our partners understand our system and policies, and help convey any challenges to our staff. It's amazing how much easier it is to resolve an issue when you have a representative on the ground.

One resource we have yet to tap is our volunteer software developers, a particularly passionate group of people. Most of them are motivated not primarily by money, but by a desire to create. In 2009 we will be launching a third-party developer program that will allow volunteer engineers to author applications using data feeds that we offer to the public for free.

I've been amazed by a surge in volunteerism in the past few years, especially among people in their twenties who seem to be yearning for a meaningful career. This yearning was less profound when I graduated from college in 2001. Now it's up to organizations like ours to harness this precious energy source.

## THE NEXT CRISIS

For years microfinanciers have touted our sector as immune to macroeconomic trends. Meanwhile, we were also touting the importance of connecting the sector to the global economic system. It was only a matter of time before the latter goal came to interfere with the former reality.

The financial crisis has affected low-income entrepreneurs across the world, in many ways. A keeper of a small store in Bolivia can no longer ignore what is happening in the economies of North America and Europe. Remittances coming from the global north are in decline. Customers at that store who depend for their income on family members abroad have seen their buying power plunge. That drop in the purchasing power of entire communities trickles down to the poorest families. As a result, MFIs are concerned with their portfolio quality and the ability of their clients to run businesses that depend on the health of remittance-dependent economies.

In addition, the crisis has hit many export-dependent businesses. I recently visited a handful of clients outside of Phnom Penh. Most of them were silk weavers or tied to the modern silk trade in some way. Their future is uncertain. A silk weaver in a remote province of Cambodia usually sells her product—elaborately woven rolls of silk—to a middleman who in turn sells to exporters. Exports of silk fell sharply in 2008, thanks to softening international demand for clothing. When international demand for silk slows, so do the looms of weavers in Cambodia. If

you are an MFI lending in Cambodia, you will probably think twice before you extend another loan to another weaver.

In addition to the declines in remittances and exports, MFIs face a tightening in lending by wholesale lenders: the banks and funds that lend to MFIs to help them grow. Kiva is a wholesale lender of a very unique breed. We started Kiva in an era when commercial banks were beginning to invest in top-tier MFIs. If you

weren't commercial, it was hard to get anyone in the field to listen. And it seemed inefficient to raise \$25 a time from millions of people when you could raise more money faster from a big bank or a hedge fund. Four years later, some of those big banks no longer exist. Given this experience, almost every commercial funder is reducing the scope of its MFI lending practice.

Over the past three years, Kiva.org has attracted hundreds of new lenders per day. Today, we are closing in on the 500 thousand lender mark. Half a million users sounds huge by nonprofit standards—but in the world of e-commerce or social networking, it is a drop in the bucket.

What if we could extend that number to 10 million or 100 million users? It does sound far-fetched. However, on the Internet, you only need to get a few things right—really right—to get that type of scale. We are still working on it.

In the winter of 2008, the first winds of the financial hurricane blew onto the shores of Kiva. We noticed a mixed reaction from our user base. Yes, new money in the system declined by about 25 percent. That is, user payments through PayPal accounts and credit cards declined by one fourth. But the loan volume at Kiva, which is a combination of new loans and re-loans, didn't drop at all. In fact, it grew by 50 percent as compared to the same period in 2007. Our 2008 loan volume came in at \$36M—double that of 2007. So it seems that our users are spending less new money than during the same period a year earlier—but our total loan volume is still doubling every year because our lenders are reluctant to withdraw their funds.

I'm alluding here to the possibility that the actions of millions of people lending small sums may prove to be a dependable source of capital for the microfinance sector. It is a false competition to pit individual lenders against Wall Street or domestic banks. However, our experience in just four years says something. If nothing else, it speaks to the power of individuals to make a difference and to create a dent in the biggest problem of all: inactivity.

Not only have the world's poor long been excluded from the financial system,

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but the world's privileged have not felt empowered to affect the situation. The Kiva community now includes thousands of individuals who have stepped up for the first time to make a small difference. The potential for big change from the aggregate tiny actions of many is now more enormous than ever.

### A CURE FOR FOUNDER'S SYNDROME

Founding an organization is one of the most rewarding experiences possible. Nothing can beat the thrill of seeing your ideas take form in the world. It can also be one of the most maddening experiences when you try to hold on to what you started.

After almost four years, many people see Kiva as a success. As a co-founder, I can be tempted to believe that our founding vision is responsible for that success. But I have to admit that a whole family of ideas was contained in the founding vision. Certainly, some of them contributed to the success—and some of them weren't as important. Some elements of the founding vision might be simply marginal. Some might have been dead wrong. Figuring out when you were right and when you were wrong can drive you insane.

A few things have, now and then, set me free from founder's syndrome. First is the reliance on data. Instead of becoming emotionally attached to an idea we had years ago, we have tried to open ourselves up to the practice of testing ideas against the data that is constantly streaming in from our users. If one of our ideas is great, certainly there should be a way to test it. For instance, if interest rates are so important, why not ask your users before you launch them on the site? Sometimes, an idea we thought was really important turns out to be unimportant to the people who use the site every day. Seeing this allows me to slowly wean myself away from the emotional bonds I have developed with my own ideas, an experience many founders have.

This is only part of the process, however. More important to curing founder's syndrome is a daily re-orientation to a cause greater than oneself. It's not about you. It's not even about your organization. Even the greatest organizations are just temporary vessels. Such organizations are able to channel energy to something much more important than any single group can tackle. For Kiva, it's about connecting people and believing in others' potential across seemingly impenetrable barriers. There's nothing new about that; we've just taken a different approach. Certainly, many others will continue to pursue this end using ever more daring methods. We have really only scratched the surface.

### PRODUCT TURNS

Kiva's product is still in the infancy. For most of our life, we've been a small team trying to keep up with a growing user base. As a nonprofit whose staff grows organically, we've always felt a little behind where we should be. Today is no different. That said, we have a lot of potential for innovation. Thus, we are gearing our-

selves up for three major product turns in the next decade. Each turn will take three to five years to achieve.

The first product turn is to make Kiva relevant to the mass market. We want to take Kiva from a philanthropy and gift-giving website to the Internet mainstream. In doing so, we are going to have to drive a truck through the idea that doing good and doing well reside in different categories of life. One way we can do this is to deliver loans in the U.S. About the time this article gets published, our lenders will be able to fund borrowers in New York and California. In the future, you can imagine us working in poverty-stricken areas wherever they exist. Another thing we will

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How long will it be before we see a Nairobi lender supporting a borrower in New York? My guess is that it will happen in the next three years.

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do is to emphasize the community aspect of Kiva. The human need to socialize can be harnessed to drive social change. We will emphasize networking around the cause of alleviating poverty in the coming years. Finally, Kiva needs to be a global. In this first incarnation, Kiva has been U.S.-centric. We support U.S. dollars and English language. Multi-language and multi-currency support are an integral part of our future. How long will it be before we see a Nairobi lender supporting a borrower in New York?

My guess is that it will happen in the next three years.

The second product turn is to extend the Kiva brand beyond lending. Once we get the lending experience right there are many new paths open to us. A growing user base can make a big impact beyond microfinance. For instance, what if farmers could insure their crops through insurance funded by Kiva lenders? What if a Rwandan secondary school could raise scholarships for students through Kiva? What about immunizations or health insurance? Remittances? The possibilities are endless, once we reach a sufficient level of maturity in our current product.

The third product turn, maybe a decade away, has to do with “scale-driven opportunities” which would present themselves should we accumulate a user base in the tens of millions. At such a point, our greatest impact may be to leverage the sheer numbers of people who use our service. As I mentioned in the initial article, Kiva, as the world's largest public database of micro-entrepreneur profiles, may become useful as a credit bureau for the developing world. For many borrowers, their Kiva profile is the first public record of their existence. One day a borrower moving from one place to another will be able to point to a Kiva profile as a reference point for creditworthiness. Lastly, Kiva may one day find itself wading into advocacy, as many non-profits do. With a large list of highly-engaged, socially-conscious users, we will have the ability to rally support behind certain causes. For instance, can Kiva help impact the way aid is dispersed in this world? Can we raise awareness for poverty alleviation as a national priority? I believe we can.

LOOKING AHEAD

It is not an insight to say that the next few years will probably be difficult economically. It's not original to note that the present and future adversity presents a tremendous opportunity. It may be unoriginal, but I believe it strongly.

We have an unusually vibrant and resilient investment opportunity on the Kiva site—the world's working poor. In the past four years, their stories have been trickling over the wire into the workplaces, homes, and minds of the world's privileged. Kiva has played a big role in that. In an era of exuberant growth, philanthropy provided a bit of meaning during the course of many people's busy, productive lives.

Now, with so much crashing around us, we are not all so busy and productive as we once were. We have an opportunity to slow down for a while and take stock of what matters most. It's a time to reflect on what the past few years were all about. Even in the worst of times, the infrastructure provided by the Western industrialized world provides us the padding to weather even the most difficult of financial hurricanes.

This can't really be said for the legion of the world's working poor who subsist on less than one dollar a day. This massive group didn't get laid off. And they never got hired either. They are farmers and tailors; they herd cattle and run small stores. They don't have the luxury of slowing down. Slowing down is literally a matter of life or death.

A few years ago, it was difficult to illustrate how our daily actions affect those in poverty. It's no longer difficult at all. A foolish mortgage extended to a homeowner in Louisiana goes into default. A mortgage-backed security, re-sold countless times, causes the collapse of a major bank on Wall Street. That bank slows lending to an MFI. An MFI withholds credit to a woman weaving silk below a house on a floodplain in Cambodia. A household income declines. Kids are pulled out of school and a bright future dissolves.

We are all connected. The connection was always there, but it is easier to illustrate now. Our fates are more clearly intertwined than ever.

The systems we construct in this world are fragile and prone to collapse. However, the people behind them remain compassionate and resilient. Now is a time to circumvent traditional systems. Now is a time for the world's privileged to demonstrate to the world's poor just how compassionate and resilient we are. Now is a time for a swelling of activity amidst so much retraction. Now is a time to build a remarkable counterexample to the dissolution that surrounds us. We're going to spend the next few years helping to make that happen. We could use your help.

*Matt Flannery*