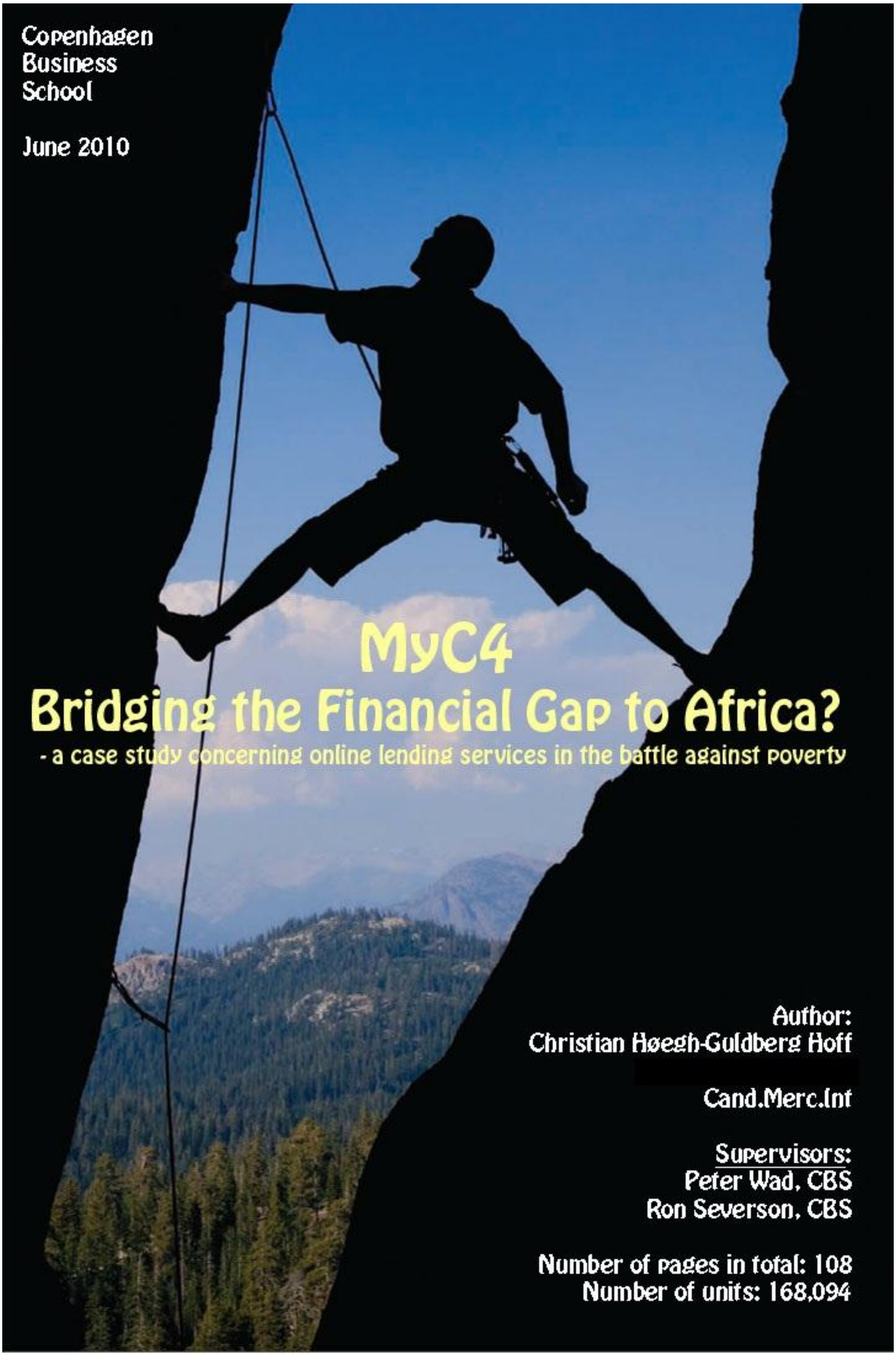


Copenhagen Business School

June 2010

MyC4
Bridging the Financial Gap to Africa?

- a case study concerning online lending services in the battle against poverty

Author:
Christian Høegh-Guldberg Hoff
[redacted]

Cand.Merc.Int

Supervisors:
Peter Wad, CBS
Ron Severson, CBS

Number of pages in total: 108
Number of units: 168,094

Contents

Acknowledgements 4
Abbreviations 5
Abstract 6
1 Introduction 8
1.1 Research question 9
1.2 Definitions and explanations 9
1.3 Delimitation 9
1.4 Structure of the dissertation 10
2 Methodology 12
2.1 Research purpose 12
2.2 Research strategy 13
2.3 Research design 14
2.4 Data collection 15
2.4.1 Primary data 15
2.4.2 Secondary data 16
2.4.3 Emails/Skype 17
2.4.4 Data triangulation 17
2.5 Validity of the data 18
2.6 Implementation of design 18
3 Theory building 19
3.1 Social capital theory 19
3.2 Principal-Agent Theory 21
4 Microfinance 24
4.1 The Grameen Bank methods 24
4.2 MFI's and their work 25
4.3 "The microfinance promise" 26
4.4 Microfinance in Africa 27
4.5 Microfinance services 28
4.6 Lending possibilities 29
4.7 Limitations of microfinance 31
5 Mesofinance – small and medium sized enterprises 32
5.1 Mesofinance obstacles 36
5.2 Mesofinance opportunities 38
6 Online lending platforms 39
6.1 Kiva 41

6.2 MyC4 42
7 MyC4 – case presentation 43
7.1 MyC4 44
7.2 MyC4 Business model 45
7.3 MyC4´s financial situation 48
7.4 Providers 50
8 Findings 52
8.1 Kenya 53
8.2 The microfinance industry in Kenya 54
8.2.1 Jamii Bora 58
8.3 SWOT analysis – MyC4 60
8.3.1 Strengths 61
8.3.2 Weaknesses 63
8.3.3 Opportunities 70
8.3.4 Threats 79
9 Conclusion 83
10 Recommendations 86
11 Reflections 88
Bibliography 90
Figures, tables and pictures 97
Appendices 99

Acknowledgements

I give special thanks to the people who have helped me throughout the process.

I am extremely grateful for all the respondents taking the time to contribute to my research and making it possible.

I owe a debt of gratitude to Lone Søndergaard, Githa Kurdahl, and Paolo Iezza , who assisted me with all the information I needed from MyC4 and gave me valuable suggestions on how to approach my research.

I am also especially grateful to Mia Schomacker, Ove Hoff, Jes Broe Frederiksen and Philippo Stroll for your support and advice which without a doubt has improved the outcome of this dissertation.

Thank you so much Robert Ndubi for your help in Kenya. If it wasn´t for your help, I probably wouldn´t have had all the interviews that I got. A special thanks also to Gabriel Kadidi for taking the time and showing me the amazing impact Jamii Bora has had in Kenya.

Finally, my gratitude goes to my two supervisors Peter Wad and Ron Serverson for your guidance and supervision throughout the entire process of writing my master thesis.

Christian Høegh-Guldberg Hoff

June 2010

Abbreviations

CGAP – Consultative Group to Assist the Poor

CSR – Corporate Social Responsibility

MFI – Microfinance institution

MIX – Microfinance Information Exchange.

MDG – Millennium Development Goal

MyC4 – My Care for (Africa)

SME – Small and medium sized enterprises

NGO – Non- governmental organization

DANIDA – Danish International Development Assistance

IFC – International Finance Corporation

IMF – International Monetary Fund

UN – United Nations

IFU – Industrialization Fund for Developing Countries

USAID – United States Agency for International Development

Abstract

The main purpose of the dissertation was to bridge the knowledge gap on the subject of online lending platforms aimed at eradicating poverty in Africa.

Through the case of the Danish online lending platform, MyC4 A/S (hereinafter referred to as MyC4), and moreover, the exploration of the problems and successes they experienced and encountered in Kenya, I have researched the concept of online lending platforms and their current operating circumstances in Africa. MyC4 targets the microfinance and mesofinance industry in Africa, offering loans to 'the missing middle' – referring to the segment of small and medium-sized enterprises, which find themselves beyond the reach of the existing African financial institutions.

As a concept, microfinance is a relatively new phenomenon, seeing as it first surfaced in the late 1970's, when Mohammed Yunus opened The Grameen Bank with the purpose of lending small amounts to poor entrepreneurs, who, in turn, would use the money to start their own businesses. Mesofinance, however, is the level above microfinance – that is to say, small and medium-sized enterprises.

Furthermore, the research had for purpose to explain how the microfinance and mesofinance industry work in Kenya. The conclusions are partly based on field work in Nairobi, Kenya and, in part, on extensive analysis of secondary data. MyC4 has created a business model, which establishes a connection between the investors in developed countries and the poor entrepreneurs in Africa with the internet as infrastructure. To enable the final link to the loaners – who typically find themselves without an internet connection – MyC4 cooperates with various African partners, who are responsible for the financial management of the loans.

Conclusively, the dissertation and the conducted research reveal that the African market was considerably more difficult to penetrate than MyC4 expected. The fact that MyC4 entered the African market without having an actual risk policy may be to blame. Their business model had an expansive approach to money-lending, which means that they depended on having as many loaners as possible, and the amount of loans being at a constant high. Consequently, MyC4 focused more on the quantity of loans than on the quality and credibility of their African partners, and, as a result, the partners neither had the necessary capacities to ensure repayment of the

loans nor the growth potential the MyC4 business model required. Supported by the principal agent theory, the MyC4 case is an example of the notion that opportunistic behavior occurs, when there are several parties involved in the loan, hence, underlining the importance of control at all levels of the loan. The online lending platforms create enormous opportunities for poor people in the developing countries. This dissertation concludes, though, that trust-building and understanding of the African market are essential for success. Thus, patience and caution is required from MyC4.

1 Introduction

More than halfway to the 2015 deadline to achieve the UN Millennium Development Goals (Appendix 1), advances in the fight against poverty and hunger have begun to slow or even reverse as a result of the global economic crises (United Nations, 2007). It is fair to say that the 2015 goals set by the UN will not be achieved. Despite more than 50 years of development efforts, poverty in Africa remains virtually unchanged. Many people in Sub-Saharan Africa are actually worse off today than 50 years ago. Microfinance is one of the newest tools to eradicate poverty and the UN considers microfinance to be one of the most important foundations to economic growth in developing countries (Year of Microcredit, 2005).

Nobel Peace Prize winner Muhammed Yunus started the Grameen Bank in 1976 with the concept of lending money to poor people who normally couldn´t get financial services. Since then the microfinance industry has exploded and new attempts with innovative business models have been made to serve the poor all over the world. However the market is still enormous and only a small percentage of the world´s poor have benefited from microfinance so the challenge is still enormous for microfinance institutions.

Demand for microfinance products clearly exceeds supply: over 2.5 billion people, or 83% of the global market, lack access to financial services (Matthäus-Maier, von Pischke, 2006). One constraint that prevents microfinance institutions (MFI´s) from reaching more customers is their lack of access to refinancing. Given the scarcity of donor funds, MFI´s seeking funding are increasingly turning to international private capital markets.

With the birth of the internet, a new way of lending has arisen. In 2005, the American online lending company Kiva began to assist MFI´s seeking funding by creating an internet platform where social investors could lend money to local MFI´s in Africa. Since Kiva´s launch a number of internet platforms have emerged and among them MyC4.

MyC4 is a Danish online funding platform where investors, companies and organizations can lend money through the internet to poor entrepreneurs in Sub-Saharan Africa. MyC4 works with African providers who operate with micro businesses and small and medium sized enterprises. One of MyC4´s goals is to prove that Africa is a business case instead of a nut-case. However, MyC4 has experienced the worst of Africa in terms of fraud, mistrust and misunderstandings. That is why the following research question has been developed.

1.1 Research question

Why has MyC4 experienced difficulties creating a financial sustainable business model in Kenya, and what can be learned from these difficulties that could help MyC4 succeed in Kenya?

To understand the industries in which MyC4 operates three sub-questions have been developed.

- How does the microfinance industry work?
- How does the mesofinance industry work?
- How have other online lending platforms proved their business model when operating with developing countries?

1.2 Definitions and explanations

There are several words or phrases which are used in the dissertation that needs some further explanations to clarify the meaning to avoid misunderstandings. Please look at appendix 2 to view these explanations if necessary.

1.3 Delimitation

My original thought was to analyze MyC4 and their operations in East Africa and then make a comparison with the different countries. However, it became obvious due to a lack of financial resources and time that if I wanted to make a valuable and reliable scientific dissertation, I had to limit my research to MyC4´s operations in one country. I chose Kenya because it is the country with most MyC4 partners and thus most interview options. Furthermore MyC4 has established a local office in Nairobi, Kenya and therefore better possibilities to collect valuable and reliable information.

Even though the dissertation is exploring industries where poverty is heavily present I do not seek to take any stance about the definition of poverty or which is the best strategy to reduce poverty. The overall purpose is to explore MyC4 and their goal to become financial sustainable. Thus I seek to explore the challenges and opportunities MyC4 has had when operating in Africa.

1.4 Structure of the dissertation

The organization and structure of the dissertation is presented below and will guide the reader through the dissertation. The dissertation is divided into 11 chapters.

Table 1: Structure of the dissertation

Chapter	Working questions	Approach	Expected Results
1. Introduction	Why have I chosen to focus on MyC4 and what is my research question?	After a short introduction about MyC4 and microfinance I outline the problem in focus.	This dissertation enhances the knowledge on online lending platforms aimed at Africa.
2. Methodology	What is my methodological approach?	I explain my research purpose, research strategy and research design.	An explorative case study design has been chosen to answer the research questions.
3. Theory	Why are the theories chosen relevant in the dissertation.	I describe the theories chosen to help answer the research questions.	How social capital can build trust and network. How important accurate information is to avoid principal-agent problems when dealing with lending practices.
4. Microfinance	How is the microfinance industry?	I review the literature concerning the microfinance industry.	That the microfinance industry has proven to assist the poor with financial services and microfinance helps build social capital.
5. Mesofinance	How is the mesofinance industry?	I review the literature concerning the mesofinance industry	A lack of information available but also suggests that small and medium sized enterprises are important for the growth of the economy.

6. Online lending platforms	What is the concept of online lending services?	My approach is a literature review concerning online lending platforms.	To clarify how online lending platforms can be a new opportunity to help eradicate poverty.
7. MyC4	How and why did MyC4 start and how does their business model work? What are MyC4´s current financial situation?	In this chapter I will describe how MyC4 is working and what their main goals are. MyC4 has assisted me with most of the information provided.	MyC4 is an innovative company that aims at working with Africa through business. They connect investors with businesses in Africa through online lending services.
8.Findings	Why has MyC4 experienced difficulties with proving their business model in Kenya?	SWOT – analysis. The field work provided in Kenya will help answering the research question.	The results among others show that MyC4 has had problems with their operations due to wrong partners, lack of risk policy, lack of communication etc.
9. Conclusion	Why has MyC4 experienced difficulties creating a self-sustainable business model in Kenya?	The information provided by the dissertation gives a final conclusion.	MyC4 has underestimated the challenges of working with online lending services in Africa.
10. Recommendation	What other options do MyC4 have in Kenya and Africa?	The gathered information provides a final recommendation.	MyC4 has had serious problems in Africa. The knowledge they have obtained the last years can help them create a new improved business model that can work.
11. Reflection	Did I achieve what I wanted with this dissertation?	A reflection on the entire dissertation.	I bridged the knowledge gap on MyC4 and their operations in Africa. I experienced on first-hand how microfinance can assist poor people with improving their lives.

2 Methodology

In this chapter, I explain the methodological choices I made to answer my research question and sub-questions. The section outlines the purpose of the research, research strategy and design as well as methods of empirical and theoretical data collection.

2.1 Research purpose

The overall purpose of the dissertation is mainly exploratory, i.e. the research *"aims to seek new insights into phenomena, to ask questions, and to assess the phenomena in a new light"* (Saunders, Lewis, Thornhill, 2007:598). The research is explorative in the sense that the dissertation embarks on an exploitation of a little researched phenomenon: online lending platforms targeting poor entrepreneurs through microfinance and mesofinance institutions in Kenya. Thus the overall knowledge interest of this dissertation is to bridge the research gap in online lending platforms geared towards poverty reduction in Africa. This will be done through a comprehensive analysis of MyC4 and its difficulties proving its business model in Kenya. The dissertation also has for purpose to explore the concept of online lending platforms and how they operate, since they give social and venture investors a new transparent way of helping the poor through business instead of donations.

A third purpose is to enhance the understanding of the microfinance industry and mesofinance industry in Africa, and especially in Kenya, since MyC4 is targeting these industries in its pursuit to prove the business model. Furthermore the information collected illustrates that several MFI´s in Kenya have succeeded with their business model. Thus the dissertation also has an explanatory purpose by explaining why these MFI´s have proven to be successful in Kenya. It was relevant to include one of the largest MFI´s in Kenya since the dissertation will explore the difficulties of MyC4 in Kenya and explain how a successful MFI is operating. Thus the dissertation will be directed/redirected between MyC4 and the microfinance industry.

I have chosen to mention the Grameen Bank and its social capital building, which will be explained in the next chapter, due to the fact that Grameen Bank is a flagship organization in the microfinance industry with a track record of two decades. The Kenyan MFI I have chosen to include in the dissertation is Jamii Bora who is somewhat similar to Grameen Bank by building social capital and is one of the most successful MFI´s in Kenya.

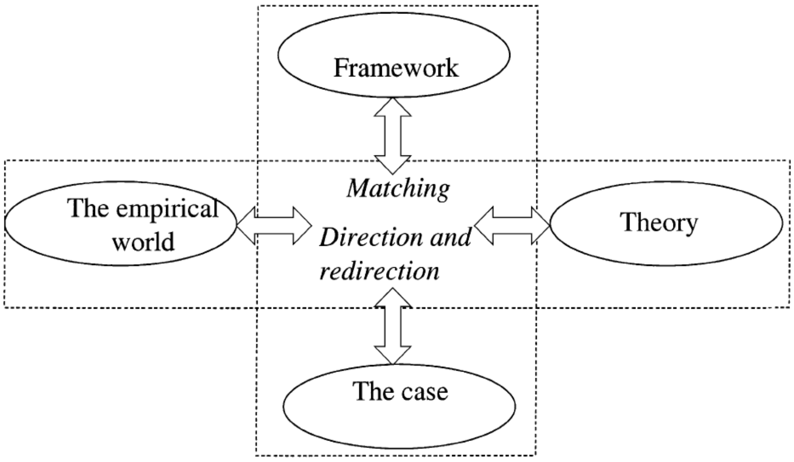
Furthermore it is important to enhance the understanding of online lending platforms in Africa; not only to MyC4 but also to people considering investing in MyC4 or other online lending services. The knowledge base is poor when it comes to online lending services and it is important to have transparency to understand MyC4 and the industry in Africa before investing in online lending platforms.

At last the purpose of the research is to give recommendations to MyC4 on how to cope with these challenges to improve MyC4´s chances of success in Africa. Thus the research also has a strategic oriented purpose.

2.2 Research strategy

Due to the predominantly exploratory nature of the research, the thesis is placed in between a theoretical and an empirical approach. Thus, the research approach is neither inductive (from observations to a general rule) nor deductive (from theory to observations), but rather an abductive approach. According to Dubois and Gadde, abductive, or systematic combining, research *"is a process where theoretical framework, empirical fieldwork, and case analysis evolve simultaneously"* (Dubois, Gadde, 2002:554). It is an advantageous research method as it allows the researcher to move back and forth between different research activities and between the empirical observations and theory (Dubois, Gadde, 2002). The constant matching and direction and redirection between theory and the empirical world, which characterize the abductive method, is necessary in this dissertation, since the project is operating in a field where little research has been conducted. Furthermore it is relevant in the dissertation since two "stories" are being explored; MyC4 as a case and the microfinance/mesofinance industries in Kenya. The main features of how the abductive research method works is listed below.

Figure 1: Abductive research method



The main objective of any research is to confront theory with the empirical world. In systematic combining, this confrontation is more or less continuous throughout the research process (Dubois, Gadde, 2002). Thus, the logic of abduction fits well into the exploratory nature of the dissertation.

2.3 Research design

The research is designed as a case study of MyC4. More specifically the design is a case study of MyC4 in Kenya. The design is aiming at answering why MyC4 has experienced difficulties with their operations in Kenya. The results will be used to build a final recommendation of how to operate in Africa and to assist MyC4 and the readers with key issues concerning the African market.

"Why" questions are being asked about a single setting, and when the researcher has little or no control (Yin, 2003). Furthermore, "how" and "why" questions are the most suitable for a case study because the approach draws attention to what can be specifically learned from the single case (Stake, 1995). The strength of using a case study is that it is designed to bring out the details from the viewpoint of the participants by using multiple sources of data including documents, artifacts, interviews and observations (Merriam, 1998).

2.4 Data collection

I knew from the beginning that the research would be a great challenge due to the fact that MyC4´s model is a new way of operating with developing countries. There exists no previous study about MyC4 and their operation difficulties in Africa. However due to the same fact it was interesting and motivating to do the research. The data collected for the dissertation is primarily qualitative data. However quantitative data has also been used in the form of tables which was necessary to enhance the understanding of the subject being described

Qualitative data analysis has a clear advantage in its ability to see the interplay of different causes and to generate knowledge on previously unknown causes. In this way, theory might be consulted afterwards, because the data suggests theories to investigate (McKeown, 1999). In general, whenever a holistic, dynamic, and contextual explanation of the phenomenon is required, qualitative methods would be the most appropriate methodological choice (Zalan, Lewis, 2004).

Generally, there are four major methods used in qualitative research which are all used in the dissertation. These methods can often be combined. Silverman (2001) distinguished between:

- Observation
- Analysing texts and documents
- Interviews
- recording and transcribing

Many studies have highlighted the advantages of qualitative research in offering an apparently "deeper" picture than the variable-based correlations of quantitative studies (Silverman, 2005).

2.4.1 Primary data

The primary data refer to the information and data I have collected in order to obtain my own information and to be able to compare and deepen the knowledge in relation to the secondary data in my particular area of research. By doing this I was able to get a better idea of the reality that I am exploring. The primary information in the sense of field interviews was essential to construct a solid insightful research. Thus it was necessary to do part of my research in Nairobi, Kenya. The use of interviews can help to gather valid and reliable relevant to the research question and objective (Saunders, Lewis, Thornhill, 2007).

The interviews chosen are semi-structured or unstructured also called non-standardized interviews. These are often referred to as qualitative research interviews (King, 2004). In semi-structured interviews I have a list of topics and questions to be covered, although they may vary from interview to interview. The unstructured interviews are informal. I use them to explore in depth the area in which I am interested.

The interviews lasted between 45-70 minutes and were recorded on sound recorder with my mobile telephone as back up. I transcribed the interviews on my lap top when I returned to the hotel in the evening. I analyzed the questions and answers prior to my next interview in case I missed something or the answers created new knowledge which I could use for my next interview. It was very important that I understood which information I needed so I chose appropriate persons to interview. My research is about analyzing the challenges and opportunities for MyC4 so for me it was relevant to meet MyC4's local partners but also with successful MFI´s who do not work with MyC4 to understand their view about MyC4. It was necessary to talk to as many people as possible to find out if it was possible to generalize from their answers. To be able to meet relevant people and not being misunderstood about my purpose I got help from Robert Ndubi, a former employee of my supervisor in Uganda, who could help me set up the meetings and explain to the different MFI´s the purpose of my interviews. This was very important to build a trust relationship before the interview started so the respondents felt relaxed when answering the questions.

The interviews were conducted with people with knowledge of any, or several, of the following areas: the microfinance industry, the mesofinance industry, and online lending platforms (Interviews, Appendix 3).

2.4.2 Secondary data

Secondary data were collected for a broader understanding of the research area and the information provides some important view points for the analysis and discussion.

In the beginning of my research process, I used secondary data in the form of papers, online articles, online newspapers, and other secondary data given to me by MyC4. MyC4 has been tremendous in assisting me with the information I needed to understand MyC4 in depth. Not at any point did MyC4 question the information I asked for. MyC4´s transparency policy has been extremely valuable in order for me to get the information I needed and thereby answering my research question.

Information gathered from the most recognized MFI´s and information from the World Bank, CGAP, and Mixmarket[1] has been very helpful. The data enabled me to familiarize with the area of study and the general context of my research area. However I knew that data on my area of focus could be scarce due to the fact that the microfinance industry in Africa is rather new and further information on the subject is needed. Especially collecting data about the mesofinance industry in Africa was challenging.

2.4.3 Emails/Skype

An additional source of information which was very valuable was the email and skype correspondence with various people working in the field related to microfinance or mesofinance. Even though it is important to keep distance to the information in terms of reliability from emails or Skype it improved my knowledge on the subject and gave me important contacts in Kenya. Due to this correspondence they knew who I was and it was easier to arrange interviews. Furthermore the information provided by the email and Skype correspondence helped to be able to answer the research questions.

2.4.4 Data triangulation

Triangulation is a powerful technique that facilitates validation of data through confirmation from more than two sources. In particular it refers to the application and combination of several research methodologies in the study of the same phenomenon (O'Donoghue, Punch, 2003).

---

[1] Internet company which collects information on MFI´s.

Data triangulation decreases the disadvantages of each research technique since the adept combination of different techniques and data sources decreases the disadvantages of each individually. The use of a combination of primary and secondary data sources strengthens the data triangulation (Yin, 2003).

2.5 Validity of the data

In terms of validity, the triangulation of data forms a basis, from which I have concluded that certain patterns exist across the cases and types of data. I have collected the data myself, which means that I am certain that the interviews are referring to the subject, I am exploring. The data collected from multiple sources of evidence was to increase the validity of the study. Furthermore the case study has been sent to a microfinance professor working in the field in Uganda, to have a key informant go through the dissertation.

The reviewed literature shows that there is a significant gap in the knowledge base on the mesofinance industry in Africa and online lending platforms and their operations in the African market which therefore stresses the importance of further study about these industries. By using literature from different fields, which cover the limited literature in some areas, it has enabled a more complete overview of the field and enhanced my possibilities of doing proper interviews.

2.6 Implementation of design

I have used a SWOT analysis to implement the MyC4 design. The SWOT analysis is based on data collected from Kenya and the secondary data. The most important information I needed were only possible to collect through my field work in Nairobi, Kenya which was my interviews with the MFI´s and MyC4 Africa. The SWOT analysis will help answer the research question and the sub-questions. Furthermore the SWOT analysis will be useful to give further recommendations on how to operate in Africa and thereby create a scalable business model.

3 Theory building

This chapter will describe the theory used in the dissertation. The theory used is gathered to create theory triangulation and to provide the best possible basis for answering the research questions.

The thesis does not adopt a specific research philosophy. This is mainly due to the dissertation´s exploratory type of research. The subsequent research is done in a pragmatic manner in which various theories are used. Since there are no specific theories which address the research question, two theories, which particular philosophies are independent from each other, have been drawn upon. The theories complement each other which will be explained in the following. The different theories consist of various theoretical approaches that will assist the dissertation in creating a valid analysis about MyC4 and their challenges but also an explanation of why some MFI´s in Kenya have been financial successful with their business model. Thus the theories will help giving further recommendation in how to operate in Kenya. This kind of theory triangulation will address the potential problems of construct validity, since multiple sources of evidence essentially provide multiple measures of the same phenomenon (Yin, 2003).

3.1 Social capital theory

In modern times social capital theory has been regarded to be one of the most influential theories in new economic sociology (Brown, 2005). Social capital, famously defined by Professor Robert Putnam as "*features of social organization, such as trust, norms and networks, that can improve the efficiency of society by facilitating coordinated actions*" (Putnam, 1993:167), is thought to be particularly valuable in low-income countries where institutions for contract enforcement remain weak (Putnam, 1993). Just as a screwdriver (physical capital) or a college education (human capital) can increase productivity (both individual and collective), social contacts can affect the productivity of individuals and groups (Putnam, 2000). According to Putnam, social capital theory makes collective problems easier to resolve, as there is less opposition between parties. This results in improved social environments, such as safer and more productive neighbourhoods. It makes business transactions easier, since when people trust each other, there is less of a need to spend time writing up contracts. As a result, economic prosperity increases generally. It helps to

increase and speed up the flow of information, which, in turn, improves education and economic production. Finally, social capital improves health and happiness through both psychological and biological processes which require human contact. The importance of trust and social capital has been highlighted in research outside that of mainstream banking and finance (Putnam, 1993). Several studies have shown that a high level of social capital in a community contributes to democracy, levels of entrepreneurship, and improved health (Putnam, 2000). In essence, the more reliable the information which the lender obtains from multiple sources, the better the term conditions are for borrowers (Uzzi, 1997).
Interest in social capital has arisen because development practitioners and researchers have observed associations between desirable developmental outcomes and the existence of social norms and networks or of certain kinds of values and norms (Dasgupta, Serageldin, 2000).

Social capital in relation to microfinance often employs group meetings and group lending techniques, potentially building human capital and strengthening the social capital of the community (Anderson, Locker, 2002). Organizing borrowers into groups who pledge joint liability for each other´s loans (social collateral) has been the chief mechanism to ensure repayment on unsecured loans to the poor (Collins, Morduch, Rutherford, Ruthevn, 2009). According to Van Bastelaer (1999), the least explored outcome of microcredit is the production of social capital arising from group-based microfinance programs. Van Bastelaer (1999) also argues that social capital is created when MFI´s like Grameen Bank and its replicators require all members to repeat the same behavior every week, such as reciting the list of decisions that accompany group membership. The Grameen Bank is perhaps the first microfinance organization where the discussion has linked social capital with microfinance. In the typical “Grameen Bank” microfinance program, clients meet weekly in groups to make loan payments. In addition to facilitating debt collection, these meetings encourage regular interaction among members of highly localized communities. Group based microfinance can lower the costs of monitoring and enforcing existing rules and norms (Anderson, Locker, 2002).

Karlan (2001) claims, that social capital generates higher repayment and higher savings. In addition, social capital helps members distinguish between willful defaults and defaults due to true negative personal shocks. It should be noted that enhancement of social capital is generally a valuable by-product of microcredit, not its primary objective. Thus, there may be more efficient ways to enhance social capital in any given setting (Anderson, Locker, 2002).

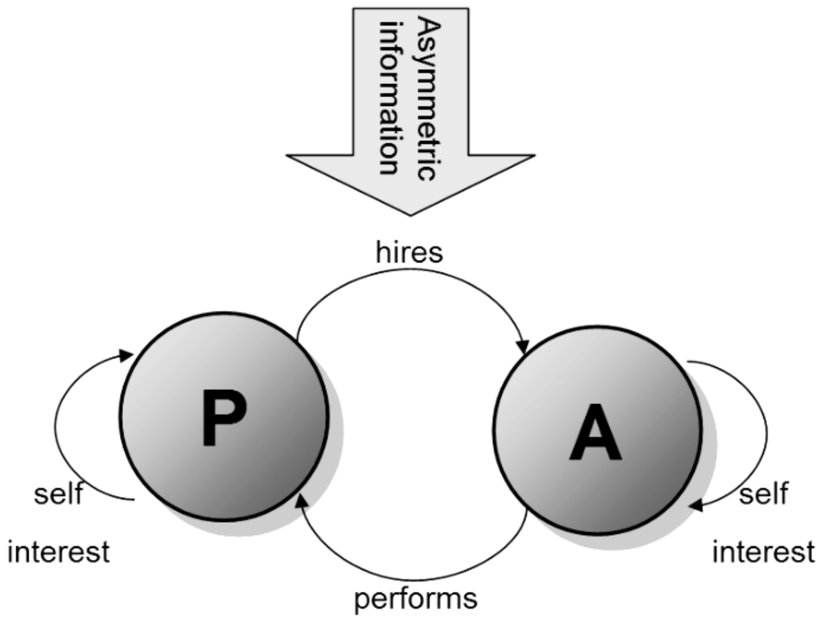
The social capital theory is important because it increases the understanding of the microfinance industry and why organizations like Grameen Bank and Jamii Bora have proven incredible success with lending to the poor.

3.2 Principal-Agent Theory

I have chosen to include PAT (Principal-Agent Theory) in my dissertation because it can enhance the understanding of MyC4´s challenges with their business model. The theory can help explaining some of the challenges in the entire value chain from investors to MyC4 to the African partners/providers to the borrower. Provider is an agent of MyC4, who in turn also has an agency relationship with the investors.

PAT arises in a business management context associated with the behavioral studies of employer-contractor or employer-employee interactions. Early work centered on dilemmas of dealing with incomplete information in insurance industry contracts (Spence, Zeckhauser, 1971). The theory was soon generalized to dilemmas associated with contracts in other contexts (Jensen, Meckling, 1976). The theory is relevant for research within a wide range of empirical relationships where cooperating parties are experiencing differences in goals and risk preferences due to self-interest (Eisenhardt, 1989). The concept of self-interest on behalf of the agent is the central concept in PAT and implies the acceptance that; *"…a non-negligible proportion of actors involved in economic transactions/inter-organizational relationships have inclinations toward opportunistic behavior and that these opportunistic actors are difficult to distinguish from the non-opportunistic"* (Koch, 1995:189). Furthermore, it is costly to sort out those who are opportunistic from those who are not, making it necessary for the principal to install precautions (Williamson, Ouchi, 1981). Below is shown a figure illustrating the principal-agent problem:

Figure 2: Principal-Agent Theory



The overall focus of PAT is concerned with the issue of cooperating parties where one party (the principal, MyC4) delegates work to another (the agent, partner) who in turn is expected to perform that work (Jensen, Meckling 1976). Jensen and Meckling (1976:305) define the agency relationship *"as a contract under which one or more persons engage another person to perform some service on their behalf which involves delegating some decision making authority to the agent*". Furthermore they claim that if both parties are utility maximizers, there is good reason to believe that the agent will not always behave in the interest of the principal. In performing the activity, the agent necessarily chooses an action which in turn has consequences. These consequences, or outcomes, affect the welfare of both the principal and the agent (Petersen, 1993). From PAT's initial accept that no such thing as a complete contract exists, the aim of the theory is to construct an "optimal" contract, which enables the principal to govern the agent´s actions (Eisenhardt, 1989). This is achieved by installing a contract that succeeds in minimizing the likelihood of the two overall agency problems from occurring within the relationship. The first agency problem occurs when the desires or goals of the principal and the agent conflict and it is difficult or expensive for the principal to verify that the agent is in fact, acting in accordance with the principal's interest. The second agency problem deals with the issues of risk sharing that becomes omnipresent when the principal and the agent have different attitudes towards risk (Eisenhardt, 1989). In this dissertation the principal agency problems exist because of asymmetric information, goal conflict and differing risk attitudes at every level of the loan process; lenders/investors – MyC4 – partners – borrowers.

The relationship between the borrower and lender has often been analyzed by using the principal-agent approach. In PAT, the concepts of adverse selection and moral hazard are vital to understanding the problems facing the lender. The term adverse selection indicates that the lender experiences difficulties in knowing good borrowers from the bad, and that the former will ultimately subsidize the latter (Akerlof, 1970). To reduce the costs of adverse selection, the lender must perform an extensive assessment of the credit risk posed by the customer or the project and must consult several different information sources before credit is granted. Moral hazard arises because defaulting borrowers often do not bear the full consequences of their inability to meet their financial obligation to reimburse their loan. The lender bears the full cost of this default, a cost usually transferred to other borrowers in the form of higher interest rates (Arrow, Hahn, 1971).

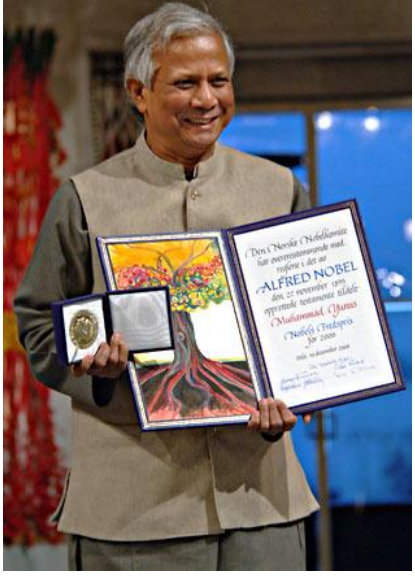
Since PAT provides important insights into the relationship between borrowers and lenders, its focus on control mechanisms has led some authors to question whether it is a representative model of the relationship (Eisenhardt, 1989). Another branch of research focuses on the positive effects of the borrower/lender relationship, specifically on how the increased flow of information from the borrower to the lender can influence the level of trust between them (Petersen and Rajan, 1994).

The PAT is important because it improves the understanding of the mechanisms involved with lending practices. It illustrates that the agent not always behaves in the interest of the principal. This is important since MyC4 is operating with lending practices and MyC4 expects its partners to operate in the interests of MyC4. By combining the control mechanisms of the PAT with the insights on the trust building derived from social capital theory, a hybrid risk management model has been created.

4 Microfinance

In the following three chapters background knowledge based on the main elements of the dissertation will be described and will therefore concentrate on microfinance, mesofinance and online lending platforms.

Some governments around the world routinely face criticism for being corrupt, bloated, and uninterested in this sort of poverty reduction. Other governments (like the one in Kenya) focus on the ways that microfinance promises to reduce poverty, fight gender inequality, and strengthen communities (Armendariz, Morduch, 2007). This chapter will review the literature on microfinance.



Picture 1: Mohammed Yunus

4.1 The Grameen Bank methods

Mohammed Yunus is known throughout the world as a pioneer of the microfinance concept and was awarded a Nobel Peace prize for his work in microfinance and poverty alleviation in 2006. Mohammed Yunus and the Grameen Bank has since their debut in 1979 continuously proven that microfinance is a viable method to alleviate poverty.

Their methodology and programs are still spreading throughout the world making *the Grameen Bank methods* well-known worldwide (Collins, Morduch, Rutherford, Ruthven, 2009). The methods rely on a group-based credit approach which utilizes the peer-pressure within the group to ensure that the borrowers follow through and use caution in conducting their financial affairs with strict discipline. In this way Grameen Bank ensures repayment and allows borrowers to develop good credit standing (Bornstein, 2005). Strong and replicable models of microfinance have been developed and adapted throughout the world, and implemented by increasingly professionalized and commercialized organizations (Daley-Harris, 2002). Somehow, these MFI´s all have duplicated the methods of Grameen Bank in different ways all over the world.

4.2 MFI's and their work

The provision of financial services like credits, savings and insurance to poor people has generated a lot of attention as a means to combat global poverty. It has similarly achieved widespread support from the donor community (Cull, Kunt, Morduch, 2009). During the last 30 years new methods for delivery of financial services have been developed and today more than 100 million poor people participate in a microfinance program (Daley-Harris, 2002). In the beginning, the formal financial sector found financial services to the poor unimportant for the economy, unprofitable for financial institutions and unnecessary for the poor. However modern MFI´s have proven them wrong and have shown that it is possible to lend to the poor in a profitable way. Several MFI´s have proven high repayment rates. High repayment rates do not only depend on circumstances and the characteristics of the borrower but on the design of the credit program; repayment depends fundamentally on factors within the control of the lending institutions (Robinson, 2001).

An MFI´s main objective is to provide poor and low-income households with an affordable source of financial services. To ensure that poor people have permanent access to the financial services, financial institutions must be able to cover their costs and make a profit that can be reinvested to further growth. Interest charged on loans is the main source of income for these institutions and because they incur huge costs, the rates are correspondingly high. At a minimum, the interest rate charged to borrowers has to be high enough to overcome inflation or else the organization cannot sustain itself (Smith, Thurman, 2007). Four key factors determine these rates: *"the cost of funds, the MFI´s operating expenses, loan losses, and profits needed to expand their capital base and fund expected future growth"* (Fernando, 2006:2).

It helps to improve repayment rates when lending to joint-liability groups like Grameen Bank. However microcredits are still high-cost operations: Establishing groups, holding group-meetings and visiting the borrower groups – which are often in remote rural areas – generate further expenses. As a result, interest rates cannot be kept as low as may be desirable when lending to poor people. Typically, MFI´s charge about 25% per annum, which is well above normal rates in the traditional credit sector (Abbink, Irlenbusch, Renner, 2006). An interesting survey made by Hudson (2003) reveals that less than 10% of the respondents that had loans at the time of interview, have changed supplier in the past 2 years based on price. Clients feel that the prices they are paying for loans are high, but are unable or unwilling to search for better deals.

4.3 "The microfinance promise"

Even though MFI's operate in various ways, they still largely try to follow the so-called "microfinance promise": The ability of microfinance to reduce poverty for the poorest of the poor, while at the same time reach financial sustainability and eventually gain independence of subsidies from governments and donors (Morduch, 1999). Sustainability is defined by Conning (1999) as the ability to achieve full cost recovery or profit making and continue operations into the future without continued reliance on government subsidies or donations. According to Addison, Hulme and Kanbur (2009), microfinance demands can be met on a global scale only through the provision of financial services by self-sufficient institutions.

Robinson (2001) states that the 1980´s represented a turning point in the history of microfinance as MFI´s like Grameen Bank began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients. To be truly sustainable over a long period of time, a program must collect enough interest and fees to cover administration costs, bad debts, and inflation (Smith, Thurman, 2007). Data from the MIX indicate that leading MFI´s have succeeded in reaching large numbers of poor clients precisely because they have been allowed to charge interest rates that reflect their true costs, including the costs of growth (Helms, Reille, 2004).

Subsequently, it is clear that microfinance is looking less like a charity case and more like an investment case (Fuchs, 2006). Many microfinance providers insist that training is the most crucial additional service they can provide for their clients and that this reflects the performance of the MFI (Smith, Thurman, 2007). In Africa groups are especially effective for educating and training microfinance participants, enhancing networking and information dissemination (United Nations, 2007).

4.4 Microfinance in Africa

Microfinance is having an impact on millions of poor people, predominantly women, but the boundaries of who microfinance can reach, and in what ways, are still to be explored (Hulme, Arun, 2009). However, microfinance stands at the threshold of a new era. Decades after the first experiment in non-collateralized credit was launched, microfinance has yet to reach those who need it most: millions of the world´s poorest in Africa (Helmore, 2008). Some 80% of the world's 4.5 billion people living in low and lower middle income economies do not have access to formal sector financial services (Hulme, Arun, 2009). There are more than 300 million economically active individuals in Sub-Saharan Africa but only about 20 million of these have access to any kind of formal financial services. That is less than 10 percent (Helmore, 2008).

However, the microfinance sector in Africa is quickly expanding, and institutions have increased their activities. In fact, African MFI´s are among the most productive globally, if measured by the number of borrowers and savers per staff member. MFI´s in Africa also demonstrate higher levels of portfolio quality with an average portfolio at risk over 30 days of only 4 percent. According to a survey made by Mixmarket, MFI´s in East Africa are the most profitable (Lafourcade, Isern, Mwangi, Brown, 2005).

In spite of the quickly expanding development, African MFI´s still face several challenges. Many MFI´s work in rural areas, where low population density and weak infrastructure result in high operating costs. Institutions continue to seek ways to increase efficiency through better communication, improved lending products, new technology, or some combination of these improvements (Lafourcade, Isern, Mwangi, Brown, 2005). Commercial banks are entering the market, and competition is increasing in many countries, especially in Benin, Cameroon, Ghana, Kenya, Madagascar, Mali, Senegal, South Africa, and Uganda. MFI´s will need to innovate and provide high-quality services to retain clients and remain competitive in their local financial services markets. (Lafourcade, Isern, Mwangi, Brown, 2005).

MFIs currently have around 100 million borrowers, while the total potential demand is approximately at one billion people. This ratio shows an unexploited growth potential, thus constituting an emerging investment opportunity (Dieckmann, 2007). Finally, the growing market show signs of additional investment opportunities such as providing supplementary services to the poor apart from lending such as saving services, pensions, insurances and housing credit (Reddy, 2007).

4.5 Microfinance services

There is a general consensus that services such as savings, insurance, training and health care are required in microfinance lending programs. For example, facilitating savings is important because there is a high demand for it among the poorest, and because savings play a role in protection against the seasonality of cash flows. In addition, building up deposits reinforces financial discipline for customers and can eventually yield collateral and serve as a source of funding for MFI´s (Robinson, 2001). The popular conception about the inability of the poor to save up is not true (Hulme, Arun, 2009).

Savings and insurance are among the most common add-ons to lending programs; they decrease the vulnerability of poor families to emergencies, disasters, and unexpected expenses (Smith, Thurman, 2007). Robinson (2001) argues that savings are better able to reach poorer people than credit, and that the extreme poor need subsidized poverty alleviation programs, not financial services. Daley-Harris (2002) argues against this perspective saying that millions of people that live below the poverty line can and do effectively use credit, savings and other financial services.

Promoting savings in Africa is crucial for two reasons. Evidence from South East Asian countries show that sustaining high economic growth is contingent upon significant levels of capital accumulation. Secondly, the promotion of national savings could boost investment and influence the prospects for sustainability of growth (United Nations, 2007). Identifying policies and institutions that promote saving should therefore be crucial in any strategy aimed at easing the transition to less aid dependence of SSA (United Nations, 2007).

Rutherford (2000) outlines how the biggest financial need for poor people is to assemble sums of money that can be used to cope with opportunities or demands. These sums can be acquired either through credit or savings (Daley-Harris, 2002). If savings are used as a financial service by microfinance institutions, poor people can use them when crises and emergencies occur. Unpredictable events such as illness, death, accidents, fire, weather and crime are common for all people and more common for the very poor who are also more vulnerable to their negative impacts (Daley-Harris, 2002). The MFI´s can then use these savings as a form of collateral and it helps the possibility of default on the loan. Recently, many larger MFI´s have turned to savings to reduce their costs of funds (USAID, 2008). Savings and credit services help people start or improve their own small businesses, providing income generation and employment for themselves and their families (United Natins, 2007). Furthermore teaming medical services with microcredit, has proven an efficient, effective way to provide health and disease prevention information that borrowers and their communities can comprehend and use (Smith, Thurman, 2007).

4.6 Lending possibilities

In microfinance there are several ways of lending to the poor. In a typical microfinance scheme, borrowers with individual risky projects form groups that apply for small loans together. The whole group is liable if one or more group members default. By spreading the risks of the individual projects, joint liability provides an insurance against individual project failures. Even if an individual project fails and the borrower is unable to repay, the group as a whole is still able to cover the losses (Abbink, Irlenbusch, Renner, 2006). In this sense, joint liability serves as a substitute for collateral, which the poor normally cannot offer in order to back their loans. A further safeguard against default is the dynamic structure of microcredits: loans are given in small portions, and follow-up loans are given subject to a good repayment history (Abbink, Irlenbusch, Renner, 2006).

According to Hirth (2007) though, group lending has begun losing its attraction during the last years. As the members of Grameen Bank became numerous, more and more group members wish to lend individually to continue a successful business. These individual loans have become popular especially in Latin America leaving the amount of group lending behind. This is because both clients demand individual loans and group lending seems to work less well in tough economic times. Also the misfortune of one borrower and her family can quickly become the misfortune of an entire group (Yunus, 2007). Group membership imposes heavy burdens on members in terms of time, risk and loss of privacy (Dichter, 2007). The fact that group members have to pay can also lead to serious retaliations towards the group member that fails to repay his or her loan (Yunus, 2007). According to Dichter (2007), group based microfinance delivery systems are temporary low-quality expedients, like shared toilets, primary school classes of 60 children, or clinics without doctors. These are the best that can be provided at the present time for some people in some places, but they are recognized as fundamentally unsatisfactory. Microfinance groups are the same. Individual loans are usually preferred because of the risk of members defaulting/being forced to rely on other persons and because clients prefer individual responsibility (Hulme, Arun, 2009). Individual loans are typically associated with longer repayment terms, a feature preferred by 81% of respondents. Clients prefer longer repayment periods (particularly for larger loans) because they result in less pressure on the business, are easier to repay and are more manageable since they provide time to generate profit. All things considered, microcredit methods designed for individuals and those designed for groups have both proven effective (Hulme, Arun, 2009).

Smith and Thurman (2007) believe that the true benefits of microfinance are dignity and self-esteem along with respect for family and community. Microfinance allows people to become givers, not takers. Informal businesses are typically the only viable employment options for the poor; the one positive aspect of this type of business is that all workers can be self-employed if they are smart enough, work hard, have inventory and a market, and keep their prices competitive (Smith, Thurman, 2007). Often the most important effect of microfinance is to help households to diversify their sources of income (Morduch, 2000).
Women are more committed to using their loans and savings for the benefit of their households rather than self-gratifying consumptions which is common for a man (United Nations, 2007). Women are also often at the lowest levels of rural societies which help making them a better credit-risk than men. The status of women, in their homes and in their communities, improves when they are responsible for loans and manage their household’s savings. All in all, credit extended to women has a greater positive impact on household food consumption and on the quality of life for children than similar loans to men (IFAD, 2009). Leading advocates for microfinance have put forward an enticing “win-win” proposition: microfinance institutions that follow the principles of good banking will also be those that alleviate the most poverty (Morduch, 2000).

4.7 Limitations of microfinance

It has been proven that microfinance does help but it is still a new phenomenon and there are many ways to approach the poor. It is very important when discussing microfinance that it is neither a panacea nor a magic bullet, and it cannot be expected to work everywhere or for everyone (Armendariz, Murdoch, 2007). Providing effective microfinance services to poor people is part of a poverty reduction strategy, but only a part. Those who present microfinance as a magic bullet to reduce poverty provide such a simple message for policy formulation that they encourage being simple-minded (Dichter, 2007).

Karnani (2008) claims that microcredit does not significantly alleviate poverty. The best way to eradicate poverty is to help create jobs and increase productivity. The Economist magazine concluded that, while heart-warming case studies proliferate, rigorous empirical analyses are rare (Karnani, 2008). A few studies have even found that microcredit has a negative impact on poverty as poor households simply become poorer through the additional burden of debt (Karnani, 2008).

The reality on microfinance as a poverty reduction tool is less attractive than the promise. The vast majority of microfinance clients are caught in subsistence activities with no prospect of competitive advantage. The self-employed poor usually have no specialized skills and often practice multiple occupations (Karnani, 2008). With low skills, little capital and no scale economies, these businesses operate in arenas with low entry barriers and too much competition; they have low productivity and lead to insufficient earnings that cannot lift owners out of poverty (Karnani, 2008). Most clients of microcredit are not micro-entrepreneurs by choice and would gladly take a factory job at reasonable salaries if possible. Critics argue that the small enterprises supported by microcredit programs have limited growth potential and thus have no sustained impact on the poor (Khandker, 1998). While much has been learned about microfinance, the number of professionally run MFIs with a realistic understanding of the limits of microcredit, is outnumbered by the growing number of new MFI´s, many of whom announce success prematurely, and may cause as much harm as help (Dichter, 2006).

Women, who account for the bulk of the clients of microcredit, have benefited in terms of increased self-esteem and empowerment. But microcredit has not had a significant impact on alleviating poverty. The women run businesses with low skills, little capital and no scale economies, and as a result do not earn enough to rise out of poverty (Hulme, 2006).

Most of these borrowers are not going anywhere with their activity except from one day's subsistence to the next. In the informal sector, such borrowers are reduced to "copycat" behavior, everyone selling the same thing, and more sellers saturating the market as more microcredit is made available. They are limited by low skills and an inability to add value (Dichter, 2006).

Microcredit is hereby destined to fail when borrowers do not use their loans properly. Many microcredit organizations educate borrowers in responsible use of credit, and they follow up with borrowers on a regular basis. Lenders who do not take precautions may be setting a trap for both the borrowers and their microcredit programs (Smith, Thurman, 2007). The SME (meso) is the next step up from microfinance. It offers the advantage of scale and size to create more employment (Tan, 2003).

The chapter points to the following:

- Microfinance has come to stay as a poverty reduction tool.
- Africa is a very promising market.
- A sustainable MFI needs to have its expenses covered.
- That a saving facility can be a replacement for loans.
- That group loans are effective but individual loans are often preferred by customers.
- That microfinance holds a lot of risks for lenders and borrowers.

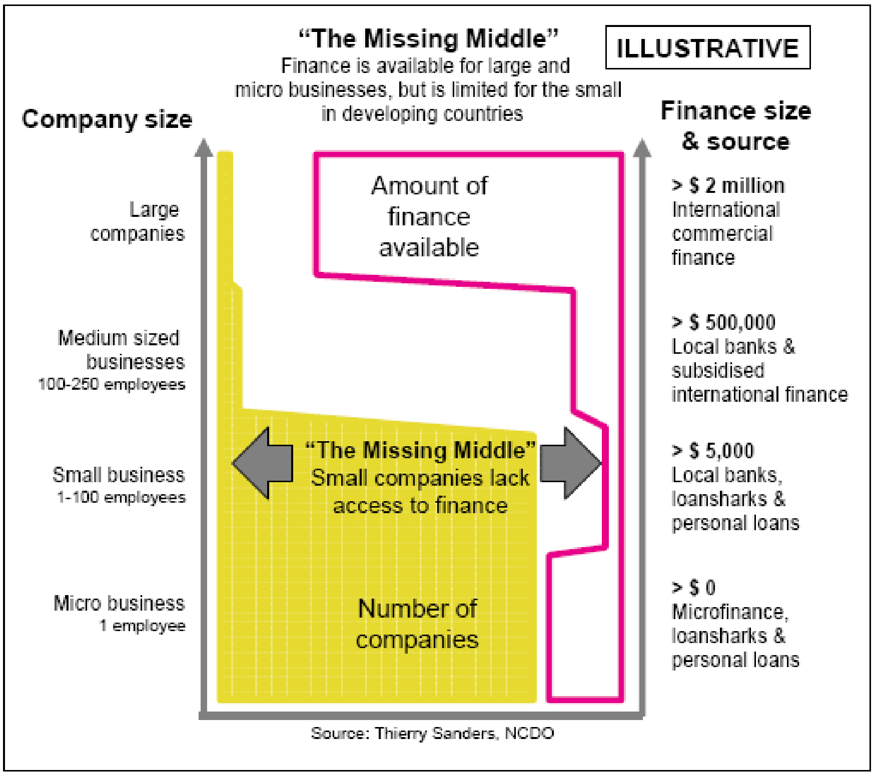
5 Mesofinance – small and medium sized enterprises

MyC4 is aiming at bridging the financial gap to small and medium sized enterprises (meso). This chapter will therefore review the data concerning this industry. A major difficulty in studying this industry is the lack of a reliable data sources (Watson, 2003). According to Helms (2006) the meso level is perhaps the least understood component of the financial system within the microfinance community. The focus here is:

- ‘Meso-Finance’ – an unofficial term for financial needs of small businesses ranging between €5,000 and €500,000. That is roughly the financial needs above the microfinance level and below the commercial and subsidized international finance level;
- The size of the SME businesses are anywhere between 2 to 250 employees. Again this is the segment above microfinance (loans to enterprising individuals, sometimes to ‘businesses’) and below large companies with more than 250 employees (Sanders, Wegener, 2006).

The figure listed by Thierry Sanders below clearly shows the lack of access to finance at small business level. Thus there is a strong need for investment in the small business segment, also referred to as “*the missing middle*”. The private sectors of many emerging economies today are hindered by a “missing middle” (Kaufmann, 2005). SMEs are often seen as being too small to serve as significant drivers of economic growth (therefore unworthy of policy consideration by governments), and yet too large to benefit from non-profit and microfinance institution schemes such as joint-liability programs. While the challenges to the SME sector can be daunting, there have been many promising initiatives to support this crucial sector in emerging economies by business leaders who recognize the clear role of SMEs in sustainable development (Newberry, 2006).

Figure 3: "The missing middle"



According to Helms (2006), the meso level is perhaps the least understood component of the financial system within the microfinance community. Bannock and Doran state that "*Perhaps the most important gap in British Statistics, and indeed in virtually all other countries, is in statistics on new enterprise formation (births) and failures (deaths*)" (Watson, 2003:4). Once a small business has ceased operating, information concerning the business becomes difficult to obtain. Typically most of the information resides with the owner as there is no systematic reporting of information on small businesses in the same way as is provided for larger concerns and particularly for listed companies. According to Dun & Bradstreet statistics, 88.7% of all business failures are due to management mistakes (Holland, 1998). This indicates that people should emphasize the importance of management training.

However, small and medium sized enterprises (SMEs) play a critical role in economic development. SMEs are often a key driver in creating employment, strengthening and expanding the private sector, and increasing per capita GDP (Mancini, Yee, Jain, 2008). The most frequently stated claim is that SMEs create a preponderant share of newly generated jobs and therefore hold the key to employment and poverty reduction. According to Karnani (2008), creating opportunities for steady employment at reasonable wages is the best way to take people out of poverty. Furthermore, the jobs created by SMEs are said to be brought about at relatively lower capital cost than those generated by larger enterprises, and therefore they are more consistent with the relative abundance of labor and shortages of capital characteristic of developing countries (Biggs, 2007).

Luetkenhorst (2004) argues that SMEs are particularly important in supporting economic growth and livelihoods in developing countries, because they:

- Tend to use more labor-intensive production processes than large enterprises, boosting employment and leading to more equitable income distribution
- Provide livelihood opportunities through simple, value-adding processing activities in agriculturally-based economies
- Nurture entrepreneurship
- Support the building up of systemic productive capacities and the creation of resilient economic systems, through linkages between small and large enterprises.

In developing economies, employment and higher income effects translate directly to fulfillment to basic human needs like health, education, better homes, and buffers for risk, etc. (Sanders, Wegener, 2006). Furthermore similar to microfinance, mesofinance holds the opportunity for investment with the promise of social and financial return. In this way the mesofinance market potentially offers a much larger financial market for Social Responsible investors (SRI) (Sanders, Wegener, 2006). Without inclusive financial systems, poor individuals and small enterprises need to rely on their own limited savings and earnings to invest in their education, become entrepreneurs, or take advantage of promising growth opportunities (Hallberg, 2000).

Financial sector policies that encourage competition, provide the right incentives to individuals, and help overcome access barriers are thus central not only to stability but also to growth, poverty reduction, and more equitable distribution of resources and capacities (The World Bank, 2008). If SME promotion increases growth, this by itself is likely to imply reduced poverty. According to Hallberg (2000), the real reason that developing country governments should be interested in SMEs is because they account for a large share of firms and employment.

> *Searching for further justification to promote smallness as an instrument of poverty alleviation is not necessary: it is enough to recognize that SMEs ARE the emerging private sector in poor countries, and thus form the base for private sector-led growth*.
>
> (Hallberg, 2000:10)

Furthermore it gives investors an opportunity to operate in markets with obvious market failures. By correcting important but neglected market failures, supporting SMEs can help a developing private sector economy to function more efficiently and thereby promote growth which tends to help the poor (Dollar, Kraay, 2002). However most financial firms see lending to SMEs as a high risk and administratively costly, which means that SMEs have less access to credit and the interest rates that they pay are higher than what larger corporations are offered (Opijnen, 2008). According to Kaufmann (2005), African SMEs main sources of capital are their retained earnings and informal savings and loan associations, which are unpredictable, not very secure and have little scope for risk sharing because of their regional or sectorial focus. Access to formal finance is poor because of the high risk of default among SMEs and due to inadequate financial services.

5.1 Mesofinance obstacles

If microfinance institutions plan to upgrade to the meso level there are different challenges. First of all, the business model is different, which is seen as there is a limit to the maximum size of loans. They lack equity financing expertise, due diligence and monitoring methods. Also meso financing requires higher transaction costs per client compared to fast and standardized operations for microfinance (Sanders, Wegener, 2006). Mesofinance will drift apart from the social strength of microfinance. It is said that the high repayment rate is the result of the social structure of microfinance. Although microfinance is also moving away from this social structure it will be much stronger in mesofinance, due to the variety of organizations, the loan size, and emphasis on other factors e.g. (Management capacity, sector analysis, market analysis) than with microfinance (Opijnen, 2008). He argues further that the larger a company grows, the more entrepreneurship is needed to make it a success.

In some African countries it takes at least 100 days to start a business. These starting entrepreneurs are often poorly equipped or trained to start their business. They lack the legal papers to prove their collateral to back their requests for credit (Sanders, Wegener, 2006).

Besides finance, growing SMEs also require more advanced banking services, like savings accounts, smooth transaction systems, longer term loans, insurances etc. At the same time the banking sector needs to develop approaches, procedures and strategies to play into this changing demand of SME´s. Financing SME requires more knowledge on industrial development, market, management and financial analysis (Opijnen, 2008).

Most financial firms see lending to SME´s as a high risk and administratively costly, which means that SMEs have less access to credit and the interest rates that they pay are higher than what larger corporations are offered. Yet, SMEs are often the most dynamic and innovative segment of many countries and provide the bulk of employment. This problem is sometimes recognized at the national and international levels but it has not been successfully resolved (Opijnen, 2008). In this sense private capital has to play a pivotal role. Some argue that the only successful way to engage sufficient private capital is through private funds that are purely commercial and credibly rated (Matthäus-Maier, von Pischke, 2006).

Governments in developing countries provide a wide variety of programs to assist small and medium scale enterprises. Despite the success of SME strategies in a few countries, the majority of developing countries have found that the impact of their SME development programs on enterprise´s performance has been less than satisfactory due to high failure rates (Hallberg, 2000). Abdelsamad and Kindling state that *"Although failures cannot be completely avoided in a free enterprise system, the failure rate could be reduced if some of its causes are recognized and preventive action is taken*" (Watson, 2003:1). Furthermore because there are no formal reporting requirements for the majority of SMEs, it is difficult, if not impossible, to obtain sufficient reliable information to measure their performance in an economic sense (Watson, 2003). Watson explored in his study how small enterprises reacted if they took advices and his study provided support for the belief that failure rates are likely to be significantly lower for businesses that access advice.

5.2 Mesofinance opportunities

The analysis of Sanders & Wegener (2006) identifies the following key issues for the development of a mesofinance market.

- Small firms are disproportionately vulnerable to the business environment
- High cost of capital for SMEs & exuberant collateral requirements
- Lack of knowledge, education and appropriate market information
- Underdeveloped financial institution structure
- Distorted lending infrastructure
- Lack of market information

Generic issues include:

- High transaction costs (relative to investment size)
- Political and currency risks
- High due diligence risks (relative to investment size)
- Need for business support services
- Identification of quality SME investment opportunities (information problem)

Sanders & Wegener (2006) argues further that money alone is not the answer. SMEs need support from various angles. Better government policies, regulatory environment, business climate, legal framework, business support services, market information plus finances are all ingredients needed to make mesofinance market grow. SEAF (2005) states that not only capital is needed. The management of small enterprises requires adequate training and assistance as much as it needs capital.

An alternative to raising professionally invested funds would be for MFI´s to tap into the vast amount of personal savings in the developed world as a source of funds. This is exactly where the new business model of online social lending can play an important role (Cagna, Santos, 2009).

This chapter states that:

- The meso level holds a lot of possibilities but
- The meso level requires much higher demands with respects to loan size, survival and management than the micro level. The meso level is therefore regarded more risky.

6 Online lending platforms

Online platforms are changing the way we engage with the world. Facebook links, eBay auctions etc. These platforms shape who we connect with as well as how we connect. This concept extends to philanthropy: *"Online philanthropy is changing the nature of how and where people give. An outgrowth of online philanthropy is online social investing. (…) The number of online lending and investment platforms focusing on microfinance is growing"* (Burand, 2009:1-2).

Peer-to-peer lending (P2P) is a means by which borrowers and lenders may transact business without traditional intermediaries, such as banks. The process may include other intermediaries who package and resell the loans but the loans are ultimately sold to individuals or pools of individuals. An enabling technology for P2P lending has been the Internet, which connects borrowers with lenders, for example through an auction-like process in which the lender willing to provide the lowest interest rate "wins" the loan to the borrower (Hulme, 2006). However in developing countries there are several constraints to using a P2P model to connect borrowers and lenders. Constraints are a lack of internet access and financial and computer literacy. To address these constraints, intermediary P2P models such as Kiva and MyC4 were established to facilitate lending to developing countries (USAID, 2008).

The P2P lending space has shown signs of quickly adapting to market changes and to broadening access to financial intermediation. However, for both borrowers and lenders, it is still a nascent industry and has yet to demonstrate its potential for scalability (USAID, 2008). The amount of online financing available to the microfinance sector as a whole is growing fast, with organizations like Kiva raising as much as $1 million every 10–12 days which then is relent to micro entrepreneurs (Burand, 2009).

Partner institutions play an important role in the intermediary P2P model in the selection and credit assessment of borrowers because of the platforms targeting developing countries are located in developed countries (USAID, 2008). This distance, combined with the absence of credit bureaus, makes it difficult to otherwise identify strong borrowers and confirm the information provided by potential borrowers to maintain the integrity of the platform (USAID, 2009). The type of partner varies by platform. Kiva[2] works exclusively with MFIs who already have an existing loan portfolio, while MyC4 works with organizations that source borrowers specifically for the site including MFI´s local NGOs, business development providers and even a large exporter that facilitates loans for its suppliers (USAID, 2008).

The model´s main strength to date has been on the lender side, because of the fact that it has opened the door for retail investors to invest in micro, small and medium enterprises in developing countries, thereby reducing barriers to entry and spreading information about the sector (USAID, 2008). The main benefit that online P2P lending platforms offer individual investors is that they have very low minimum investment requirements, providing broad access to investments in micro, small and medium sized businesses. Obtaining a social return is often a stronger motivation for lenders to lend than the financial return (USAID, 2008).

Among the other benefits are that intermediary online platforms increase their partner's ´ability to serve their local communities. Increasing access to finance is one of the main goals of P2P in developing countries (USAID, 2008). For Micro & SME lenders, and particularly for microfinance institutions, the growing success of the P2P marketplace offers an opportunity to increase access to capital and diversify funding sources by attracting a new investor class of small, socially motivated investors (USAID, 2008).

For-profit P2P´s the constraints are finding the right message and breadth of product offering for investors, creating the necessary partnerships, dealing with complex regulatory environments, and overcoming the challenge of balancing transparency with borrowers´ privacy (USAID, 2008). Anytime a photo and story of a micro entrepreneur is posted on the Internet, be it to capture donations or to capture financings, customer privacy and consumer protection issues should be of

[2] Kiva is an American online lending platform.

concern to the MFI that serves that customer. This concern can become particularly acute when an online lending platform shares data with the public about a particular micro entrepreneur's credit and repayment history (Burand, 2009).

In addition, platforms which cross international borders face many of the same constraints as microfinance investment vehicles, such as political risk and currency risk and determining who is best equipped to manage this risk (USAID, 2008). In terms of the interest rate paid by borrowers, working through an intermediary does increase the margin between the interest a lender receives and what a borrower pays. The intermediary P2P platforms do not seek to limit this margin, which can result in very high final interest rates to the borrowers (USAID, 2008). Social networking has helped integrating online lenders and investors to today's online lending and investment platforms. Importantly, online lending platforms can contribute to paving the way for the next generation of socially responsible investors by showing the small investor/lender how his and her money can be used to do good in the world while returning the principal amount of that financing to the lender and perhaps even generating a financial return on this principal (Burand, 2009). However it is important as also pointed out by the Principal-Agent Theory that the different parties communicate so no misunderstandings are created. It is critical that the platforms take appropriate care that this same social networking phenomenon does not one day trigger a rush for the exit, too (Burand, 2009).

6.1 Kiva

The first online intermediary P2P lending platform geared towards microfinance was Kiva, which launched in November 2005 (USAID, 2008). The Direct P2P model connects borrowers and lenders but due to the lack of internet access or financial computer literacy Kiva establishes contact with a partner in a developing country who is responsible for disbursing the loan to the borrower why their model is called intermediary P2P (USAID, 2008).

Kiva is a non-profit organization that connects online lenders with microenterprises through MFI partners, currently 88 MFIs in 42 countries (Microfinance Gateway, 2008). According to Burand (2009), Kiva gains a level of trust as a non- profit that would be harder to gain as a for-profit.

As of April 2008, Kiva´s 270,000 lenders have loaned a total of almost $ 27 million. The average loan term is 10.2 months (Microfinance Gateway, 2008). Kiva is raising as much as $ 1 million every 10-12 days to be lent out to micro entrepreneurs. Kiva lenders who are fully repaid are relending approximately 60-65% of their loan reflows (Burand, 2009).

Kiva financing is offered to MFI´s at 0% interest and lenders do not receive any interest on the loans they fund through Kiva, only repayment of the principal (Microfinance Gateway, 2008). The way Kiva can pay for its administrative costs are through the donations people give them (Kiva, 2010). In terms of default the MFI´s will take on the loan repayments themselves as they want to protect their own reputation (Ashta, Assadi, 2009).

As with many online businesses, there is a strong first-mover´s advantage as these platforms compete for funds and market share. Among online lending and investment platforms focusing on microfinance, Kiva has enjoyed such an advantage (Burand, 2009).

6.2 MyC4

As with Kiva, MyC4 is part of a growing market for online investments in the field of microfinance. The number of online lending and investment platforms focusing on microfinance is growing (Burand, 2009). Among the constraints facing MyC4 as a profit platforms are as mentioned before finding the right product offering partners and investors and thereby creating the necessary partnerships which is in alignment with the interests of MyC4.

MyC4 is a hybrid between the Grameen Bank, eBay and the Kiva model since MyC4 offers investors an opportunity to invest money in Africa. MyC4 can attract profit by seeking investors and social driven investors (Christoffersen, Plenborg, 2008). MYC4´s model is as with Kiva an intermediary P2P model (USAID, 2008).

MyC4 works with organizations that source borrowers specifically for the site including MFI´s, local NGOs, business development providers and even a large exporter that facilitates loans for its suppliers (USAID, 2008). MyC4 has chosen to work exclusively with Africa in order to help end extreme poverty and achieve the MDGs by 2015. By focusing on larger microenterprises and

SMEs, MyC4 seeks to put capital into the hands of businesses that can have a significant and sustainable impact on job creation and economic growth (USAID, 2008).

A major issue which threatens the growth of the P2P lending industry is the issue of transparency and specifically finding a balance between protecting the privacy of borrowers and the interest of lenders (USAID, 2008). Focusing on Sub-Saharan Africa, MyC4 allows African entrepreneurs of small and medium size businesses to obtain loans through a network of local providers. All applicants must undergo a screening process before they are accepted into the MyC4 network (Ashta, Assadi, 2009).

MyC4 allows investors to see all potential borrowers, a description of the business, the amount of loan needed, and the maximum interest rate that can be afforded. Then a Dutch auction model takes place among lenders who would like to provide the loan. This process ensures that the African entrepreneur is supposed to receive the best deal possible (Ashta, Assadi, 2009).

This chapter states:

- That online lending is a very flexible way of connecting lenders in the developed world with borrowers in the developing world.
- That online lending has given access to a new area of investing and opened the door to a new market. But also that online lending involves a number of constraints such as a requirement for internet available to the borrowers and strict procedures for assessment of the projects.
- That Kiva as a non-profit organization has an advantage with respect to the interest level as a competitive factor.
- That MyC4´s focus on addressing poverty requires a shift towards the meso market.

7 MyC4 – case presentation

The case of MyC4 will be presented in this chapter. Since the dissertation is exploring the concept of online lending services to Africa and the difficulties MyC4 has had in Africa the main focus will be on MyC4´s business model and what challenges MyC4 has had in Africa.

7.1 MyC4

> *Our vision is to end poverty through business by ensuring that everyone has the same access to capital and knowledge. Our mission is to create prosperity for all. Therefore, MYC4 bridges the gap between people with needs and people with means using the internet as infrastructure.*

(MyC4.Com, 2010:*MyC4's vision and mission*)

MyC4´s mission is to create prosperity for all. Therefore, MyC4 aims at bridging the gap between people with needs and people with means using the internet as infrastructure (MyC4.Com, 2010). The way eBay has built a business around revolutionizing the flea market, by connecting buyers and sellers across the world in a transparent way, has served as great inspiration in building MyC4. MyC4 wish to "replicate" their digital infrastructure and connect investors and African businesses in order to create free flow of capital and knowledge to build growing sustainable businesses in the developing world. The goal of MyC4 is to become the first company in the world to be owned by the world. In essence this would mean 6.6 billion shareholders. Ultimately, MyC4 is striving to become a universal platform that unites capital, people and knowledge in a common pursuit of promoting sustainable businesses in Africa.

In December 2006, MyC4 received a grant of DKK 5 million (EUR 670.000) from DANIDA to support the development of the MyC4 platform. Furthermore IFU and CSR Capital have invested EUR 2.2 million in Africa through MyC4 (Wiseclerk, 2010).

The goal is to create sustainable prosperity in Africa by connecting investors in the developed world with poor entrepreneurs in the developing world. One of the goals of MyC4 is to contribute to the achievement of the UN 2015 development goals. However at the midway point between their adoption in 2000 and the 2015 target date, the UN predicts that Sub-Saharan Africa will not achieve these goals. 800 million people live in Sub-Saharan Africa and poverty is more severe here than in any other region of the world. This is why MyC4 is focused on Sub-Saharan Africa. MyC4 is determined to end poverty in Africa focusing on growth amongst SMEs also referred to in the literature review as "the missing middle". Whereas Africa is the primary focus of MYC4 at the outset, ultimately the model can potentially be applied to any other part of the world with poverty and lack of access to capital and knowledge, but activities outside of Africa are not within the time span of the business plan.

Transparency is the core value of MyC4. Transparency is the only explicit value of MyC4, since transparency covers and permeates everything they do. In Africa, the business environment is characterized by non-transparency, barriers and unreasonable terms. That is why MyC4 aims to build a sustainable marketplace by encouraging transparency at all levels.

7.2 MyC4 Business model

MyC4 is operating at the top of the microfinance market (loans > EUR100) and at the bottom of the meso-segment, medium sized and small businesses (loans < EUR 100,000). Below a simple figure of the MyC4 model is illustrated.

Figure 4: MyC4 business model

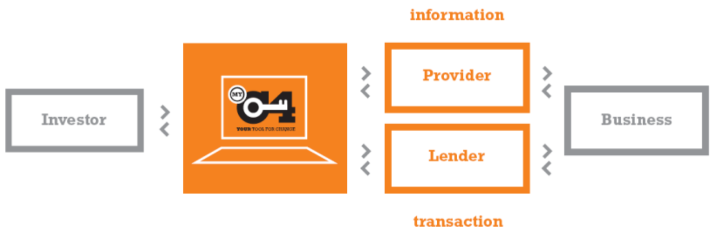


Figure explanation: The first box (investors) illustrates all the people who want to invest in businesses (borrower) in Africa. Investors find an entrepreneur at the platform (MyC4) who they want to lend money to. These entrepreneurs are at the platform because they lack capital to grow or sustain their business. Investors find the entrepreneur they find most attractive according to the investors preferences. The figure below shows how it takes form on the MyC4 platform. As MyC4 has an ambition to be 100% transparent they post the pictures of the different entrepreneurs on the platform and their names. Furthermore you can view what kind of business they are doing and which provider MyC4 is working with.

Picture 2: Entrepreneurs at MyC4 platform who needs funding

When the loan amount has been reached MyC4 transfers the money to their provider in the selected country. The MyC4 marketplace is built around a network of local providers who handles the business (entrepreneur) regarding loan disbursement and collecting the monthly repayments. So in the end the providers are in charge of the monthly payments and make sure everything is as it should be.

The business model is based on transaction fees alone. Investing via the platform is free of charge, and it is free of charge for the African Business to try to obtain a loan as the model works on a "no cure-no pay" principle (meaning that if the loan is not funded or the wanted interest rate not reached, there are no costs for the business). MyC4´s African partners charge a fee for their services. These fees vary from each partner, but they are stated on each Business on the MyC4 platform in order to create transparency in regards to the cost structure of the loans. Part of the partner fees is fully dependent on the Business being able to pay back the loan successfully. It is also possible to see the APR (annual percentage rate) and the total cost for the Business in EUR. With the MyC4 business model, investors earn income from the interest; the African partners grow their business; and MyC4 gets 3% from the borrower over time.

MyC4 uses a Dutch auction principle, inspired by eBay, to connect investors and borrowers. The Dutch auction principle determines the final interest rate the entrepreneur will pay on her/his loan. This principle only applies to decide the investor interest rate. To this interest commissions by MyC4, Partners will be added. Bids made by investors can range from 0% to 25% and they will be filled from the lowest interest rate until the total amount of the loan is funded. When a bid ends, the investor will lend to the borrower the amount she/he asked for. In fact 50 different investors funding one specific loan may each earn different, self-set interest rates. While MyC4 sets a maximum for the weighted average interest rate for each loan, it is still possible for an individual lender to bid higher and earn more after funding.

The loans are supposed to be repaid monthly with an incentive for the African business to repay as early as possible. Early or on-time repayment also gives African businesses a good track record with MyC4, allowing them to apply for a bigger loan next time, potentially at a lower interest rate. All investments are potentially at risk, and there are no guarantees that investors will receive a return on their investment or even get back their principals. "*The average successful bid rate has been **13.2%** whereas the net interest earnings have been -9.54% per annum encompassing defaults, currency losses and gain, late repayments and idle times for transactions"* (MyC4.Com, May 2010:*Frontpage*). Thus, as it is right now investors have a negative return on their investment.

Lending via MyC4 happens in local currency to protect the African businesses from a potential currency risk, which is hard to understand and manage. Currency risk could have a severe negative impact on a business's possibility to grow and create a sustainable business. Currency risk relates to the country of resident for the African business; some countries are pegged to EUR while others fluctuate. Consequently, currency risk in the MyC4 model is placed entirely on the investors. The investor decides the interest level based on assessment of the credit risk and currency risk. This may vary considerably from currency to currency, for example the CFA (Central African francs), used in most of West Africa, has not experienced any fluctuation to EUR since 1994, whereas the Kenyan and Ugandan Schilling, in the period November 2008 to January 2009, depreciated by +20% (IMF, 2009). Consequently it makes sense for investors to spread their investment over several currencies and providers.

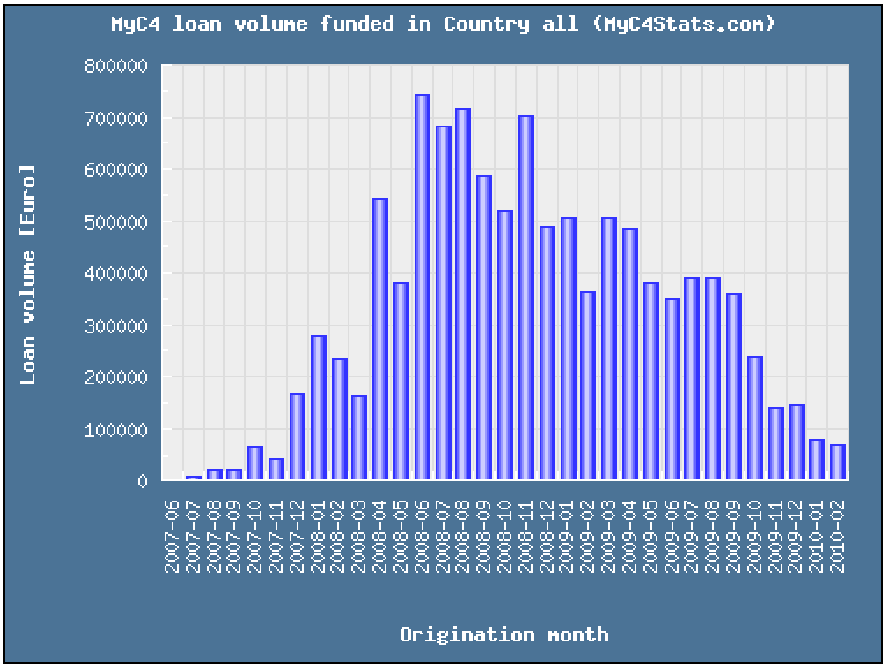
Every bid is binding and cannot be withdrawn unless other investors will exclude them from the auction due to their too high interest rate. In this case investors will receive their money back on their accounts within few minutes and are allowed to bid again offering a lower interest rate. When the deadline is reached, the bid finishes. The size of the loan varies of course dependent on each provider. Some of their partners operate close to the SME segment and other partners operate at microfinance level. As it is right now, the smallest loan is at Euro 246 and the biggest loan is at Euro 13,706 (MyC4.Com, 2010). Bigger loans take much longer until they are 100% funded.

The MyC4 Business model has been developed to tackle the problem that finance is not available for many small and medium sized businesses (SMEs). So far 17,187 investors from 100 countries have invested €11,166,400 in 5,595 businesses in 7 African countries (MyC4.Com, 2010). The seven countries are: Cote D'Ivoire, Ghana, Kenya, Rwanda, Senegal, Tanzania, and Uganda.
The quickest auction financing came in under an hour while the longest, for a loan of EUR 20,000, took a month. The closing time for auctions depends on the amount required. The more investors on the platform willing to lend, the shorter is the closing time on the loans. On average, an auction lasts 14 days. However at the moment several loans have problems being funded. The reasons for this will be touched upon later.

7.3 MyC4´s financial situation

MyC4 is run for-profit which means that many investors invest in MyC4 with the expectation of getting a profit of the invested money. MyC4 management is responsible for the preparation and fair presentation of an annual report in accordance with the Danish Financial Statements Act (MyC4 Annual Report, 2010).
MyC4´s financial situation is dependent on a large loan portfolio because they make profit when loans are being repaid. MyC4 aims at becoming financial sustainable and to reach this goal investors have to invest EUR 100 million or more each year (MyC4.Com, 2010). According to MyC4's annual report from 2009, they are self-sustainable when they reach break-even which is estimated to be in 2012 (MyC4 Annual Report, 2010). MyC4´s loan volume is listed below. The data is until February this year.

Table 2: Loans funded through MyC4 platform



As shown in the figure above it is evident to conclude that 2008 was the best year for MyC4. However they did not reach DKR 100 million which was the goal of 2008. At the end of 2009 and beginning of 2010 MyC4 is struggling to reach the EUR 100 million needed funded through the platform. As it is right now the loan volume will be at the same level or below last year, around EUR 6 million. For MyC4, 2009 was an extremely difficult year as default rates of the loans of nearly all local providers peaked. The volume of new loans slowed to about a quarter of the high reached in mid-2008 as several providers paused to evaluate the situation.

The owners expect the business to be sustainable in 2011 and therefore MyC4 needs new capital and shareholders. According to the financial statement they need four investors who should invest DKR 10 million. To reach the goal MyC4 created three rounds where “musketeers” are invited to join. The musketeers are a key part of MyC4´s strategy to become the preferred infrastructure to connect African people and countries with each other and with the world. Only the D.O.B Foundation, a Dutch company investing in companies and projects with a social outcome, has joined MyC4 at round two and has invested new capital in the platform. MyC4 expects a deficit of DKR 25 million this year. MyC4´s main shareholder The Way Forward ApS, owned by MyC4 co-founder and manager Mads Kjær, has assisted with EUR 1.1 necessary capital to keep the business running.

7.4 Providers

This section will briefly describe the drawbacks when working with the wrong partners. As a start-up company, MyC4´s only option was to build the African supply chain in greenfield collaboration with African partners. Since MyC4 started it wanted to scale its loan volume as fast as possible and because of this MyC4 had to have as many providers as possible who could find clients and place their details on the platform so investors could lend them money through MyC4. Clearly the result of this has been lack of quality with the partners they have worked with. Partners in Africa are essential for MyC4 to work why this part will mention various MyC4 partners in Africa.

Below some different unfortunate cases will be described. When looking at the different numbers posted it is relevant to look at the default rate and portfolio at risk which shows how the repayment rate has been and how much of the money is still at risk. When the default rate exceeds 10 % it is critical (MyC4.Com, 2010).

Ebony, Kenya: is without a doubt the worst case for MyC4 so far. They are currently in court with Ebony in Kenya trying to get back the lost money. All businesses with Ebony are currently suspended.

MyC4 partner since 16.04.2008.

Businesses Funded: €2,430,698.00

Repayments Received: €649,066.79

Default risk: 135.23%[3]

Defaults to Date: 37.31% with €906,904.37 in 380 loans

Total Portfolio at Risk**:** 100.00%[4]

FED/CMC, Uganda: is temporarily suspended from uploading new loans to the MYC4 marketplace, since CMC/FED's PAR (portfolio at risk) has grown to be too high. CMC is currently focusing all

---

[3] Default at risk – Not considered as default yet due to the repayment schedule.

[4] Portfolio at risk - total outstanding amount of loans which are late in their repayments at any point in time

efforts on collecting outstanding funds. MyC4 reports that collections nearly stopped due to a lack of staff and working capital.

MyC4 partner since 31.05.2007

Businesses Funded**:** €2,808,533.00

Repayments Received: €1,683,067.36

Default risk**:** 105.40%

Defaults to Date**:** 30.70%

Total Portforlio at Risk**:** 94.00%

Ivorie Credit, Cote D'ivoire. The responsibility for Ivoire Credit's portfolio has been handed over to TRIUM, a specialized local company, who is currently handling all collections on defaulted loans.

MYC4 Partner Since: 18.10.2007

Businesses Funded**:** €398,589.00

Repayments Received: €180,699.53

Default risk: 54.66%

Defaults to Date: 54.66%

Furthermore there are other providers who experience serious problems with their repayment status. Birima (MFI from Senegal) has almost 82% portfolio at risk due to technical problems and a bad economic situation in Senegal. Furthermore MyC4 has canceled all loans to borrowers in Ivory Coast which has decreased their country portfolio to six countries. The reason for the unfortunate situation was weak partners who could not handle the growth within a short period and a bad economic environment in Ivory Coast. This is very unfortunate since MyC4´s model is dependent on having high numbers of loans disbursed.

MyC4´s goal was to operate in 20 countries but due to these problems in the different countries the focus is now on the current countries.

Generally, we have been too optimistic, both with growth and with how many countries we would diffuse in. We have underestimated the complexity of rolling out in Africa, so it is right now to consolidate and get the ongoing projects to perform ideally, before we give our energies to new markets. (…) We have had to acknowledge that it is more complex than that to build a strong and sustainable structure in Africa.

(Mads Kjær, 2010c:*MyC4 Newsletter*)

The chapter has illustrated the importance of working with reliable providers. These providers manage all transactions with the clients. The providers are supposed to act as MyC4´s eyes on the ground in Africa.

8 Findings

This chapter will help answering the research question as listed below:

Why has MyC4 experienced difficulties creating a financial sustainable business model in Kenya, and what can be learned from these difficulties that could help MyC4 succeed in Kenya?

This chapter will analyze how MyC4 is operating in Kenya and briefly describe the economic profile of Kenya. The field work collected in Kenya will be the main contribution to the information provided about the industry in Kenya and MyC4´s operations.

Before analyzing the part regarding MyC4 and the operations in Kenya I will briefly describe the Kenyan market since MyC4 has chosen to operate in Kenya. Thus I Have chosen to include one of the most successful MFI´s in Africa to enhance the understanding of how the microfinance industry works in Kenya.

8.1 Kenya

Picture 3: Map of Kenya and its location

Kenya is located in the heart of East Africa by the Indian Ocean. Of a population of over 38 million, nearly 17 million people live below the national poverty line which are people living below a dollar a day.

Kenya is the strongest economy in East Africa and generally seen as a good example in terms of its development path. From 2003 to 2007 strong economic growth of 5-7% per year showed encouraging signs of development. In comparison Denmark´s growth was 1.7% in this period (CIA, 2010). Kenya is a member of the East African Community (EAC) which is an intergovernmental organization comprising five east African countries; Burundi, Kenya, Rwanda, Tanzania, and Uganda. The plans are among others to introduce a monetary union with a common currency, the East African shilling, between 2011 and 2015. There are also plans for a common market and a political union, the East Africa Federation, with a common President and a common parliament by 2010 (EAC, 2010). However, several factors can postpone the ambitious goals set by EAC. Political unrest has been a common threat in several countries in Africa.

Kenya experienced widespread violence and ethnic division in early 2008 after a disputed presidential election. Although peace has returned to the country, the post-election violence, combined with the global economic downturn and a sustained drought, has had a significant impact on the economy and thereby also the microfinance industry. Growth declined to 1.7% in 2008 with rising inflation and unemployment (DFID, 2008).

Even though improvements have been made it is still difficult to have a business in Kenya. Political bureaucracy, terrible infrastructure, and security problems are some of the worst challenges.

According to Doing Business (2010), it takes 34 days to start up a business. The reason it takes longer to start a business in Kenyan localities is the many steps required as there are 12 different procedures. However, in some African countries it takes at least 100 days to start a business. These starting entrepreneurs are often poorly equipped or trained to start their business. They lack the legal papers to prove their collateral to back their requests for credit (Sanders, Wegener, 2006).

In terms of the internet, Africa is still far behind the rest of the world. Africa has 4% of global internet users (Internet World Stats, 2009). However, Kenya is one of the best internet countries in Sub Saharan Africa only behind Nigeria, South Africa and Sudan. Furthermore the internet growth from 2000-2009 was 1,809% compared to the rest of the world which had a growth rate at 381% (Internet World Stats, 2009). It is encouraging to experience this internet growth in Africa since the internet has importance to the economy and connection with the rest of the world.

8.2 The microfinance industry in Kenya

As an industry, microfinance is a relatively new phenomenon in Kenya, with a few agencies starting about 20 years ago but the sector have gained the status of an industry only in the last 10 years. With only 19 percent of the population of Kenya served by the formal financial sector, microfinance institutions play an important role in the economy. This is also highlighted by the President of Kenya. In his first address to Parliament, President Mwai Kibaki said:

> *Microenterprises are expected to play a crucial role in the creation of jobs in Kenya. However, we recognize that the sector's growth potential is inhibited by several constraints. These include: poor access to markets, lack of credit and a poor policy environment. My government will soon be presenting to the House, a paper on the development of micro and small enterprises for poverty reduction and employment creation.*

(UNCDF, 2005:30)

In 2006 the first microfinance paper was made by the Kenyan government. The principal object of the Microfinance Act is to regulate the establishment, business and operations of microfinance institutions in Kenya through licensing and supervision. The Act enables Deposit Taking Microfinance Institutions licensed by the Central Bank of Kenya to mobilize savings from the general public, thus promoting competition, efficiency and access.

Kenya has more than 250 organizations that practice some form of microfinance business, only 20-practice pure microfinance, of which 4 are deposit-taking, K.W.F.T, Faulu, Equity Bank, and Jamii Bora, and 17 are credit only. Being deposit taking means that the MFI´s have capacity to offer savings and credit products.

In March 1999 The Association of Microfinance Institutions (AMFI) was created to promote the growth of a vibrant microfinance sector that meets the financial needs of needy Kenyans. AMFI aims at improving the microfinance sector by promoting sustainable, efficient and effective delivery of microfinance services. Because the industry is relatively young they support the MFI´s in order to build their capacity when operating with “poor” Kenyans. Currently, AMFI has 43 members comprising of the major MFIs in Kenya (AMFI, 2010). Two of these, Fusion Capital and Micro Africa, are MyC4 partners. The biggest MFI in Kenya is Equity Bank, a commercial bank with more than 500,000 borrowers. In 2008 and 2009 Equity Bank has been named the microfinance Bank of the year in Africa (Equity Bank, 2010). Equity Bank is a great example of the possibilities existing in the Kenyan microfinance market. According to Coppoolse (2007), Equity Bank is among the leaders of MFI´s in the world. In his article for Micro Capital, Equity Bank is ranked third among MFI leaders. CEO of Equity Bank Dr. Mwangi claimed the success of Equity Bank was underpinned by its focus on the low income earners, historically excluded from the financial system.

Furthermore they focus on women and youth, who make up more than 70% of Kenya´s population and thus have a huge growth potential. To cater for the women entrepreneurs, the bank leverages on “social capital” which has been perfected by various groups that have evolved over time to savings vehicles (Njeri, 2010). Thereby Equity Bank´s strategy is in alignment with the main features of social capital theory where group meetings in low-income countries builds trust and network and these social contacts can affect the productivity of individuals and groups.

The Financial Times praised Equity Bank for transforming the lives of many people in Kenya including house helps and low income earners who have been able to borrow as little as $ 6 from the bank (Equity Bank, 2010). What is also truly remarkable is that even though the microfinance industry is young compared to the other regions Equity Bank is ranked at the top nine of leading MFI´s. Equity Bank has proved that doing microfinance profitably in Africa is possible. Below is shown a figure of the nine leaders from 2005.

Table 3 – The nine leading MFI´s globally

2005	Country	Capital/ assets (%)	Average loan (USD)	Financial revenue (%)
Compartamos	Mexico	37.7	399	74.7
ASA	Bangladesh	53.6	61	23.9
MiBanco	Peru	17.2	1342	30.7
Al Amana	Morocco	28.8	331	24.6
Equity Bank	Kenya	13.9	738	21.1
XacBank	Mongolia	16.1	599	23.4
ACLEDA	Cambodia	25.8	709	24.2
BancoSol	Bolivia	11.4	1531	18.4
SHARE	India	7.5	101	27.9
Average		*23.6*	*645.7*	*29.9*

What is eye-catching about these numbers is the financial revenue of Mexican Compartamos. They are by far the bank who makes the biggest profit from lending to the poor. Furthermore they have started a debate on whether this kind of microfinance is ethical. Even though Equity Bank also has proven that working with microfinance can be very profitable they are no way near the financial revenue of Compartamos. A common element for each of the nine MFIs and a reason why they are able to lend to the poor and be profitable is that they are all located in the operating country. Furthermore they do not use intermediaries which mean they are able to lend money to the poor directly and it is easier to build a relationship between the two parties and less likely to create misunderstandings. Thereby they prove that when they operate in the same country as the borrower they decrease the principal-agent problem as mentioned in the theory.

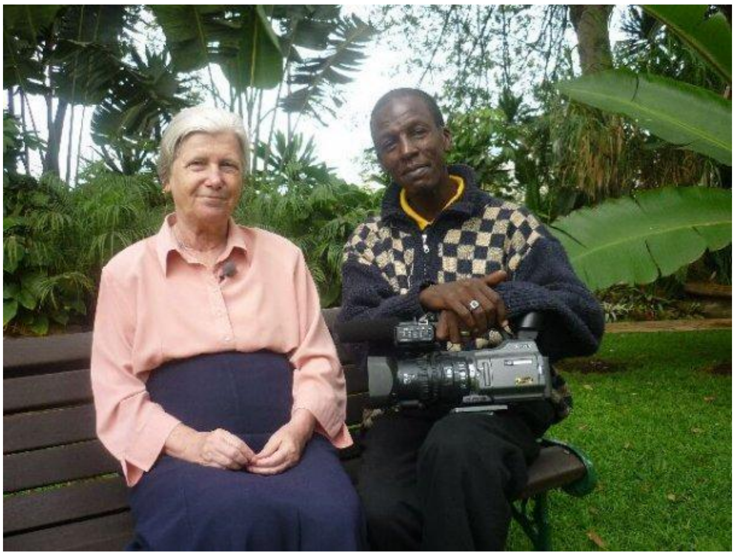
Today, commercialization is considered a potential key to MFI growth, and donors are recognizing the benefits of weaning MFIs off donor funding. Others argue that this trend toward commercialization has led critics to ask whether MFIs will continue to serve the world’s poorest people and thereby not really having an impact on poverty. They point out that many profit-minded MFI´s have either raised their interest rates or failed to lower them when reductions in costs allowed them to do so (Counts, 2008). Onyando also stresses concerns about microfinance and the contribution to poverty reduction "*Microfinance in my opinion keeps people in a vicious circle as the interest rates are too high and often people just got from extreme poverty but never really move to a position of independence through microfinance"* (Onyando, 2010:*appendix 7*). She argues further that

> *If it was slightly more effective and not so expensive to give, considering that we have had microfinance for over 20 years and most people have joined microfinance when starting business, we would be having less unemployment as the businesses would grow enough to employ more than 10 people. The reality is that microfinance does not enable small businesses to really grow.*
>
> (Onyando, 2010:*appendix7*)

My interview with Faulu Kenya also illustrated that most of the MFI´s view other aspects than poverty reduction as more important. According to Faulu (2010), their aim is transformation; to change people´s lives, give their clients confidence and let them know they have potential. Faulu also works with group formations and thereby illustrates how social capital builds confidence within their members. Furthermore by having this close relationship to their clients they also reduce the principal-agent problem. One MFI in Kenya continues to serve the poorest people and the MFI has been called "the shining star" of African MFIs.

The MFI is called Jamii Bora and I was very fortunate to meet the organization while I was doing my research in Nairobi. Jamii Bora has been remarkable at offering loans to people who would never have obtained a loan elsewhere. I met with Jamii Bora´s information officer, Gabriel Kadidi, who spent a day with me in Nairobi. He explained the work of Jamii Bora and showed me the slums of Nairobi and a huge housing project they have created. They are so important for the microfinance industry in Kenya that it was necessary for me to include them in the project since the dissertation´s sub-question is related to how the microfinance industry works. In this respect it is relevant to include Jamii Bora to understand the industry and understand why they have proven to be successful with lending to the poor.

8.2.1 Jamii Bora



Picture 4: Founder of Jamii Bora Ingrid Munro & Senior Information Officer Gabriel Kadidi

Jamii Bora which means good families in Swahili, was founded by Ingrid Munro a Swedish architect who has lived in Kenya for more than 20 years. Jamii Bora began lending to 50 beggars in 1999 and has than 250,000 clients, 87 branches, and 140 outlets across Kenya making Jamii Bora one of the largest MFI in Kenya. Many of their clients live in Kibera and Mathare of Nairobi - two of Africa's largest slums, with 1.2 million and 800,000 residents respectively. The slums are divided along tribal lines, making certain groups more vulnerable to attacks when clashes occur. Jamii Bora is somewhat similar to The Grameen Bank where members save and borrow using colleagues as guarantors, thus removing the requirement of collateral, which remains a major barrier to accessing commercial mortgage. Hereby they create social capital which helps the individual to obtaining a loan and improving the possibilities in life. One example of this is the housing project I mentioned earlier. Jamii Bora has seen its clients build the first African Microfinance Town, Kaputei.

The town is expected to have 10.000 people living. The houses will be financed and sold only to Jamii Bora members. There is already a long waiting list for these houses with priority being given to those members living in the slums of Nairobi.

Picture 5: Kaputei – The first microfinance town in the world

Clients are consequently moving from slums where they have lived in squalor and filth into clean, two and four bedroomed houses with water, solar power, schools for their children and a safe place to build a better life for themselves and their families. Kadidi took me to Kaputei where I met one of Jamii Bora´s clients who suffer from HIV and spent most of her life in the streets. Today she is a very proud mother of four children all living together in a nice house with a garden. She used her first loan to buy a sewing machine to make clothes and sell it. By paying back her loans and improving her business she can live in one of these microfinance houses and bring her children to school. This could never have happened if Jamii Bora did not make use of the elements of social capital theory.

However as with the entire country, Jamii Bora and their clients were heavily affected by the post-election violence in 2008. Many of them are still in the process of reconstructing their lives. Kadidi guided me to the slums of Nairobi and to some of the places that were affected by the violence and I met some of Jamii Bora´s clients. They seemed happy and were ready to work hard to re-establish themselves. Kadidi emotionally described the effects of the post-election violence; "*The only reason I could go outside to buy food and collect water is because I speak nine languages -- they couldn't tell which tribe I belonged to"* (Jena, 2008:*CGAP article*). About 50% of Jamii Bora's clients were affected by the crisis. During this period, many businesses and homes were burned and destroyed. Businesses suffered severe losses as customers were either confined indoors or displaced. According to Kadidi some internally displaced people have yet to return to their homes. The financial and psychological impact on the post electoral crisis in Kenya has been considerable. With this being said it was still amazing to see how the poor continue to move on and fight to get back on track with their business. This also shows how social capital creates crucial solidarity among the microfinance members.

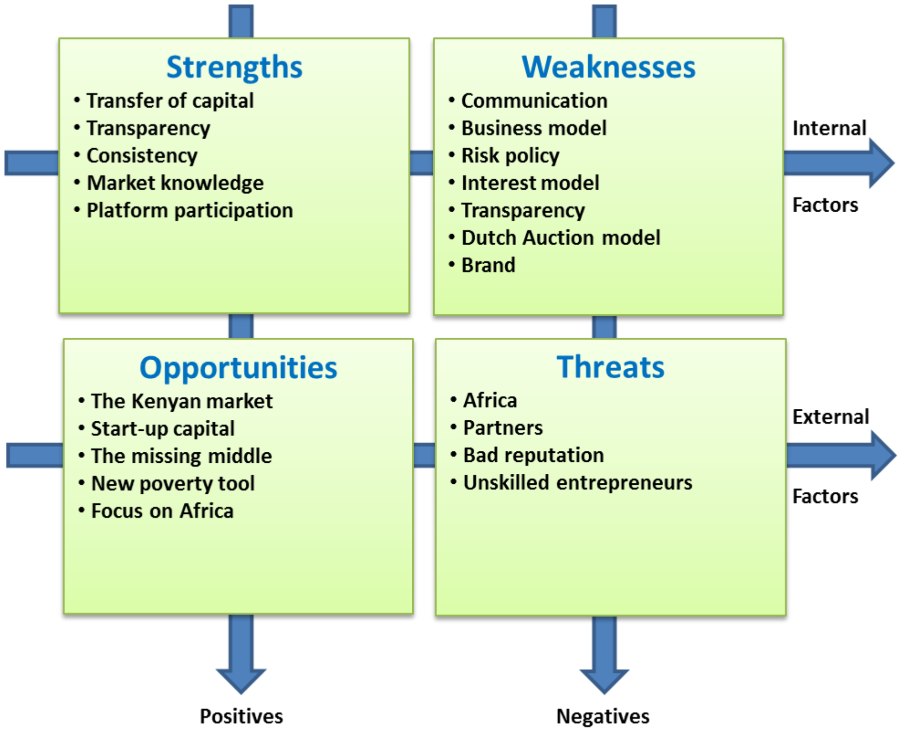
When meeting the Jamii Bora clients, I experienced how proud they were of being Jamii Bora clients and they did not hesitate to show me their Jamii Bora membership card when I asked them about their relationship to Jamii Bora. Each member of Jamii Bora is issued an identity card embedded with a biometric reading of their fingerprint. To deposit or withdraw funds, Jamii Bora staff simply swipe the card on a small machine, open the member´s account and record the transaction. To confirm and authorize the transaction, the Jamii Bora member must press their thumb to the machine and a receipt is printed for the member records. By giving all their members a membership card Jamii Bora has given the poor a sense of identity and has created a relationship build on trust and respect. This is truly remarkable and also a reason why Jamii Bora is called “the shining star” of Africa.

As both highlighted by Social Capital theory and Principal Agent theory trust is key to a high repayment. Faulu, Equity Bank, and Jamii Bora all aims at transforming people’s lives in terms of increased confidence and give them respect by lending to them. A key for success for these MFIs is that they are close to their client. They visit their client and build a trust relationship. They use training as part of their strategy to avoid any misunderstanding and to clarify that their client act in the interest of the MFI. Jamii Bora also emphasizes training of the staff as very important. For Jamii Bora the staff is the secret behind their success as they come from membership and therefore understand the members. Gabriel Kadidi who is now the Senior Information officer also started as a member at Jamii Bora. Jamii Bora has courses and seminars, for already employed Jamii Bora staff to enhance performance and dedication (Belfrage, 2009).

8.3 SWOT analysis – MyC4

I have used a SWOT analysis to structure the MyC4 analysis part. The various points are taken from the data I have collected. This being all secondary data and the data collected in Kenya. Some of the elements in the analysis may overlap so that the same elements fit into different boxes. For example, I claim that it is a strength that MyC4 continuously pursue their goal of proving their model in Africa. However this could also be a weakness due to the fact that the model has not been successful and a conclusion could be that it is not possible to operate in Africa with their current business model.

Figure 5: SWOT analysis of MyC4



While I was in Kenya I interviewed several people involved with the microfinance industry and people in connection with MyC4. I interviewed the head manager of MyC4´s Africa office about what has gone wrong for MyC4 in Africa, which enabled me to understand the difficulties and therefore helped to answer the research question. To understand the challenges MyC4 has had in Kenya it was essential to collect these interviews from people working in the field.

8.3.1 Strengths

Transfer of capital

Transfer of capital to Africa is MyC4´s biggest strength. MyC4 has created a new way of helping poor entrepreneurs in Africa with their business because they have no other alternative to raise capital. No matter how MyC4´s model is interpreted in terms of return on investment or other difficulties, MyC4 has been able to transfer capital from investors in the developed world to Africa in a new transparent way.

So far 17,281 investors from 100 countries have invested EUR 11,347,694 in 5,697 businesses in 7 African countries (MyC4.Com, June 2010). This amount has been transferred to African businesses since MyC4 started in 2006.

Transparency

It is considered a strength that MyC4 emphasize transparency with everything they do. As mentioned earlier in the dissertation trust is a huge issue in Kenya and it is important that potential partners and the authorities know about MyC4 and the online lending service concept. As highlighted by Principal-Agent theory there has to be information between the agent and the principal, therefore it is a strength that the MyC4 model is built on 100% transparency. This creates a trust relationship to the stakeholders. Furthermore when MyC4 choose to work with a transparent business model they illustrate that they don't have any hidden agenda. Thus MyC4´s transparency policy seems like a very important strength that is worth recognizing.

Consistency

MyC4 has great ambitions which is also illustrated by their goal to be the first online lending platform to be owned by the world; 6 billion shareholders. MyC4 has so far showed incredible consistency to prove its business model. Even though the company has been struggling the last year or two and has lost a significant amount of money they continue to believe in the business model and are motivated to prove they can succeed. This can also be a weakness if they get blinded by their drive to prove the model but keep losing money; their own money and the investor's money. However consistency and believing in the business model are vital elements for survival. Furthermore MyC4 shows that they are serious with the operations. At last if MyC4 manage to change the negative results to their own benefit they can gain a first mover advantage as they are the first for-profit online lending platform targeting the microfinance and mesofinance industry.

Market knowledge

MyC4 has had challenges with proving their model and have witnessed the worst of Africa which actually contradicts their goal to prove that it is possible to do business with Africa. However, MyC4 can use these experiences to its own benefit. MyC4 has obtained comprehensive experience and practical insight into the microfinance industry and lending business in Africa, which equips the organization for handling current issues as well as the possibility of building a strong, scalable model.

Platform participation

MyC4 has from the beginning had a platform on the internet where investors can get in contact with MyC4. This is called platform participation and is an advantage for MyC4 to offer the investors. When offering this kind of service, you reinforce the trust between MyC4 and the investors which is strength for MyC4. In PAT, trust is fundamental when working with lending practices. This is especially important in Africa. According to Growth Africa (2010a), one of the biggest strengths of MyC4 is the platform participation among investors. The forum of MyC4 is created to give the investors the possibility of sharing thoughts and communicate ideas to the staff of MyC4.

8.3.2 Weaknesses

Communications

The platform participation was created to emphasize MyC4´s aim of being 100% transparent. But MyC4's participation is inadequate as they do not answer the investors' questions on the platform sufficiently.

> *I have lost my trust in MyC4 after Cote ivorie, Ebony, FED.... and MyC4 not being able to really respond to the fears/needs of its investors. This has made me stop investing and pull out what money I have left on MyC4*. (…) *MyC4 is focusing on software development instead of being active on the forum and responding to their investors. Investors have over and over again been asking how MyC4 is checking that borrowers are real and if the provider is actually paying our money to the borrower.*

(Chrillesen, 2010:*MyC4 Forum*)

This is only one out of many examples of investors who are dissatisfied with MyC4´s participation in the forum. This can be viewed upon as a Principal-Agent problem where the investors are the principal and MyC4 the agent. The investors are a necessity for MyC4 to work but MyC4 does not act in the investor's interest. This creates a mistrust relationship which can lead to investors leaving the MyC4 platform as illustrated above. Companies continue to overlook how damaging threats from online activists and pressure groups can be if they are not prepared to respond quickly and decisively (Shandwick, 2007). It does not seem like MyC4 has capacity enough to satisfy the needs of the investors and for the participation model to work for their benefit efficiently.

The lack of communication is also apparent between MyC4 and their African partners where the CEO of Growth Africa, who is Danish, is the only one really participating at the forum. This decreases the possibilities for the investors to know which businesses are less risky. The investors have no idea how to calculate the risk or know which MFI to trust when there is no communication between the parties. It is almost impossible for an investor in Denmark or another country to know which borrower will pay back the loan and what methods MFI´s use to collect repayment. Again a typical Principal-Agent problem since PAT indicates that it is impossible to screen the good partners from the bad ones.

From the information mentioned above it seems like MyC4 has a communication problem or don't emphasize the importance of a serious communication strategy. This is not only evident with the investors but also mentioned by Micro Africa (2010) who claims that there has been a lack of sufficient information in terms of understanding the business model and product. This is also mentioned by the interview with MyC4 Denmark (2010a:*appendix 3*), *"Communication has been weak because they do it their way. We made a mistake only selling the product to the investors"*. This illustrates that MyC4 thought that the operations in Africa was the least problem.

Co-founder Tim Vang knows that the communication and the technology behind it is not quite up to date but also stresses concern about the constructivism of the questions and remarks posted at the platform. He says that MyC4 does not have a specific employee to handle their communications. Instead all employees manage each area matching their own qualifications (MyC4 Denmark, 2010b). This could result in missing information and misunderstandings around the field of communication as a substitute to having only one employee making sure that everything is covered, answered and provided for the investors and partners. This does not only apply for the platform participation but also communication in general. Especially in relation to the PAT, information is a huge part when building a trust relationship (Jensen & Meckling, 1976).

Business model

One of my first interviews in Kenya was with the head manager (Ondeng) of MyC4´s African office. He was very frank about MyC4 and its challenges in Africa. According to Ondeng one of the factors that hurt MyC4´s African operations was their urgency and haste to grow. "*MyC4 was about grow grow grow – and the MFI´s grew grew grew until they could not handle it anymore"* (MyC4 Africa, 2010:*appendix 3*). The MFI's which MyC4 worked with could not grow at the same pace as MyC4. MyC4´s business model is dependent on a large loan volume because they only make profit from each loan disbursement. Because of this, decisions were not clearly thought through. *"Many of the organizations MyC4 started to work with should never have been in the system. MyC4 made a mistake in spreading their operations out on the continent"* (MyC4 Africa, 2010:*appendix 3*). Some of the organizations only started because of MyC4 since it was something new and a possibility for MFI´s to scale and provide capital. The quality of the loans worsened and it became difficult to secure a high repayment rate. "*They should have started in one country and slowly expanded to other countries"* (MyC4 Africa, 2010:*appendix 3*). Smorfitt who has been working in the mesofinance industry in Africa for many years is even more offensive with MyC4´s scale policy. "*Scaling is easy when you are giving away money as they are. Sustainability is another issue*" (Smorfitt, 2010:*appendix 4*). Sustainability is the key for MyC4 to prove the model since it is a profit seeking company. According to Fusion Capital MyC4 have a sustainability problem not only now but also in the future; *"MyC4 will not break even. 6% is barely enough to pay costs"* (Fusion Capital, 2010:*appendix 3*).

Interest model

Growth Africa´s manager claims that MyC4 is too expensive and to complicated.

> *You don't get any money here by having money on an account. MyC4 wants to have 21 %. MyC4 6%, investors 15%. And it is too expensive. We are also looking for capital independent from MyC4 and they cost 5-6%. MyC4 is relatively expensive. Our goal is to become less dependent on MyC4.* (…) *If investors decrease the interest rate to about 8-10% they are more*

> *attractive to small and medium sized MFI´s. They will create value in regard to their visibility. Better exposure.*

(Growth Africa, 2010a:*appendix 3*)

These arguments make it even more difficult to find reasons why MyC4´s business model should work in Kenya. Fusion Capital claims that 6% is not enough to pay MyC4´s costs and Growth Africa claim MyC4 is too expensive. There seems to be a bias between what MyC4 wants and how their business model will be attractive to MFI´s in Kenya. I experienced the same attitudes when I talked to different successful MFI´s in Kenya. Unfortunately they would not let me record the interviews. They could not understand why they should partner with MyC4. MyC4 has tried to partner with MFI´s such as Jamii Bora, Faulu and Equity Bank but these have not been interested in working with MyC4 (Ovazik, 2010:appendix 5). This indicates that their business model is not attractive enough for MFI´s that operate with social capital. This makes sense since the MFI´s are all financial sustainable and partnering with MyC4 would increase the interest rate to the borrower. Furthermore as mentioned earlier the MFI´s working with social capital emphasizes protecting their clients and by partnering with MyC4 they could hurt the relationship with their clients.

<u>Risk Policy</u>

One of the biggest problems for MyC4 has been the lack of a risk policy. Right now only Fusion Capital holds 15 % risk. This fact has been illustrated at almost every interview in Kenya as a major weakness of MyC4.

> *Myc4 will always fail when working with greenfield and no risk policy*. *You can´t have a lending policy where there is no risk. Fraud is a huge problem in Africa. There are no incentives to pay back the MyC4 money when no risk policy. We must lose money – then greater motivation to collect loans.*

(Micro Africa, 2010:*appendix 3*)

Ebony exploited this to perfection by uploading one ghost project onto the platform after another — basically using the cash flow for new ghost projects to service the loans for the older projects in an endless game of deception. At some point Ebony had used a significant amount of money which was missing. That´s how MyC4 found out something was wrong. MyC4 is now in court but the money will probably never be seen again. Ebony is now claimed insolvency and Mr. “fraud” is out of the country nowhere to be found. By applying this “no risk” policy the MyC4 system left major loopholes for these lords of poverty to exploit. If there is a chance to cheat it will happen as claimed over and over again during my interviews. *“The culture here in Kenya is people will get the loan and not repay it. You HAVE to put a system to ensure people will repay the money”* (Faulu, 2010:*appendix 3*). This statement is in alignment with what MyC4 Africa told me.

> *They (partners) didn´t have a system to be able to track their customers. This was the same in Uganda, Tanzania, Ivory Coast. Challenge is – if you are going to get a lot of money channeled to the organization, you’d better be able to handle this amount of money.*
>
> (MyC4 Africa, 2010:*appendix 3*)

As mentioned MyC4 wanted to work with good partners with a track record but they were not interested. Now MyC4 is trying to work with organizations who have been working in the field for 2-3 years. But there are not enough of those yet. It is the same problem in the other countries as in Kenya (MyC4 Africa, 2010). Thus it increases the chances that MyC4 team up with the wrong partners as mentioned before unless MyC4 is consistent with incorporating a proper risk policy. Furthermore if the microfinance provider looks like it will fail, decide to go out of business, or even reduce the amount of microloans it makes, then the borrowers are likely to quit paying back their money and the partner´s non-collateralized microloan portfolio is likely to collapse (Smith, Thurman, 2007). This statement corresponds with what Micro Africa told me “*Dependent on how strong the institution is, that is how the client will treat you. Thus important for MyC4 to identify the right institutions”* (Micro Africa, 2010:*appendix 3*). Furthermore investors lost a lot of money because of this lack of risk policy. If partners don’t have anything to lose default will stay high.

<u>Transparency</u>

Besides being strength, transparency has unfortunately also become a weakness to MyC4. I experienced during my field work in Kenya that transparency is not always what the partners wants. According to Growth Africa, “*transparency is a core value for MyC4. But transparency for* *every price is not worth it. The information provided to the investors is misunderstood"* (Growth Africa, 2010a:*appendix 3*).

The PAT illustrates the importance of delivering accurate information. Transparency as a basic principle is a good thing but some information is not meant for transparency and should be handled thoughtfully. This is also claimed by Fusion Capital;

> *It is not always attractive to be on a platform – then the borrower wants' to be financed from other platforms because of too much information of the client on the platform. The information should only be available for the involved parties.*
>
> (Fusion Capital, 2010:*appendix 3*)

This indicates that entrepreneurs emphasize privacy which is understandable since their problems and potential default can be viewed for everybody when occurring on a website.

This was also illustrated earlier by USAID that a major issue which threatens the growth of MyC4 and the industry in general is the issue of transparency and specifically finding a balance between protecting the privacy of borrowers and the interest of lenders (USAID, 2008). This is a typical Principal-Agent problem when the different parties have different interest in the information being viewed to the public. These statements could indicate that MyC4 should consider their transparency policy even though it is difficult to argue against full transparency but MyC4 is trying to gain transparency in an area of the world that resists transparency. However, MyC4 also needs to reevaluate the transparency strategy since the privacy of the poor should be prioritized since they have more to lose. Furthermore when most of the information is provided on the internet people can interpret the information in different ways.

Transparency is seen as strength of MyC4 but it can also be a threat since everybody will know about the problems which can turn some of the investors against MyC4. At last due to their transparency policy the risk of negative media is constantly present.

<u>Dutch auction model</u>

MyC4´s loan (bidding) process is based on a Dutch auction meaning that the more people that are investing, the more favorable the interest rate is for the African business. The model is built out of an inspiration of eBay which means the market forces regulates the price of the product. There are several factors that make the Dutch auction principle a weakness for MyC4. First of all the dissertation has mentioned that poor entrepreneurs in the developing world are not price sensitive. They just want access to financial services. Therefore there is no reason for the Dutch auction system (Smorfitt, 2010). Furthermore with the Dutch Auction model it can take time before the loan is completed and sometimes the poor don't have the luxury of time. The model creates a bias between social investors and venture investors. Some investors are investing in a loan out of social purposes and some investors are lending to make a big profit and therefore seeking a high interest rate. In this way it is confusing and difficult to understand whether it is out of social purposes that people invest or because they want return on investment. However this is the way MyC4 has built its model but due to the different motives from investors of using the auction model Principal-Agent problem exists.

MyC4 was actually intended for Mesofinance, however due to the fact that most of the auction bidders are in Europe and the bidding amounts are small, this started reflecting on the quality of loans, that were quickly financed and as a result larger loans have not been financed on the platform effectively. There is always an alteration between the businesses and the amount of financing on the platform. Either there is a lot of money on the platform and not enough businesses or many businesses and no financing so this affects the interest rate that a loan would get (Onyando, 2010). After the investors have experienced the problems in Africa with several partners there are several loans which are not being funded. This has brought up big concerns which are expressed by Growth Africa at their post on the MyC4 platform.

> "*This month's activities have been overcast by the fact that more and more loans are failing to get funded. In total 12 loans, amounting to more than EUR 30,000, of our loans alone have been cancelled. This is a significant loss of revenue for a small organization like ours, and thus something that preoccupies us tremendously. We are left with a couple of questions: Have the investors lost interest in investing generally, or in Growth Africa specifically? Is the platform turning into a microfinance platform, only financing loans under EUR 1,000? Is this only a temporary - wait and see - period, and if so, when can we expect to see increased activity?*

So, we'd like to hear from investors, and preferably also some of the investors who normally only read these blogs, what your thinking is"

(Growth Africa, 2010b:*MyC4 Forum*)

These statements mentioned illustrate that the Dutch auction model creates a bias between the loan sizes and bigger loans have difficulties getting funded. This could indicate that MyC4 shoud reevaluate the use of the Dutch auction model and MyC4 should consider choosing between microfinance or mesofinance. A combination of the two seems to be too complicated.

Brand

As mentioned earlier, most of the MFI´s did not really understand what MyC4 is about which indicates that they have not branded themselves sufficiently or effectively. Even though it seems strange it makes sense due to the fact that MyC4´s business model is built upon the principles of eBay. John Grant, a marketing philosopher, says that branding is essential to run a successful business. He also claims that eBay didn´t succeed in branding; let alone try to *"…eBay has a household name, but it doesn´t have a brand image. It is a marketplace; which happens to have a name, rules, and a thriving local culture, even a dialect"* (Grant, 2007:277-278). Therefore it makes sense that MyC4 hasn´t emphasized a branding strategy since their model is built after the principles of eBay. This is also mentioned by Growth Africa (2010a), saying that MyC4 still thinks too much like a dot.com company. It is a big weakness of MyC4 if they continue to brand themselves like eBay. To have a strong brand is important in Africa to attract string partners which will affect the quality of the loans. Thus MyC4 should reconsider their branding policy.

8.3.3 Opportunities

The Kenyan market

According to Onyango (2010), Kenya is a tough market but also the place to be. The market is big and has tremendous opportunities. First and foremost, since MyC4 decided to operate exclusively in Africa, Kenya was an obvious choice for MyC4 due to their economic position in East Africa, their predicted annual growth, and a well-established microfinance market. Furthermore the first microcredit summit in Africa was held in Kenya which could indicate an acknowledgement of the microfinance industry in Kenya. Furthermore Kenya is one of the best internet countries in Africa and the industry is growing faster than any other continent. So in terms of country selection Kenya was an obvious choice for MyC4 to operate. Several MFI´s have proven financial sustainability and have repayment rates close to 100% (AMFI, 2010).

Start-up capital

According to Growth Africa (2010a), MyC4´s biggest strength is that they give new starters (MFI´s) an opportunity to scale their business by providing them capital. Growth Africa started with MyC4 and is only operating today because of the start capital they received from MyC4. Growth Africa had problems with a high default rate in the beginning but has improved their business model in terms of defaults. The CEO, Johnni Kjelsgaard, is Danish which made it interesting to get his view of the culture and challenges existing in Kenya. Kjelsgaard claims that the success of the partnership is due to the fact that he is Danish and understands the culture and what they want. "*I understand the value of how to approach the clients. It is important not to make the information to complex. Furthermore I have a more aggressive communication strategy in terms of bridging the knowledge to the investors"* (Growth Africa, 2010a:*appendix 3*). These statements are in alignment with the Principal-Agent theory; if there is a misunderstanding or different interests, a problem will occur at the different levels. According to MyC4, Growth Africa is a company they hope will be a success. "*They have changed their model and improved their business and now don't have so many defaults"* (MyC4 Africa, 2010:*appendix 3*). The reason for this is that Growth Africa has decreased the number of big loans, "*Bigger loans give bigger problems. Now our loans are between EUR 2000 – 5000. This segment gives fewest problems"* (Growth Africa, 2010a:*appendix 3*). This illustrates that it is possible to change a high default when enhancing the knowledge about the market and its clients and adjust the business model thereafter. Growth Africa did it by recognizing where the problems occurred. Furthermore every Sunday they have meetings with their clients to train them and explain exactly how the business model works. This has undoubtedly created an improved trust relationship to Growth Africa and improved the results in terms of repayments. Thus Growth Africa has proved that my connecting sudden elements from Social capital theory and Principal-Agent theory, by building a trust relationship through an aggressive communication approach, an improved business model can be developed. The success of Growth Africa has been very important for MyC4 in order to experience a reverse situation when reflecting on former problems with partners.

<u>Mesofinance industry</u>

MyC4 is the first online lending platform (that I know of) who aims at bridging the financial gap for small and medium sized enterprises in Sub-Saharan Africa.

As mentioned previously there is a significant knowledge gap concerning the mesofinance industry and "the missing middle". MyC4 has seen an opportunity to penetrate these market failures and to operate in a market which has not been thought in depth. MFI´s and banks are ill prepared to target the missing middle, competences have to be sharpened (Smorfitt, 2010). Especially statistics on new enterprise formation (births) and failures (deaths) are lacking. Typically most of the information exists with the owner as there is no systematic reporting of information on small businesses in the same way as is provided for larger concerns and particularly for listed companies (Watson, 2003).

> *There is no tool for assessing the potential success or failure of a SME. Large corporations are evaluated on the strength of their financial statements. SME´s are evaluated on their credit history or on the individual who owns the business. If the SME is evaluated on credit history and had previous cash flow or credit repayment difficulties, this will be factored into the loan decision. While this is reasonable it becomes the sole criteria, which is not fair and biased*.
>
> (Smorfitt, 2010:*appendix 4*)

When reflecting on the SME industry in a historic perspective there are reasons to suggest that a healthy SME industry is important for the economic growth of the country. The US has the largest number of small to medium enterprises in the world; it is also the richest country in the world. The rise in the number and productivity of Japan's small-scale businesses ran parallel with the growth of the nation's wealth. China is busily increasing the range of its own small sector and believes that when it outstrips the US in terms of small to medium businesses; it will outstrip it in terms of overall wealth as well (Versi, 2008). A vibrant industrial sector that includes growing small and medium-sized enterprises is boon to any economy (McCormick, Kinyanjui, Ongile, 1997).

The information collected from my field work in Kenya also illustrated an importance to improve the understanding of the meso segment. Onyando who has been working in the field in Kenya gave her opinions about MyC4 targeting the mesofinance and microfinance industry.

> *For MyC4, mesofinance makes more sense from a development perspective. Also bigger businesses create more jobs and have more stakeholders to check on growth and effectiveness. Individuals are not assumed to be all entrepreneurs like in microfinance thus individuals get the opportunity to excel whether they are entrepreneurs or good employees in different capacities.*
>
> (Onyando, 2010:*appendix 7*)

However, still too many people are graduating without the right skills and can't keep a job or get one. Then they end up starting micro businesses though they would be happy in employment and a number are not given the opportunity to really start good businesses as resources are spread too thin amongst too many not good enough microbusinesses (Onyando, 2010).

At the micro level there is too much to be done just to improve capabilities and capacities therefore from a business perspective investments should be focused on middle size businesses so they can avail more jobs (Onyando, 2010). Communities will require exceptional capacity building and a lot of resources pumped to enable the poor build confidence in their abilities and educate children and youth and prepare them to start medium size business and/or have ready skills for the job market. Also when good entrepreneurs start good businesses it takes longer from the businesses to grow because the learning curve is longer as new employees take long to catch up and truly become productive. If the right business and entrepreneurs receive the right resources and are given the right support they would excel in what they are really good at and those happy to be employed would find more suitable jobs and not worry about basic needs like food shelter and clothing (Onyando, 2010).

The importance of the mesofinance industry is highlighted by IFC who May 10, 2010 launched a new fund that will focus exclusively on investing in small and medium sized enterprises in Central Africa, helping to improve access to finance, create employment, and reduce poverty in some of Africa´s least developed countries. IFC will invest $12.5 million in equity in the Central Africa Small and Medium enterprise Fund, which will make equity and equity-related investments in smaller businesses across the central Africa region.

> *By providing financing for small and medium enterprises, the Central Africa SME Fund will address a key constraint to the further development of Africa's private sector. The fund will aim to be an important source of socially responsible financing for companies across central Africa and contribute to reducing poverty across the region. We are very proud and pleased to help African entrepreneurs build sustainable businesses that create jobs and income.* (…) *Supporting the growth of small and medium enterprises in Africa's poorest economies and in countries emerging from conflict is a strategic priority for IFC in the region. The Africa SME Fund is an important part of IFC's efforts to improve access to finance for entrepreneurs and create opportunities for people in places that need it the most.*

(Ziegler, Bassiri, 2010:*IFC press release*)

That IFC will exclusively focus on supporting the mesofinance industry illustrates the importance of the industry but is also an opportunity to MyC4 since small and medium entrepreneurs have improved possibilities of creating a successful business. When the industry is as it is right now the mesofinance industry is difficult for MyC4 due to the lack of information concerning how to operate with small and medium sized entrepreneurs and also the failure rate is very high meaning the default rate will stay high.

<u>New poverty tool</u>

MyC4 has built an innovative poverty reduction tool. The MyC4 business model concept gives millions of investors the possibility of lending a small amount of money to needy Africans. Furthermore MyC4 has created an opportunity for investors to do business with entrepreneurs in Africa and thus showing that Africa is a business case instead of a nut case.

Online lending platforms play a new important role since they give MFI´s the possibility to tap into the vast amount of personal savings in the developed world as a source of funds.

One of the major innovations of online platforms geared towards developing economies has been their ability to make investments in the microfinance sector and the mesofinance sector for as little as $10 or $20 (Burand, 2009). There are seven online lending platforms dedicated to provide capital to micro, small and medium enterprises in the developing world: two works exclusively in Africa. This is MyC4 and Investors Without Borders. However, Investors Without Borders only operate in Ghana.

Table 4: Seven online lending platforms focusing on developing countries

Name	Launch Date (1)	Legal Status	Country of Orgin	Geographic Coverage	Methodology	Funds Lent on Site to Date (2)
Kiva	Nov-05	Non-profit	Un ited States	Global	Intermediary Model	49,000,000
MyC4	May-07	For Profit	Denmark	Uganda, Kenya, Cote D'voire, Rwanda, Ghana	Intermediary Model	6,750,000
MicroPlace	Oct-07	For Profit	Un ited States	Global	Investment Fund Model	NA
Rangde	Jan-08	Non-profit	India	India	Intermediary Model	20,000
dhanaX	Feb-08	For Profit	India	India	Intermediary Model (Pure P2P to come)	25,000
Investors Without Borders	Expected in 2009	For Profit	Un ited States	Ghana (to start)	Intermediary Model and Pure P2P	-
Globefunder	Pending	For Profit	India	India	Intermediary Model	-

(1) Investors Without Borders and Globefunder India are not yet operational.
(2) As of September 2008 as reported by the respective platform on-line or during interviews with management

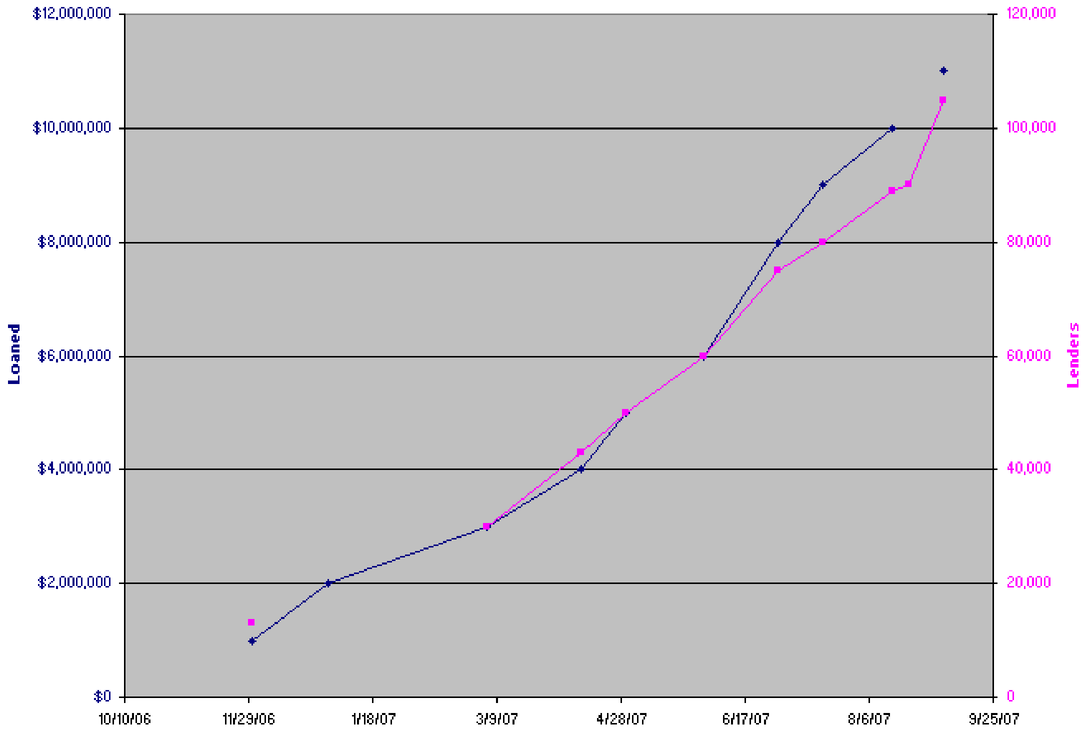
Online platforms can carry many different roles that are currently essential to financing microfinance:

- Raising awareness of less known MFIs, and Microfinance altogether
- Financing MFIs that are in need, in the form of debt (or equity)
- Improving the information efficiency for financing providers

One bottle neck of online platforms still is the internet acceptance for providing finance (in an asset that remains risky) and for MFI´s to master the online application process. However, the online tool is improving worldwide (and assumingly within the Microfinance industry).

Online lending as a tool to eradicate poverty is still a very new concept, especially in Africa and further research is needed regarding their impact and purpose. Kiva was the first company who started lending to Africa and they have globally proven that there are enormous market possibilities. Kiva has benefited from first mover advantage. Ever since they started in 2005, the number of lenders and borrowers has increased dramatically as shown in the figure below.

Table 5: Growth of Kiva´s loaned amount and lenders from 2006-2007



Kiva is the biggest online lending and investment platform aimed at eradicating poverty. Kiva has inspired many other new online lending platforms and as mentioned also MyC4.

Kiva's success has gained the attention of a growing number of MFI´s that are searching for the capital and public awareness that the Kiva online lending platform often can provide. One of the most successful MFI´s in Kenya, Faulu, has been working with Kiva for 10 months (Kiva, 2010). I met with Faulu to explore their motive to partnering with Kiva and to know if other online lending platforms had success with any MFI´s in Kenya.

> *We started with Kiva last year. It has been a success. We did not know about Kiva before they came here last year. They are cheap and they benefit the organization. They are able to show good partners. Online lending can be successful and demand is still high. I have seen it work but the model has to be clear…… They don't require us to pay interest rate.*

(Faulu, 2010:*appendix 3*)

If using this statement as benchmark there are several problems related to MyC4. MyC4 is claimed to be expensive and therefore not attractive. Kiva can show good partners which are critical for MyC4 since they only work with MFI´s with no track record and proved difficulties in working with MyC4. Furthermore Faulu emphasizes the importance of having a simple model. MyC4 has had problems with MFI´s who don't understand the model. But she also claims that online lending can be successful and the demand is high. This again illustrates that MyC4 has an opportunity in Kenya if they can prove to exploit this demand to their own benefit.

Signing up great partners was Kiva´s lifeline. While many such institutions exist in Africa, the majority are elsewhere. Africa currently represents only 10.4 percent of microfinance world-wide; the greatest areas of concentration lie in Southeast Asia and Central and South America (MixMarket.Org, 2010). Today Kiva operates in most parts of the developing world as seen in the picture listed below.

Picture 6: Countries where Kiva operates

This figure clearly illustrates that online lending services have been expanding the last years and that Kiva has been able to attract partners all over the world and thereby proved that online lending services has an opportunity if used in the right way. It is necessary to repeat the fact that Kiva is non-profit and offers a 0% interest rate which makes their model far more attractive to local providers, in terms of price. According to Flannery (2009), Kiva would reduce their investor base with 50% if they changed from non-profit to for-profit. This indicates that the market for social investors is enormous and a significant amount of investors don’t need any return on investment.

When taking Kiva´s statements into consideration it seems extremely challenging for MyC4 to make it work for two different reasons. First, Kiva is non-profit and offers 0% interest rates and still has been struggling to find good partners in Africa. In fact for them to further expand they had to find partners in other regions. Kiva reduced their partner base with 90% by limiting their operations to Africa. Second Kiva would reduce their investor base with 50% if they changed to a for-profit model. This could indicate that MyC4 limit their investor base due to the fact that they operate as for-profit and SOME people expect a return on investment.

Faulu claims that the online lending industry is a new concept and upcoming in Africa. The MFI´s must have a full explanation of how it works (Faulu, 2010). As mentioned earlier MyC4´s model is portrayed as complex and for some MFI´s difficult to understand. Taking into consideration the importance of trust in Africa and a mutual understanding between the lenders and borrowers problems can expand quickly. Both the MyC4 and the Kiva model work through intermediaries meaning that investors and borrowers have no direct communication. This creates a Principal-Agent problem as illustrated earlier in the dissertation. This enhances the importance of finding reliable partners. But it also enhances the importance of having a simple business model which is understood at all levels. This will create a common understanding of the model and increase the trust relationship. For a social lending website to be trusted by both lenders and borrowers, satisfaction and excitement of individuals who have used the site are important (relation-based trust). It is a great advantage if individual users share the ideas with others (reputation-based trust). Word of mouth and popularity are exceedingly important for attracting peers and convincing them to proceed to transactions. Once trusted, a P2P website investors consider repayment behaviour, reputation, relational signalling, along with borrowers’ projects. MFI´s or field partners do the same (Ashta, Assadi, 2009)

As mentioned the online lending concept is very new in Africa and not well understood. This increases the importance of explaining the concept when communicating with potential partners. MyC4´s partner Micro Africa reinforced this statement, “*I believe their model can succeed they* *have a good chance – they just have to clarify their product and encourages the good MFI´s to work with them”* (Micro Africa, 2010:*appendix 3*).

Focus on Africa

MyC4 is determined to work exclusively in Africa. Hereby they increase the focus on Africa and make some important experiences with the operations. By focusing on Africa they have proven that there are a significant number of investors who are willing to invest their own money in businesses in Africa. MyC4 have proven through its business model that there are poor Africans who are willing to do everything they can to start up a business and repay the loan. If MyC4 manage to prove the business model in Africa, MyC4 has big opportunities of making an enormous impact in Africa.

8.3.4 Threats

Africa

MyC4 has chosen only to operate in Sub-Saran Africa which makes it very challenging to find good partners when taking Kiva´s argument into respect signing up partners was elsewhere than Africa.

According to the founder of Kiva the focus was exclusively on Africa in the beginning. However Africa has proven to be a more difficult place to work than other regions (Flannery, 2007). Therefore Kiva decided to expand to other regions.

> *Limiting ourselves to Africa, we would artificially reduce our potential partner base by 90 %. Plus, by early 2006 Kiva user base was growing and we were in danger of not being able to find enough investment opportunities to meet the demand.*

(Flannery, 2007:49)

Corruption and fraud are issues every company has to take extremely serious when operating in Africa. Out of a total of 180 countries in the world, Kenya is ranked as the 145th most corrupted country in the world (Transparency International, 2009). I don’t claim that MyC4 has been unserious with their way of operating in Africa. However, the information provided in this dissertation has illustrated that MyC4 has underestimated the difficulties of operating in Africa. This is also stressed by MyC4-Africa earlier mentioning that MyC4 spread their operations to fast without knowing the challenges that exist in Africa. Furthermore political unrest is constantly a potential threat to MyC4 as experienced in Kenya where partners can be forced out of business and adding the potential for inflation a big risk for the investors to end up losing money. Furthermore the internet is way behind other regions and since MyC4 is operating with online lending services they have to be patient with Africans understanding their business model.

Unskilled entrepreneurs

Another threat to MyC4 is the aim to target African small and medium sized enterprises whereas the market is mainly unskilled entrepreneurs. Fusion Capital claims that "*entrepreneurs don't have the capacity to structure businesses. They work with instinct. If the structures are in place they can be able to go to next step"* (Fusion Capital, 2010:*appendix 3*). According to Growth Africa (2010a), small business cannot control their business and economy because they need financial knowledge. Furthermore artisan skills are for example too expensive in developed countries, so African people with high level skills move to developed countries to get jobs here. There is a broad shortage of skills in developing countries. "*Bigger chances of failure than success*" (Smorfitt, 2010:*appendix 4*). Furthermore formal sector SME's generally do not create jobs because failure rate is equal or greater than start up rate - situation remains static (Smorfitt, 2010). These claims by Growth Africa, Smorfitt and Fusion Capital who all work in the mesofinance industry illustrate the importance of incorporating training with their loan so they understand how to expand their business. If these circumstances are in place it also reduces the risk of MyC4 lending to entrepreneurs who don't know how to create a sustainable business.

Partners

Due to the nature of the MyC4 business model the partners in Africa have enormous responsibility in terms of acting after the principles of MyC4. The partners are responsible of screening the borrowers and ensure repayment of the loan. Partners can both be an opportunity and a threat to MyC4. However due to former experience with MyC4´s partners I have chosen to place partners as a threat. It has proven very difficult for MyC4 to screen potential partners and know which ones are to be trusted. This problem was illustrated earlier in PAT, arguing that it is costly to sort out those who are opportunistic from those who are not, making it necessary for the principal (MyC4) to install precautions (Williamson, Ouchi, 1981). Furthermore it has proven very difficult to start partnerships with the most well-known MFI´s. The good institutions are not interested in working with MyC4. They don´t lack capital as witnessed earlier with Faulu, Jamii Bora, and Equity Bank. They have no reason to re-create themselves to fit into the MyC4 system. They have well established procedures (MyC4 Africa, 2010). So since the well-established MFI´s didn´t have any reason to work with MyC4, MyC4 had to partner with new starters who needed capital to expand their business. However this also became a problem for MyC4. As mentioned earlier it is very difficult to distinguish between opportunistic and non-opportunistic candidates. Since there is a problem in Africa with corruption it is difficult to find reliable partners (Onyando, 2010). Growth Africa reinforces this view, ”*Myc4 started to work with three new partners. They still suffer from this. Their business model is not attractive enough for sustainable MFI´s*” (Growth Africa, 2010a:*appendix 3*).

The weakness in the business model as mentioned before is that MyC4 needed to grow fast and they started partnerships with the wrong partners due to lack of information and understanding. The experience with Ebony is a classical Principal-Agent problem. According to Jensen and Meckling (1976), the agent hired by the principle will not always behave in the interest of the principle, which is the case with Ebony.

MyC4 “hired” several MFI´s as their agents from which they didn´t get their loans back. This is being considered a “breach of contract” because the agent does not act in the interest of the principal. This also correspondence with the fact that the principal and the agent have different attitudes towards risk. MyC4 risked a lot of money by trusting these agents, and as the principle-agent approach confides, this is a common problem. When MyC4 is giving loans to people without interacting with them face to face, but through online lending, you do not know who the lender is and therefore it is very risky to lend them money with no risk attached. Principal-agent theory suggests that the more links there are in the process, the more opportunities for opportunism will exist. To enhance the level of trust an increase in the flow of information is needed (Petersen, Rajan, 1994). The “underestimation” of the challenges when starting partnerships with an agent in

Kenya did in the case of Ebony cost EUR 1.5 million, affecting 6,700 investors, 576 borrowers and MyC4 (Mads Kjær, 2010b).

Bad reputation

These experiences with unreliable partners have damaged MyC4´s reputation. Thus MyC4 is facing problems with the existing partners because of the problems with Ebony. Micro Africa who is one of MyC4´s partners don't want to lend more money from MyC4 because of the reputation; even though they lack capital. MyC4 damages the reputation of Micro Africa (Micro Africa, 2010). This again is related to the importance of trust. If Micro Africa gets a bad reputation, it will hurt their business in the sense that their borrowers will stop believing in them and thereby stop repaying the loans.

MyC4´s reputation has weakened the last year because of the problems with unreliable partners. It affects the investors who run away because they lose money and don´t trust the model anymore. Furthermore MyC4 hasn´t managed to respond the investors sufficiently which also affects the reputation. MyC4 should emphasize the importance of rebuilding a good reputation.

Peter J. Firestein, President of Global Strategic Communications, once said *"A risk to its reputation is a threat to the survival of the enterprise".*

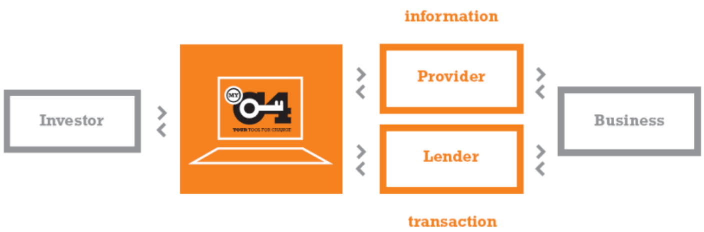
9 Conclusion

The objective of this dissertation was to conduct an explorative case study of MyC4 and answer the research question

Why has MyC4 experienced difficulties creating a financial sustainable business model in Kenya, and what can be learned from these difficulties that could help MyC4 succeed in Kenya?

To answer the research question the aim was to bridge the research gap in online lending platforms operating in Kenya. Thus it was essential to do part of the research in Nairobi, Kenya. The overall purpose with the field work was to explore why MyC4 has experienced the problems with its operations. The research has brought some important conclusions that need to be addressed when operating in Africa with online lending services. The research has provided information on why MyC4 has experienced difficulties with their operations. Furthermore the research has provided information of what can be learned from these difficulties which will be mentioned in the recommendation part. The information provided is relevant for people working with online lending services and investors who considers investing in online lending platforms. The information provided by the field work in Kenya has been supported by the chosen theory to increase the validity of the conclusions.

The previous discussion on MyC4´s operations in Kenya has revealed some positive and negative aspects with respect to the business model.



On the positive side are the following:

MyC4 has managed to build an innovative model which has channeled €11,347,694 to seven different countries in Africa. MyC4 has created a business model that gives investors a new way of helping poor entrepreneurs with their business and also gives investors a possibility of a return on the investment. MyC4 is aiming at being 100% transparent in everything they do which is remarkable when operating with a continent that resists transparency. MyC4 has built a participation model with focus on Africa. Thus the MyC4 has started a debate on how to operate in Africa which can prove to be very useful. The problems MyC4 has experienced in Africa are worrying but with their consistency to prove the business model it is possible that MyC4 can turn their transparency strategy to their own benefit.

The results have proven that MyC4 has created an opportunity for African MFI´s to expand their business since the capital gives MFI´s an opportunity to reach more clients. Growth Africa has proven to be one of MyC4´s partners who have been able to decrease the default rate which has been caused due to a better understanding of the products they sell and training the clients so they understand the responsibilities with the loan.

It is a common conclusion from the interviews that MyC4 has not managed to secure a strict repayment regime. This falls back on the selected partners, who obviously have not succeeded in solving their tasks. It is of utmost importance that the partners have the necessary tools to secure the repayments from the businesses.

On the negative side is that there are some huge challenges MyC4 needs to approach. The research has shown that MyC4 is targeting both the microfinance industry and the mesofinance industry. However there are significant challenges when operating in both industries. In the microfinance industry the well-established microfinance institutions do not have any incentives to work with MyC4. The most successful MFI´s in Kenya operate by building social capital and having a close relationship to their clients. However MyC4´s business model is not attractive to these MFI´s since they don´t lack capital and MyC4 is portrayed to expensive and thus no reason to work with MyC4. Partnering with MyC4 could jeopardize the strong client relationship which their business model is built upon.

The mesofinance industry is poorly understood and the results show that SMEs have bigger chances of failure than success. To create sustainable business knowledge and skills are vital elements which are in shortage in Africa. The qualified African people moves to the developed world. This could indicate that defaults will remain high if MyC4 continues to focus on this segment.

Furthermore MyC4 operates exclusively in Africa. Kiva has mentioned that Africa was the most difficult place to operate due to corruption and not enough reliable partners. Kiva even works as non-profit and Kiva gains trust as non-profit. This reinforces the challenges for MyC4 when operating in Africa as for-profit company.

MyC4 has experienced the worst of Africa even though the goal was the opposite. The results have shown that it is absolutely essential to have a risk policy when operating through online lending services. Partners have to lose something else they have no motivation to collect repayments. The research can conclude that MyC4 has underestimated the African market which is also mentioned by MyC4´s founder Mads Kjær. MyC4 had too much focus on pleasing the investors. Ironically the investors are now leaving the platform because they lose money and they complain on the platform that MyC4 don’t respond to their questions. MyC4 has not emphasized communication and branding due to the fact that they have been built on the principles of eBay. However the results in the research have proven that branding and communication is crucial if succeeding in Africa.

With all this said online lending platforms can contribute to growing the next generation of socially responsible investors by showing the small investor/lender how his and her money can be used to do good in the world while returning the principal amount of that financing to the investor/lender and perhaps even generating a financial return on this principal. If this does not happen the risk is, that the sources of lending capital will dry out as proved in the argument of Growth Africa who can´t get the loans funded.

It is critical that online lending platforms take appropriate care with the operations or else the possibility of the online lending concept may vanish as fast as it started.

In extension of the conclusion, recommendations on how MyC4 can succeed in Africa through online lending services will be drawn upon in the following.

10 Recommendations

The purpose of this chapter is to give my recommendations on how to operate through online lending services. This recommendation is based on the information I have collected during the research period. My recommendation will be based upon the belief that MyC4 plans to continue operating exclusively in Africa.

1 The first and most essential factor to succeed with lending to Africa like MyC4 does is to recognize and understand the market they operate. Furthermore this information has to be channeled through the entire organization. MyC4 focused on the investors from the beginning believing that the investors were the biggest challenge to create a successful business model. However Africa is an extremely challenging market as illustrated earlier and to make it work in Africa is undoubtedly first priority.

2 Know what your product is. My field work showed me that several MFI´s didn´t really know what MyC4 is offering. An understanding of the business model is essential when MyC4 has to find good reliable partners especially to avoid principal-agent problems.

3 This leads to the next important factor which is to find good reliable partners. It is essential for MyC4 to work with reliable partners. This is not only important to MyC4 and the investors who expect a return but more important for the borrower so he/she can use the loan effectively. My field work proved that MyC4 is too expensive for good reliable partners. My advice is to adjust the prize so they become attractive to successful partners. The African organizations look at who MyC4 operate with. If they can´t show any good partners it becomes increasingly difficult to attract good partners and as mentioned the poor will treat the MFI after how successful the MFI is.

4 This leads to the importance of patience. MyC4 has to have patience to be successful with their operations in Africa. Scaling to fast in Africa will increase the possibility of unreliable partners. MyC4 is incredible ambitious which is indicated when viewing their mission to be the first company in the world to be owned by the world. Ambitions are good but when operating with poor people in the most difficult region of the world small steps are essential.

5 MyC4 has had serious problems with partners because they did not have any risk policy. Procedures have to be in place to be sure people collect the loans. From PAT's initial accept that no such thing as a complete contract exists, the aim of the theory is to construct an "optimal" contract, which enables the principal to govern the agent´s actions. MyC4 has to build the best contract possible to govern the partner's actions. The first step is to make sure all partners holds a risk.

6 Training is an important part of working with the clients therefore also important that MyC4 place emphasis on training their partners so they understand the MyC4 model. It will decrease the chances of misunderstandings**.** Furthermore emphasis should be put on developing SME screening as these skills are in short supply in Africa and because this is important when addressing the meso segment.

7 I find the Dutch auction model as a weakness even though I know it is an important part of MyC4. This is due to several reasons. The model creates a bias between social investors and venture investors. This can create a Principal –Agent problem due to asymmetric information and different motives of using the model. This reflects back to having a simple model. The more simple the better when operating in Africa. Furthermore it takes longer time to fund bigger loans. The poor entrepreneurs don't always have the luxury of time. MyC4 should consider if they will target the microfinance or mesofinance industry. A combination of the two seems to be a weakness and to complicated. Also illustrated by Growth Africa who stresses concern that they can´t get their loans funded.

8 At last the brand MyC4 has been seriously damaged and it can be hard to regain the trust from the investors. If MyC4 continuous to be based on the principles of eBay it will be very difficult to gain what is lost. Branding is not a problem for eBay but it is and will be a big problem for MyC4. This is due to misunderstandings on why MyC4 don´t emphasize branding and the brand can be portrayed as unserious.

This concludes my recommendations to MyC4. MyC4 has a perfect idea and they have the possibilities to prove the model when operating in Africa. MyC4 has started something good and innovative. It would undoubtedly be a shame if their concept vanishes. Best of luck!

11 Reflections

The purpose of this chapter is to reflect on the period I have worked on the dissertation and if I got the results I expected. I knew from the beginning that the subject of the dissertation had to be interesting and motivating else I would never be finished.

I was and still am very fascinated about MyC4´s innovative concept of online lending services. What I like about it is the way you engage with poor people through business instead of donations since I am of the belief that donations do not have any positive impact in the long run. MyC4 is of the same belief and want to prove it exclusively in Sub-Saharan Africa. It became obvious early on that MyC4 had serious challenges with its business model. This reflected on my research question since I had to explore these challenges and enhance my understanding of the market in which they operate. Lone Søndergaard who worked at MyC4 at the time I started writing was extremely helpful and gave me all the information I needed and took the time for an interview. At some point I had all the secondary date possible and it became obvious that it was not enough in order to answer my research question sufficiently. After a meeting with my supervisor I decided that a field work trip to Kenya was necessary.

The most valuable experience I had during the dissertation process was the field work in Nairobi, Kenya. I was very fortunate that I had a network that could help me make the trip a success. My secondary supervisor has a lot of experience from working in Africa and in this way he could advise me how to approach the different MFI´s. Furthermore he established contact with a Kenyan, Robert, who assisted me during the entire stay. We met almost every morning at 8 o´clock and planned the day and to which MFI´s to talk to. Robert gave me valuable advice how to approach the MFI´s and thereby I experienced that when only having two weeks it was necessary to have an aggressive approach. Thus we approached a number MFI´s without setting up a meeting first. When reflecting on the trip, two weeks was not quite enough since the first week was about convincing the MFI´s of an interview another day. However I got insight to the industry and I got the information I needed in terms of making a valid dissertation. I experienced the difficulties MyC4 has had and collected the interviews I needed in order to provide a strategic oriented paper. I also found that it is possible to work with Africa through online lending services but the business model and appropriate implementation is crucial. Microfinance and online lending is a very new concept in Africa and therefore patience is a key word to make it work.

I hope that this project has clarified the concept of online lending platforms for people interested in the field. I hope that the investors don´t give up on online lending platforms even with the MyC4 problems in perspective. It is learning by doing when operating like MyC4 do in Africa and the improved knowledge MyC4 has gained can build a new scalable business model.

Bibliography

Abbink, K., Irlenbusch, B., Renner, E. (2006). *Interest Rates in Group Lending: Behavioral Investigation*. Pacific Economic Review, Vol. 11, No. 2.

Addison, T., Hulme, D., Kanbur, R. (2009). *Poverty Dynamics, Interdisciplinary Perspectives*. New York: Oxford University Press.

Akerlof, G. A. (1970). *A Market for "Lemons": Quality Uncertainty and the Market Mechanism*. Cambridge: Quarterly Journal of Economics, MIT Press. Retrieved from http://www.jstor.org/pss/1879431.

AMFI (2010). Information retrieved from http://www.amfikenya.com/.

Anderson, C., Locker, L. (2002). *Microcredit, Social Capital and Common Pool Resources*. Seattle, WA, USA: University of Washington.

Armendariz, B., Moduch, J. (2007). *The Economics of Microfinance*. Cambridge: MIT Press.

Arrow, K., Hahn, F. (1971). *General Competitive Analysis*. San Francisco, USA: Holden-Day.

Ashta, A., Assadi, D. (2009). *An Analysis of European Online Micro-lending Websites*. Brussels: Université Libre de Bruxelles. Retrieved from http://www.microfinancegateway.org/gm/document-1.1.4811/13.pdf.

Belfrage, S. (2009). *Jamii Bora: The Shining Star of Africa*. Norge: Mikrofinanshuset. Retrieved from http://www.jamiibora.se/docs/PDF%202%20Final-%20About_Jamii_Bora_Eng_version.pdf.

Biggs, T. (2007). *Is Small Beautiful and Worthy of Subsidy?* Retrieved from http://rru.worldbank.org/documents/paperslinks/tylerspaperonsmes.pdf.

Bornstein, D. (2005). *The Price of a Dream: The Story of the Grameen Bank*. New York: Oxford University Press.

Brown, T. F. (2005). *Theoretical Perspectives on Social Capital*. Retrieved from http://www.beiwang.com/bbs/archiver/showtopic-307.aspx.

Burand, D. (2009). *Microfinance Consider Online Funding: Is It Finance, Marketing, or Something Else Entirely?* Focus Note CGAP. Retrieved from http://www.afminetwork.org/fichiers/ressources/56958.pdf.

Cagna, A. M. C., Santos, F. (2009). *Kiva versus MyC4: Business Model Innovation in Social Lending*. INSEAD The Business School of the World. Retrieved from https://www.myc4.com/Images/Users/29906/KivavsMYC4_INSPECTION%20COPY.pdf.

Chrillesen, C. (2010). *Hi Growth Africa (Johnni)..*. Posted 02.06.2010 on MyC4 Forum: Monthly Update as at 1st June 2010: https://www.myc4.com/Forum/View/20/12043?page=3.

Christoffersen, J., Plenborg, T. (2008). *Investors Afkastkrav på Mikrokredit*. Copenhagen: Copenhagen Business School.

CIA (2010). *The World Factbook*. Retrieved from https://www.cia.gov/library/publications/the-world-factbook/geos/da.html.

Collins, D., Morduch, J., Rutherford, S., Ruthven, O. (2009). *Portfolios of the Poor*. New Jersey: Princeton University Press.

Conning, J. (1999). *Outreach, Sustainability and Leverage in Monitored and Peer-monitored Lending*. Journal of Development Economics No. 60 (1).

Coppoolse, M. (2007). *Microfinance: An Emerging Asset Class for Equity and Debt Investors*. Retrieved from http://www.microfinancegateway.org/gm/document-1.9.29213/Emerging%20Asset%20Class%20for%20Equity%20and%20Debt.pdf.

Counts, A. (2008). *Reimaging Microfinance*. Stanford: Stanford Social Innovation, Leland Stanford Jr. University.

Cull, R., Kunt, A. D., Morduch, J. (2009). *Microfinance Meets the Market*. Journal of Economic Perspectives, American Economic Association, vol. 23 (1).

Daley-Harris, S. (2002). *Pathways out of Poverty: Innovations in Microfinance for the Poorest Families*. West Hartford: Kumarian Press.

Dasgupta, P. (2008). *The New Palgrave Dictionary of Economics*. 2nd edition. USA: Palgrave MacMillan.

Dasgupta, P., Serageldin, I. (2000). *Social Capital: A Multifaceted Perspective*. Washington D.C.: World Bank.

Dichter, T. (2006). *Hype and Hope: The Worrisome State of the Microcredit Movement*. Legal Magazine. Retrieved from http://www.legalcity.net/Index.cfm?fuseaction=MAGAZINE.article&ArticleID=8803808.

Dichter, T. (2007). *What's Wrong With Microfinance?* England: Practical Action Publishing.

Dieckmann, R. (2007). *Microfinance: An Emerging Investment Opportunity*. Germany: Deutsche Bank Research. Retrieved from http://www.db-research.org/PROD/DBR_INTERNET_DE-PROD/PROD0000000000219174.pdf.

Doing Business (2010). *Doing Business in Kenya: Starting a Business*. Doing Business. Retrieved from http://www.doingbusiness.org/exploreeconomies/?economyid=101#StartingBusiness.

Dollar, D., Kraay, A. (2002). *Growth Is Good for the Poor*. Journal of Economic Growth. Development Research Group. Washington DC: World Bank. Retrieved from http://siteresources.worldbank.org/DEC/Resources/22015_Growth_is_Good_for_Poor.pdf.

Dubois, A., Gadde, L.-E. (2002). *Systematic Combining: An Abductive Approach to Case Research*. Journal of Business Research, vol. 55, pp. 553-560.

EAC (2010). *East African Community Portal: About EAC*. Retrieved from http://www.eac.int/about-eac.html.

Eisenhardt, K. M. (1989). *Agency Theory: An Assessment and Review*. The Academy of Management Review, vol. 14 (1), Stanford University.

Equity Bank (2010). *Achievements*. Retrieved from http://www.equitybank.co.ke/about.php?subcat=8.

Faulu (2010). Interview with Mary Munyiri, Vice President from Faulu, provided on field work in Kenya. See appendix 3.

Fernando, N. A. (2006). *Understanding and Dealing with High Interest Rates on Microcredit: A Note to Policy Makers in the Asia and Pacific Region*. ADB Asian Development Bank. Retrieved from http://www.adb.org/Documents/Books/interest-rates-microcredit/Microcredit-Understanding-Dealing.pdf.

Flannery, M. (2007). *Kiva and the Birth of Person-to-Person Microfinance*. Innovations Winter/Spring 2007, vol. 2, no. 1-2, pp.31-56. USA: Tagore LLC. Retrieved from http://www.mitpressjournals.org/doi/abs/10.1162/itgg.2007.2.1-2.31.

Flannery, M. (2009). *Kiva at Four. Innovations Case Narrative: Kiva*. MIT Press Journal, vol. 4, no. 2.

Fuchs, Z. (2006). *Beyond Philanthropy*. Euromoney, vol. 37, issue 449.

Fusion Capital (2010). Interview with James McClean, Business Advisor of Fusion Capital, provided on field work in Kenya. See appendix 3.

Grant, J. (2007). *The Green Marketing Manifesto*. USA: John Wiley & Sons.

Growth Africa (2010a). Interview with Johnni Kjelsgaard, CEO from Growth Africa (MyC4 partner) provided on field work in Kenya. See appendix 3.

Growth Africa (2010b). *Dear Investors & MyC4 Community*… Posted 02.06.2010 on MyC4 Forum: Monthly Update – as at 1st June 2010: https://www.myc4.com/Forum/View/20/12043?page=3.

Hallberg, K. (2000). *A Market Oriented Strategy for Small and Medium Sized Enterprises*. IFC Discussion Paper No. 40. Washington DC: World Bank.

Helmore, K. (2008). *Bringing Financial Services to Africa's Poor*. State of the Sector Report. Retrieved from http://care.ca/ckfinder/userfiles/files/accessafricasosreport.pdf?PHPSESSID=b193a0636066203dfff97f13ad97c762.

Helms, B. (2006). *Access for All: Building Inclusive Financial Systems*. Washington DC: World Bank.

Helms, B., Reille, X. (2004). *Interest Rate Ceilings and Microfinance: The Story So Far*. Washington DC: World bank.

Hirth, L. (2007). *Microfinance in Latin America*. USA: University of Massachusetts at Amherst Department of Economics.

Holland, R. (1998). *Planning Against a Business Failure*. Agricultural Development Centre, ADC Info #24.USA: The University of Tennessee. Retrieved from http://cpa.utk.edu/pdffiles/adc24.pdf.

Hudson, R. (2003). *An In-Depth Quantitative Assessment of the Ugandan Micro-Finance Environment*. Nairobi, Kenya: TMS Financial/Micro Save Africa.

Hulme, M. K. (2006). *Internet based Social Lending: Past, Present and Future*. UK: Social Futures Observatory.

Hulme, D., Arun, T. (2009). *Microfinance: A Reader*. London: Routledge.

IFAD (2009). *Rural Finance: Small Amount Making a Big Difference*. International Fund for Agricultural Development. Retrieved from http://www.ifad.org/events/microcredit/eng.pdf.

IMF (2009). *IMF Country Report No. 09/79*. International Monetary Fund. Retrieved from http://www.imf.org/external/pubs/ft/scr/2009/cr0979.pdf.

Internet World Stats (2009). *Internet Usage and Population Statistics: Africa Internet Usage and Population Statistics*. Retrieved from http://www.internetworldstats.com/stats1.htm.

Jena, F. (2008). *Reflecting on Kenya's Post-Election Crisis*. CGAP Microfinance Gateway. Retrieved from http://www.microfinancegateway.org/p/site/m/template.rc/1.26.9162/.

Jensen, M. C., Meckling, W. H. (1976). *Theory of the Firm: Managerial Behaviour, Agency Costs and ownership Structure*. Journal of Financial Economics, vol. 3, no. 4. USA: Harvard University Press.

Karlan, D. (2001). *Social Capital and Group Banking Processed*. USA: Department of Economics, Massachusetts Institute of Technology.

Karnani, A. (2008). *Employment, Not Microcredit, Is the Solution*. Journal of Corporate Citizenship. USA: Stephen M. Ross School of Business, University of Michigan.

Kaufmann, C. (2005). *Financing SMEs in Africa*. Paris: OECD Development Centre, Policy Insights No. 7, African Economic Outlook 2004/2005. Available at: http://www.oecd.org/dataoecd/57/59/34908457.pdf.

Khandker, S. (1998). *Fighting Poverty with Microcredit: Experience in Bangladesh*. Washington DC: World Bank.

King, N. (2004). Using Interviews in Qualitative Research. In: Cassel, C., Symon, G. *Essential Guide to Qualitative Methods in Organizational Research*, pp. 11-22. London: Sage Publications.

Kiva (2010). Information retrieved from https://www.kiva.org/.

Koch, C. A. (1995). *Economy Transactions: Opportunistic Behaviour and Protective Mechanisms*. Odense, Denmark: University of Southern Denmark, Department of Management.

Lafourcade, A.-L., Isern, J., Mwangi, P., Brown, M. (2005). *Overview of the Outreach and Financial Performance of Microfinance Institutions in Africa*. Washington DC: Microfinance Information Exchange.

Luetkenhorst, W. (2004). *Corporate Social Responsibility and the Development Agenda: The Case for Actively Involving Small and Medium Enterprises*. Berlin: Springer.

Mads Kjær (2010a). *MyC4 in DR P4 Fyn*. Posted 12.02.2010 on MyC4 Forum. Retrieved from https://www.myc4.com/Forum/View/2/10974.

Mads Kjær (2010b). *Ken Watta/Ebony*. Posted 04.05.2010 on MyC4 News page. Retrieved from https://www.myc4.com/About/PRESS/NEWS#11_05_2010.

Mads Kjær (2010c). *The Year That Was – and the Year That Lies Ahead*. MyC4 Newsletter status 2009. Retrieved from https://www.myc4.com/Newsletter/status2009.

Mancini, A. S., Yee, M., Jain, S. (2008). *SME Lending Africa: Challenges, Current Trends, and USAID Initiatives*. USA: USAID and Financial Services Volunteer Corps. Retrieved from http://www.fsvc.org/vertical/Sites/%7B86C49EB7-0DF3-4B6A-96DE-713FA73BFC2F%7D/uploads/%7B6194BD8E-6E3C-4223-876B-653DD935044E%7D.PDF.

Matthäus-Maier, I., von Pischke, J. D. (2006). Micro*finance Investment Funds: Leveraging Private Capital for Economic Growth and Poverty Reduction*. Berlin: Springer.

McCormick, D., Kinyanjui, M. N., Ongile, G. (1997). *Growth and Barriers to Growth Among Nairobi's Small and Medium-sized Garment Producers*. Kenya: University of Nairobi.

McKeown, T. J. (1999). *Case Studies and the Statistical Worldview: Review of King, Keohane, and Verba's "Designing Social Inquiry: Scientific Inference in Qualitative Research"*. USA: Cambridge University Press, The IO Foundation and the Massachusetts Institute of Technology.

Merriam, S. B. (1998). *Qualitative Research and Case Study Applications in Education*. San Francisco: Jossey-Bass Publishers.

Micro Africa (2010). Interview with James Mugambi, Director for Business Development and Strategy from Micro Africa, provided on field work in Kenya. See appendix 3.

MixMarket.Org (2010). Information retrieved from http://www.mixmarket.org/.

Morduch, J. (1999). *The Microfinance Promise*. Journal of Economic Literature, vol. 37, issue 4.

Morduch, J. (2000). *The Microfinance Schism*. New Jersey, USA: Princeton University.

MyC4 Africa (2010). Interview with Pete Ondeng, Director of African Operations from MyC4 Kenya, provided on field work in Kenya. See appendix 3.

MyC4 Annual Report (2010). *MyC4 A/S Annual Report 2009*. Copenhagen: MyC4. Retrieved from https://www.myc4.com/Images/Admin/Download%20Centre/MYC4_Annual%20report%202009.pdf.

MyC4 Denmark (2010a). Interview with Githa Kurdahl, employee of MyC4 Denmark, provided in Copenhagen. See appendix 3.

MyC4 Denmark (2010b). Email interview with Tim Vang, Co-Founder of MyC4 Denmark. See appendix 6.

MyC4.Com (2010). Information retrieved from https://www.myc4.com/.

Newberry, D. (2006). *The Role of Small- and Medium-sized Enterprises in the Futures of Emerging Economies*. Earth Trends World Resources Institute Under a Creative Commons License. Retrieved from http://earthtrends.wri.org/pdf_library/feature/eco_fea_sme.pdf.

Njeri, M. (2010). *Press Release: Equity Bank Targets Women, Youth in Countrywide Financial Training.* Kenya: Equity Bank. Retrieved from http://csr.palsoftweblink.com/?c=117&a=2213.

O'Donoghue, T., Punch, K. (2003). *Qualitative Educational Research in Action: Doing and Reflecting*. London: Routledge Falmer.

Onyando, A. (2010). Email interview with Annabel Onyando, former employee of MyC4 in Kenya. See appendix 7.

Opijnen, M. V. (2008). *"MESO-Financing"*. Kenya: Framework of Round Table Africa. Retrieved from http://www.roundtableafrica.net/media/uploads/File/Meso-financing%20-%202008.pdf

Ovazik, E. (2010). Email interview with Erdem Ovazik, former employee of MyC4 Denmark. See appendix 5.

Petersen, M., Rajan, R. (1994). *The Effect of Credit Market Competition on Lending Relationships*. Quarterly Journal of Economics.

Petersen, T. (1993). *The Economics of Organization: The Principal-Agent Relationship*. London: Sage Publications.

Putnam, R. (1993). *Making Democracy Work: Civic Traditions in Modern Italy*. New Jersey: Princeton University Press.

Putnam, R. (2000). *Bowling Alone: The Collapse and Revival of American Community*. New York: Simon & Schuster.

Reddy, R. (2007). *Microfinance Cracking the Capital Markets*. United States: ACCION International.

Robinson, M. (2001). *The Microfinance Revolution: Sustainable Finance for the Poor*. Washington DC: Open Society Institute, World Bank.

Rutherford, S. (2000). *The Poor and Their Money*. Delhi: Oxford University.

Sanders, T., Wegener, C. (2006). *MESO-Finance: Filling the Financial Service Gap for Small Businesses in Developing Countries*. USA: Position Paper.

Saunders, M., Lewis, P., Thornhill, A. (2007). *Research Methods for Business Students*. 4th edition. England: Pearson Education.

SEAF (2005). *The Development Impact of Small and Medium Enterprises*. Retrieved from http://www.seaf.com/main_report.pdf.

Shandwick, W. (2007). *Safeguarding Reputation*. Survey in partnership with KRC Research. USA: Haymarket Media Inc.

Silverman, D. (2001). *Interpreting Qualitative Data: Methods for Analysing Text and Interaction*. 2nd edition. London: Sage Publications.

Silverman, D. (2005). *Doing Qualitative Research*. 2nd edition. London: Sage Publications.

Smith, P., Thurman, E. (2007). *A Billion Bootstraps*. USA: McGraw-Hill.

Smorfitt, R. (2010). Skype chat interview with Robert Smorfitt, SME expert from South Africa. See appendix 4.

Spence, M., Zeckhauser, R. (1971). *Insurance, Information and Individual Action*. American Economic Review 61 (2), pp. 380-387.

Stake, R. E. (1995). *The Art of Case Study Research*. 1st edition. London: Sage Publications.

Tan, K. (2003). *Enterprise Against Poverty: The Case for Social Venture Capital*. 1st edition. Dr Kim Tan.

The Microfinance Gateway (2008). *Open Up Your Virtual Wallet*. Retrieved from http://www.microfinancegateway.org/p/site/m/template.rc/1.26.9154/.

The World Bank (2008). *Finance for All? Policies and Pitfalls in Expanding Access*. A World Bank Policy Research Report. Washington DC: World Bank. Retrieved from http://siteresources.worldbank.org/INTFINFORALL/Resources/4099583-1194373512632/FFA_book.pdf.

Transparency International (2009). *The Corruption Perceptions Index 2009*. Transparency International. Retrieved from http://www.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table.

UNCDF (2005). *Microfinance and the Millennium Development Goals: A Reader's Guide to the Millennium Project Reports and Other UN Documents*. USA: United Nations Capital Development Fund. Retrieved from http://www.yearofmicrocredit.org/docs/mdgdoc_MN.pdf.

United Nations (2007). *The Millennium Development Goals Report 2007*. New York: United Nations. Retrieved from http://www.un.org/millenniumgoals/pdf/mdg2007.pdf.

USAID (2008). *Person-to-Person Lending. Is Financial Democracy a Click Away?* Micro Report #130. USA: United States Agency for International Development (USAID). Retrieved from http://www.microlinks.org/ev_en.php?ID=27742_201&ID2=DO_TOPIC.

USAID (2009). *Deepening the Microfinance Sector in Malawi: Final Report*. USA: United States Agency for International Development (USAID). Retrieved from http://pdf.usaid.gov/pdf_docs/PDACP483.pdf.

Uzzi, B. (1997). *Social Structure and Competition in Interfirm networks: The Paradox of Embeddedness*. Administrative Science Quarterly, No. 42, pp. 35-67. USA: Cornell University, Johnson Graduate School of Management. Retrieved from http://www.kellogg.northwestern.edu/faculty/uzzi/ftp/social_structure.pdf.

Van Bastelaer, T. (1999). *Imperfect Information, Social Capital and the Poor's Access to Credit*. IRIS Center Working Paper No. 234. USA: Center on Institutional Reform and the Informal Sector (IRIS), University of Maryland.

Versi, A. (2008). *MyC4 – Denmark's Answer to Financing the 'Unfundable'.* African Business. Retrieved from http://www.allbusiness.com/banking-finance/banking-lending-credit-services/8957511-1.html.

Watson, J. (2003). *The Potential Impact of Accessing Advice on SME Failure Rates*. Australia: The University of Western Australia, Department of Accounting and Finance. Retrieved from http://www.cric.com.au/seaanz/resources/10WatsonThepotentialimpactofaccessingadvicefinal.pdf.

Williamson, O. E., Ouchi, W. G. (1981). A Rejoinder. In: Van de Ven, A., Joyce, W. F. *Perspectives on Organizational Design and Behaviour*, pp. 387-390. New York: John Wiley & Sons.

Wiseclerk (2010). *IFU and CSR Capital Invest 2.2M Euro in Africa via MyC4*. Retrieved from http://www.wiseclerk.com/group-news/services-microfinance/myc4-ifu-and-csr-capital-invest-2-2m-euro-in-africa/.

Year of Microcredit (2005). *International Year of Microcredit 2005: Building Inclusive Financial Sectors to Achieve the Millennium Development Goals*. Retrieved from http://www.yearofmicrocredit.org/pages/whyayear/whyayear_learnaboutyear.asp.

Yin, R. K. (2003). *Case Study Research: Design and Methods*. 3rd edition. London: Sage Publications.

Yunus, M. (2007). *Creating a World Without Poverty: Social Business and the Future of Capitalism*. London: Perseus Running.

Zalan, T., Lewis, G. (2004). Writing About Methods in Qualitative Research: Towards a More Transparent Approach. In: Marschan-Piekkari, R., Welch, C. *Handbook of Qualitative Research Methods for International Business*, pp. 507-528. Cheltenham, UK: Edward Elgar.

Ziegler, J., Bassiri, H. (2010). *IFC Launches New Fund to Invest in Smaller Companies in Central Africa*. USA: International Finance Corporation (IFC), World Bank Group. Retrieved from http://www.ifc.org/ifcext/media.nsf/content/SelectedPressRelease?OpenDocument&UNID=A91F8E7C920B7CFE8525771F006326C0.

Figures, tables and pictures

Figure 1: *Abductive Research Method*. Retrieved from Dubois, Gadde (2002). *Systematic Combining: An Abductive Approach to Case Research*. Page 555 in Journal of Business Research, vol. 55, pp. 553-560.

Figure 2: *Principal-Agent Theory.* Retrieved from http://ounceofstrategy.wordpress.com/2009/01/03/topic-agency-theory/.

Figure 3: *"The missing middle"*. Retrieved from Sanders, Wegener (2006). *MESO-Finance: Filling the Financial Service Gap for Small Businesses in Developing Countries*. Page 7. Position Paper.

Figure 4: *MyC4 business model.* Retrieved from MyC4.Com (June, 2010) https://www.myc4.com/About/HOW_DOES_MYC4_WORK.

Figure 5: *SWOT analysis of MyC4*. Own creation.

Picture 1: *Mohammed Yunus.* Retrieved from http://nobelprize.org/nobel_prizes/peace/laureates/2006/yunus-photo.html.

Picture 2: *Entrepreneurs at MyC4 platform who needs funding.* Retrieved from MyC4.Com (March, 2010) https://www.myc4.com/Invest/Loans/Open.

Picture 3: *Map of Kenya and its location*. Retrieved from www.stroudcenter.org/lpn/more/lpkenya.htm through Google Search.

Picture 4: *Founder of Jamii Bora & Senior Information Officer Gabriel Kadidi*. Sent personally from Gabriel Kadidi, Senior Officer for Jamii Bora.

Picture 5: *Kaputei – The first microfinance town in the world*. Retrieved from Jamii Bora (June, 2010) http://www.jamiibora.org/housing.htm.

Picture 6: *Countries where Kiva operates*. Retrieved from Flannery (2009). *Kiva at Four. Innovations Case Narrative: Kiva.* MIT Press Journal, vol. 4, no. 2, p. 5.

Picture 7: *Robert Ndubi and me in Nairobi, Kenya*. Own picture from field work in Kenya.

Table 1: *Structure of the Dissertation*. Own creation.

Table 2: *Loans funded through MyC4 platform*. Retrieved from Wiseclerk.com (June, 2010) http://www.wiseclerk.com/myc4-loans/.

Table 3: *The nine leading MFI´s globally.* Retrieved from Coppoolse (2007). *Microfinance: An Emerging Asset Class for Equity and Debt Investors,* p. 2: http://www.microfinancegateway.org/gm/document-1.9.29213/Emerging%20Asset%20Class%20for%20Equity%20and%20Debt.pdf.

Table 4: *Seven online lending platforms focusing on developing countries*. Retrieved from USAID (June 2008). *Person-to-Person Lending. Is Financial Democracy a Click Away?* Micro Report #130. United States Agency for International Development (USAID), p. 8: http://www.microlinks.org/ev_en.php?ID=27742_201&ID2=DO_TOPIC.

Appendices

Appendix 1 – The UN Millennium Development Goals

Goal 1: Eradicate extreme poverty & hunger

- ***Target 1*** – Halve, between 1990 and 2015, the proportion of people whose income is less than $ 1 a day.
- ***Target 2*** – Achieve full and productive employment and decent work for all, including women and young people.
- ***Target 3*** – Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

Goal 2: Achieve universal primary education

- **Target 1** – Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

Goal 3: Promote gender equality and empower women

- ***Target 1*** – Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015.

Goal 4: Reduce child mortality

- ***Target 1*** – Reduce by two thirds, between 1990 and 2015, the under-five mortality rate.

Goal 5: Improve maternal health

- ***Target 1*** – Reduce by three quarters the maternal mortality ratio.
- ***Target 2*** – Achieve universal access to reproductive health.

Goal 6: Combat HIV/AIDS, Malaria and other diseases

- ***Target 1*** – Have halted by 2015 and begun to reverse the spread of HIV/AIDS.
- ***Target 2*** – Achieve, by 2010, universal access to treatment for HIV/AIDS for all those who need it.
- ***Target 3*** – Have halted by 2015 and begun reverse the incidence of malaria and major diseases.

Goal 7: Ensure environmental sustainability

- ***Target 1*** - Integrate the principles of sustainable development into country policies and programmes and reverse the loss of environmental resources.

- ***Target 2*** - Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss.
- ***Target 3*** - Halve, by 2015, the proportion of the population without sustainable access to safe drinking water and basic sanitation.

Goal 8: Develop a global partnership for development

- ***Target 1*** - Address the special needs of least developed countries, landlocked countries and small island developing states.
- ***Target 2*** - Develop further an open, rule-based, predictable, non-discriminatory trading and financial system.
- ***Target 3*** - Deal comprehensively with developing countries' debt.
- ***Target 4*** - In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries.
- ***Target 5*** - In cooperation with the private sector, make available benefits of new technologies, especially information and communications.

Source: http://www.un.org/millenniumgoals

Appendix 2 - Definitions and explanations

The dissertation is both using the term **microcredit** and **microfinance**. It is very important to highlight the differences between the two. When the dissertation is mentioning **microcredit** it is important to understand that microcredit refers exclusively to small loans. **Microfinance** however is a range of products next to small loans. The other products saving, insurance, health, pensions etc. The company that provides these services is called an **MFI** or **microfinance institution**. They can also be called something else but this is how they are referred to in the dissertation.

Other important concept that needs further explanation is **mesofinance** and **SME** which are used several times. Meso means "middle" and **mesofinance** is an unofficial term that covers the financial needs of **SME´s** or small and medium sized enterprises. An unofficial estimate is that **mesofinance** is between €5,000 and €500,000 and **microfinance** is below €5,000.So when the dissertation is referring to the **mesofinance** industry I refer to small and medium sized enterprises. Another concept that needs further explanation which also has to do with mesofinance is "**The missing middle**". "**The missing middle**" refers to the large amount of **SME**´s in Africa that are without access to financial services. This is why MyC4 aims at assisting this segment with capital. Another aim of MyC4 is to become financial sustainable. Thereby **double bottom line** is important for MyC4 which is financial profit and a positive social impact. When I mention MyC4 and their aim to be **sustainable** I refer to the loan amount or **loan volume** investors have to lend to businesses in Africa. The **Loan volume** has to be more than DKR 100 million before they reach sustainability. An important part of the loan process is the **Dutch auction model** which purpose is to make the loan as favorable for the African business as possible. The more investors are interested in investing in a given project, the more favorable the situation is for the African entrepreneur since if the interest rate is too high it will be out priced by another investor who is willing to charge a lower interest rate. The loan is transferred to a local **partner** in Africa. The dissertation uses several definitions of the partner. **Partner**, **provider**, **agent** or **intermediary** is all the same. Since MyC4 has to use a partner to manage the loan, MyC4 is called an intermediary **P2P** (person to person) model. **P2P** model is also mentioned in the dissertation which refers to a model that lends direct from lender to borrower.

Scalability is also mentioned in the dissertation which implies that the underlying business model offers the potential for economic growth within the company.

To structure my findings I have used a **SWOT**-analysis which is a tool for auditing an organization and its environment. It is the first stage of planning and helps marketers to focus on key issues. **SWOT** stands for strengths, weaknesses, opportunities, and threats. Strengths and weaknesses are internal factors. Opportunities and threats are external factors. Identification of these factors is important because subsequent steps in the process of planning for achievement of the selected objective may be derived from the **SWOTs**.