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*World Development* Vol. 40, No. 3, pp. 643–655, 2012

0305-750X/$ - see front matter

doi:10.1016/j.worlddev.2011.09.009

# Competition Between Microfinance NGOs: Evidence from Kiva

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**Summary.** — This paper investigates empirically the effect of competition between microfinance NGOs seeking subsidized capital from individual social investors. Although NGO behavior in competitive environments is often subject to controversy, there is little formal empirical evidence to illustrate theoretical findings and inform policy. Using data from Kiva, an online peer-to-peer (P2P) microfinance platform, we find that competition has a sizable negative impact on projects' funding speed and that the effect is stronger between close substitutes. This is important because competition for subsidized capital implies organizational pressures similar to those faced when NGOs compete for donations.


*Key words* — Nongovernment Organizations, microfinance, competition, charitable giving, developing countries

## 1. INTRODUCTION

The promise of microfinance is to deliver poverty alleviation while allowing its providers to be financially sustainable, maybe even profitable.[1] However, this popular idea has been questioned. In India, microfinance organizations have been accused of seeking profits at the expense of the poor, and even blamed for the suicides of borrowers in distress (Polgreen & Bajaj, 2010). In fact, empirical evidence suggests that microfinance institutions face a trade-off between profitability and reaching the poorest customers (Cull, Demirguc-Kunt, & Morduch, 2007). Then, subsidies can play an important role to help organizations that seek to serve the poorest (Cull, Demirguc-Kunt, & Morduch, 2009). Subsidies may be explicit, in the form of donor and government grants, or implicit, when microfinance organizations have access to capital at below-market interest rates. In fact, Nongovernment Organizations (NGOs) compete for such implicit subsidies, much like they do for donations. Yet, to our knowledge, the impact of competition on NGOs' fundraising effectiveness has never been studied empirically. This paper examines the role of competition in the case of a novel and growing source of such implicit subsidies: the American NGO Kiva, an online peer-to-peer (P2P) microlending website. Kiva works with microfinance NGOs around the world registered as its "field partners." Field partners select entrepreneurs and post their projects and profiles on Kiva. On Kiva, prospective individual lenders can browse through entrepreneurs' profiles and create a user account (formally becoming a "Kiva lender") to lend and contribute to funding projects. Kiva acts as an intermediary between individual Kiva lenders and the field partners who collect funds on behalf of their entrepreneurs. Figure 1 summarizes the different layers involved in Kiva lending.[2] In the event of repayment, individual Kiva lenders only recover the loan principal and forgo all financial returns. In other words, Kiva lenders are social investors, and Kiva provides its partner organizations with access to capital at zero interest, thanks to individual lenders' altruism.

The growth of P2P microlending (Bishop & Green, 2009) has created a new space for microfinance organizations to compete for access to capital subsidized by the generosity of individuals. This has created a bridge between microfinance practitioners and individuals interested in charitable giving. Given the importance of the debate regarding subsidies in microfinance, it is critical to understand how projects compete on these platforms. This is especially important because the competition between microfinance NGOs for subsidized capital implies that they face pressures similar to those faced by nonprofit organizations that compete for donations. Often, NGOs' behavior in competitive environments generates controversy. For example, in the wake of the 2010 earthquake in Haiti, The Lancet criticized NGOs for "jostling for position" and failing to coordinate humanitarian efforts (The Lancet, 2010). Furthermore, using several case studies, Cooley and Ron (2002) have found that NGOs' fierce competition for funding can distort their incentives in ways sometimes detrimental to their primary missions. Meanwhile, economic theory has shown that intense competition between NGOs for donor funds may lead to inefficiently high spending on fundraising and the diversion of funds away from development projects (Aldashev & Verdier, 2010; Rose-Ackerman, 1982).

In this paper, we investigate the impact of competition between projects posted on Kiva on their ability to raise funds, using a rich data set on 132,495 projects between April 2007 and September 2009. We find that an increase in the number of competing projects is associated with significantly slower funding times, and the effect is stronger between projects that are closer substitutes. This finding has important implications. If fiercer competition for social investors makes subsidies harder to get, the potential trade-off (discussed by Cull *et al.* (2007)) between profitability and serving the poorest implies

* We are grateful to the editor of World Development and five anonymous referees for insightful comments and suggestions. We benefited from the comments of Cynthia Howson, Sang-Hyop Lee, James Roumasset, and seminar participants at the University of Puget Sound and the University of Hawaii at Manoa. We thank Tipan Verella for accessing the API and sharing the data. Final revision accepted: August 8, 2011.


Figure 1. *The Kiva model.*

that NGOs may have to focus on better off borrowers to remain financially viable. Alternatively, NGOs may increase their fundraising efforts to grab a share of the scarce subsidies. Theory suggests this may be associated with a shift of resources away from project implementation and a reduction in project impact (Aldashev & Verdier, 2010). In the case of microfinance, it could lead to fewer resources being devoted to screening entrepreneurs or providing them with additional services such as business training. [3]

Furthermore, we account for the role of the prospective lender side of the market. First, consistent with economic intuition, we find that an increase in the number of registered Kiva lenders helps reduce funding time and relaxes the effect of competition. When competitive pressure is relaxed on the market for subsidized capital, microfinance NGOs may be able to spend fewer resources on ensuring financial survival, and thus focus on their social impact and outreach to the poor. However, conversely, this also implies that in times when the pool of prospective social investors is reduced, competitive pressure increases, holding the number of competing projects constant.

In addition, we examine the impact of two specific events that induced large increases in traffic to the website. In each case, we focus on a subset of the data, starting one month prior to the event and up to one month after the event. We discuss how the difference in content between the two events matters. First, on September 4, 2007, Kiva founders appeared on the Oprah Winfrey Show. We find that the resulting increased publicity was associated with a decrease in funding time. In addition, it led to a reduction in the effect of competition on funding time.

Second, on June 10, 2009, Kiva advertised its first microloans to entrepreneurs based in the United States. The event, which specifically advertised a specific subset of projects, was widely publicized in the media. We find that like Oprah, it helped relax the marginal effect of competition. However, we show that average funding time only improved for loans from North America, while it worsened for those from the rest of the world. Since the latter represented the vast majority of the sample over that period, overall, the event led to an increase in funding time. Thus, these results suggest the effect of media exposure depends on its content.

Although the role of subsidies has been discussed in the microfinance literature, the present paper is the first to examine the impact of competition for subsidies between microfinance organizations. Moreover, despite the vast economic literature on nonprofits, there is little empirical evidence on the effect of competition to illustrate theoretical findings and inform policy. [4] To the best of our knowledge, this paper is the first formal empirical investigation of the impact of competition on NGOs' fundraising success. By shedding light on the effect of competition on Kiva, our paper contributes to understanding the functioning of an increasingly popular source of subsidies to microfinance organizations.

Our results have clear policy implications. First, since P2P development finance makes it easier for registered NGOs to increase their fundraising effort to advertise projects, it may be desirable for platform managers to regulate the entry of new projects.

Second, we provide evidence of the power of media exposure. More specifically, as the case of the US loans event illustrates, advertising can be used to compensate for the initial disadvantage of projects that are inherently harder to sell to donors. However, this also means that advertising a specific type of project to improve its fate may come at the expense of the fundraising effectiveness of other projects, at least temporarily.

The rest of the paper is organized as follows. Section 2 briefly reviews related literature to clarify the analytical framework. Section 3 describes the data and explains our empirical methodology. Section 4 discusses the results and Section 5 concludes.

## 2. COMPETITION BETWEEN NGOs

The issue of NGO entry on the market for donations has been analyzed in theoretical papers. However, to the best of our knowledge, this is the first econometric study on the effect of competition between charitable projects on their fundraising success. Several papers provide related empirical insights on competition between charities. In the case of US medical research charities, Feigenbaum (1987) finds that more competition is associated with more spending on fundraising but less on administration. Castaneda, Garen, and Thornton (2008) find similar results in a larger sample of nonprofits across sectors. Nunnenkamp and Öhler (2010) find similar results for US NGOs, using an index of overlap between NGOs' in foreign countries. The case of Kiva allows us to use a more direct measure of competition, by counting the number of entrants at different points in time.

Our analysis contributes empirical evidence illustrating several important findings in the theoretical literature. Aldashev and Verdier (2010) show that entry of new NGOs on the market for donations decreases the marginal benefit of fundraising. Here, we provide empirical evidence of this negative externality on the Kiva credit market, and its magnitude is large. Aldashev and Verdier's (2010) results suggest this has important implications. In particular, when increased entry triggers fiercer competition for funds, NGOs may shift their use of time more toward fundraising and less toward project implementation. In fact, posting profiles on Kiva can be time