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Journal of Business Ethics, vol. 126, no. 3, pp. 487-512, 2015

Comparing Virtue, Consequentialist, and Deontological Ethics-Based Corporate Social Responsibility: Mitigating Microfinance Risk in Institutional Voids

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Received: 21 March 2012 / Accepted: 4 November 2013 / Published online: 21 November 2013
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Abstract Due to the nature of lending practices and support services offered to the poor in developing countries, portfolio risk is a growing concern for the microfinance industry. Though previous research highlights the importance of risk for microfinance organizations, not much is known about how microfinance organizations can mitigate risks incurred from providing loans to the poor in developing countries. Further, though many microfinance organizations practice corporate social responsibility (CSR) to help create economic and social wealth in developing countries, the impact of such CSR practices remains an underdeveloped area of inquiry. We use a normative ethics lens to develop an ethics-based CSR theory that differentiates between three forms of ethics-based CSR—virtue, consequentialist, and deontological. We argue that while all three forms can help mitigate risk, virtue ethics-based CSR is potentially the most useful form of CSR toward mitigating microfinance portfolio risk. We test our hypotheses using a sample of microfinance organizations from across the world. Our findings suggest that virtue ethics-based CSR is not just an important philosophical paradigm; it can actually help mitigate microfinance portfolio risk when implemented in practice.

Keywords Ethics-based CSR theory · Social entrepreneurship · Stakeholder theory · Institutional theory · Sustainability · Bottom of the pyramid

Introduction

Microfinance is a risky business (Armendáriz and Mor-duch 2000; Fernando 2006, 2008; Mersland and Strom 2010). Risk in the microfinance industry arises for two separate, yet related reasons. Fundamentally, microfinance institutions (MFIs) are organizations that provide “loans, savings, and other basic financial services to the poor” (CGAP 2011). MFIs may also choose to provide non-financial services, such as business training and development consulting, health and educational services, and social services such as the promotion of women’s empowerment to impoverished individuals (Cheston and Kuhn 2002; Karlan and Valdivia 2011). Thus, MFIs incur risk from providing financial, and sometimes non-financial, services to an impoverished segment of the population that lacks financial, knowledge, and social resources (Chakrabarty and Bass 2013a, b). An additional source of risk arises because MFIs (and their borrowers) operate in countries that are economically undeveloped and often unstable. These countries are rife with “institutional voids,” i.e., lacking in effective regulatory institutions and hard and soft infrastructure. Additionally, these countries have inefficient political systems and economic markets (Khanna et al. 2005; Mair et al. 2012). These ineffective institutional systems create “voids” that make creating and supporting business in these contexts more difficult.

Risk, for MFIs, is therefore a part of reality. Their borrowers and the institutional voids in which they operate are risky. A question that has plagued microfinance, then, is how MFIs should mitigate risk. Neither the context nor the borrowers served by MFIs will change. Therefore, the MFI itself is responsible for mitigating the risk it faces from borrowers in institutional voids (Chakrabarty and Bass 2013a, b). We turn to ethics and corporate social

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responsibility (CSR) as a possible mechanism for MFIs in mitigating risk. Ethics describe the moral principles and values of an organization that guide the organization's actions as it interacts within individuals, regulatory agencies, and society as a whole (Borgerson and Schroeder 2008; Jones et al. 2005; Solomon 1991). One branch of ethics, normative ethics, specifically examines how ethics are practiced, or ethics in action (Kagan 1998). Thus, ethics can help guide organizational activities (Michalos 1995), such as ethical treatment of employees and customers, which can help organizations mitigate risk (Canales 2010; Francis and Armstrong 2003). Similarly, CSR can help organizations focus on socially responsible corporate activities and shape the role of the organization in the society in which it operates (Matten and Moon 2008). We suggest examination of the ethical underpinnings of CSR to investigate whether different forms of normative ethics drive different actions that can help mitigate risk in MFIs.

We develop an *ethics-based CSR theory* to suggest that three forms of normative ethics are instrumental in understanding CSR—virtue, consequentialist, and deontological. First, *virtue ethics* suggests that the moral character of an entity is the driving force for ethical behavior (Koehn 1995, 1998; Moore 2005; Murphy 1999; Whetstone 2001). CSR based on virtue ethics emphasizes the moral character of the organization as a guiding force for action. In this form of CSR, the virtues and moral standing of the MFI are reflected in the CSR practices employed. Second, *consequentialist ethics* emphasizes the outcomes of actions (Gandz and Hayes 1988; Kujala and Pietiläinen 2004). CSR based on consequentialist ethics characterizes CSR practices focused on the costs and benefits of the outcome, rather than the costs and benefits of the original action. MFIs that adopt consequentialist CSR practices provide financial and non-financial resources in a manner that maximizes social value for society as a whole (Somerville and Wood 2012). Third, *deontological ethics* describe ethical actions driven by duties or rules (Koehn 1995; Rawwas et al. 2005). CSR based on deontological ethics characterizes CSR practices focused on fulfilling responsibilities or duties to employees, customers, community, and society (Somerville and Wood 2012). MFIs that adopt deontological CSR practices do so not because it is reflective of the moral character of the MFI or because of the costs and benefits of the outcome. Rather, it is because they believe that they are responsible for providing financial and non-financial resources to the poor as per the rules, regulations, laws, or norms prevalent in their institutional environment.

Given the three normative ethics-based approaches to CSR, we specifically ask: *Can these forms of ethics-based CSR help mitigate the risk of the MFIs?* Subsequently, we ask: *Do these forms of ethics-based CSR impact risk*

differently, and if so, which form of ethics-based CSR has the greatest impact on mitigating the risk of MFIs?

All three types of ethics-based CSR can incite actions that are reflective of ethical management of the organization itself and also ethical treatment of the staff and borrowers. Such ethical behavior can mitigate the risks that the MFI is vulnerable to in institutional voids. Nonetheless, comparing the three types of ethics-based CSR, we suggest that MFIs that adopt virtue ethics-based CSR may be most successful in mitigating portfolio risk. With virtue ethics-based CSR, the character of the organization is reflected in its cultures and values. Further, the organization emphasizes the importance of virtuous behaviors as evidenced in the training it offers to employees. Virtue ethics-based CSR can, therefore, encourage behaviors that can mitigate risk to the greatest extent.

Theory and Hypotheses

Institutional Voids

Institutional voids exist in contexts in which “institutional arrangement[s] that support markets are either absent or weak” (Mair and Marti 2009, p. 41). Institutional voids in developing countries may arise from “the absence of specialized intermediaries, regulatory systems, and contract-enforcing mechanisms” (Khanna et al. 2005, p. 63). These voids contribute to socio-economic issues that create difficulties for firms operating in these markets, and even threaten organizational viability (Hillman and Keim 2001; Strand 1983). Institutional voids in developing countries may include voids in the political and social system (Hajer 2003), labor markets (Khanna and Palepu 1997; Miller et al. 2009), and product markets (Khanna and Rivkin 2001). Furthermore, voids in the financial markets of developing countries prevent impoverished individuals from accessing financial markets.

The Microfinance Industry

The microfinance industry surfaced because of the inability of traditional financial systems to reach impoverished individuals in institutional voids (Mair and Marti 2006; Mair and Marti 2009). As noted above, MFIs provide small loans to low-income borrowers, as well as other financial services, such as savings or insurance (CGAP 2011). Yet, many impoverished borrowers lack access to various necessities, apart from money. For instance, these individuals may lack education and training to help themselves out of poverty. Thus, the industry has since grown to provide non-financial services in addition to financial services to the aspirational poor. Business training and

development consulting services are designed to encourage the start-up of small-businesses or microenterprises, characterized by “few employees, few assets, and informal operations” (Gudz 1999, p. 1). MFIs can also increase access to health and educational services and encourage the promotion of women’s empowerment (Cheston and Kuhn 2002; Kim et al. 2007). In sum, MFIs seek both social and wealth value creation (Mair and Marti 2006; Seelos and Mair 2005); however, providing borrowers in developing countries with financial, and sometimes non-financial, resources, also creates risk for the MFI.

Risk in the Microfinance Industry

In general, risk includes “the potential for events or ongoing trends to cause future losses or declines in future income of an MFI or deviate from the original social mission of an MFI” (Fernando 2008, p. 3). Risk arises from both the borrowers that are served and the contexts in which the MFI operates, and is often reflected in the loan portfolio of the MFI (Rosenberg 2009). More specific information on risks arising from the two sources—borrowers and context—is provided below.

Risk Arising from Borrowers

The microfinance industry is unique in comparison to other financial industries in developed and developing countries in the way in which lending is conducted. Risks arising from borrowers are specific to the lending process of MFIs. Risk stems from the type of lending employed by the MFI, the lack of financial information available about borrowers, the dual focus on social and economic wealth creation, and demographic characteristics of borrowers (Chakrabarty and Bass 2013a, b).

The type of lending employed by MFIs includes individual and group lending. Individual lending provides loans that are “specifically tailored to the individual and business involved” (Crabb and Keller 2006, p. 26). Individual lending is often characterized by a series of transactions between the individual and the MFI over time (Armendáriz and Morduch 2000). Group lending organizes individual borrowers in groups that are liable for each other’s financial repayment and responsibility (Lehner 2009). Group lending arose to mitigate some risk associated with repayment (Crabb and Keller 2006; Morduch 1999). The objective of group lending is that individual borrowers within the group are more likely to repay loans because social norms and pressure from the group to repay the loan exists. Thus, an MFI that employs individual lending may incur more risk than an MFI that employs group lending, or a mix of both individual and group lending.

MFIs face risk arising from the lack of financial information about the borrowers they serve. Impoverished borrowers often do not have credit scores, have deficient collateral, have sparse or inexistent financial histories (Morduch and Haley 2002), and may also lack formal training and education (Karlan and Valdivia 2011). Thus, MFIs are exposed to credit risk stemming from unsecured lending to individuals with sparse or inexistent financial histories. For example, when considering lending to borrowers, MFIs do so without typical instruments such as financial histories and credit scores used by other financial organizations to mitigate risk associated with a borrower borrowing too much or missing loan repayments.

MFIs operate with a dual focus on creating social and economic wealth in the communities in which they operate. MFIs improve incomes by providing a means to encourage entrepreneurship, strengthen human capital, and strengthen technological development. MFIs do this by providing educational and training services to the aspiring poor, and lowering the economic and social vulnerability of these communities in the process. MFIs that target impoverished individuals do so with a social agenda that is more prominent than MFIs that do not practice lending targeting, or target broad- or high-end borrowers and businesses instead. MFIs that do not clearly define their target market and ensure that the services provided to the target clientele contribute to social and economic wealth incur social mission risk (Churchill and Coster 2001). For example, an MFI that simply operates to provide financial services to anyone, rather than specifically to impoverished borrowers or aspiring entrepreneurs, makes vulnerable its social mission of aiding impoverished individuals out of poverty (Morduch 2000).

In addition to social mission risk, targeting impoverished clientele also increases the risks incurred by MFIs associated with demographics. Demographics of this group of impoverished individuals, such as increased occurrence of early death and disease, low education levels, and little entrepreneurial experience create vulnerabilities for MFIs (Churchill and Coster 2001). Additionally, social norms guiding the communities of impoverished borrowers, such as tolerance for corruption or social cohesiveness, can also increase the risks incurred by MFIs. For example, an MFI operating in a community that has a higher tolerance for corruption is more vulnerable to risk than an MFI operating in a community with a lower tolerance for corruption because the loan collectors working for the MFI may be more corrupt in their loan repayment practices and steal from clients and the MFI (Canales 2010).

Risk Arising from Context

Serving impoverished borrowers in institutional voids in developing countries is the ideal context for MFIs. MFIs

tend to focus on the “long-ignored lower classes” or the “aspirational poor—people earning less than \$2 a day who make up three-quarters of the world’s population” and who seek access to financial and related resources in order to improve their work and living standards (Time 2005). These individuals live in developing countries, which are often low-income countries with relatively weak human capital and technological development, and high economic vulnerability (Cuervo-Cazurra and Genc 2008). Contextual factors, such as the proliferation of fraud and theft, interest rates and inflation, the threat of natural disasters paired with weak infrastructure, and problems with regulations, contribute to risk in MFIs.

MFIs face contextual risk arising from fraud and theft. Like other financial organizations, MFIs experience risk resulting from handling large volumes of money and because the money handled changes hands from the borrower to the loan collector to the staff at the MFI. MFIs are more vulnerable to fraud than other financial organizations, however, because they operate in poor economic environments where fraud tends to occur more frequently (Churchill and Coster 2001). Fraudulent activity increases when the MFI has poor information systems, ineffective or ill-defined policies and procedures, has high levels of turnover, or grows quickly (Churchill and Coster 2001). Like fraud, theft tends to be higher in environments in which crime is prevalent because regulation and enforcement is either weak or inefficient. MFIs operating in contexts in which fraud and theft are prevalent incur more risk than those operating in less crime-ridden contexts. As an example, in a context in which theft is prevalent, the MFI may be exposed to greater risk associated with staff, including loan collectors and others, stealing from the MFI.

An additional risk faced by MFIs that arises from context is related to interest rates. MFIs need high enough interest rates to cover high operational costs (Churchill and Coster 2001; Morduch 2000). Interest rates can also affect MFIs’ interest earnings and interest payments, influencing the MFIs’ profit margins. Developing countries tend to be more inflationary, and as such, these risks are increased for MFIs operating in these environments. If an MFI is operating in an inflationary context, it may have difficulty setting and securing interest rates that are appropriate to ensure that it covers costs and operates viably.

MFIs, like other organizations, face risks associated with natural disasters such as floods or drought—the effects of which are often exacerbated in impoverished regions. Natural disasters affect normal business operations for MFIs, such as the ability to serve borrowers or creating disruptions in income for the MFIs. However, for MFIs operating in developing countries, natural disasters carry even more of a risk because hard infrastructure in these countries tends to be less developed than other

countries (Chakrabarty and Bass 2013a, b). Thus, when natural disasters affect communication and transportation infrastructure, it may be more difficult and time-consuming to recover from these interruptions in business operations (Churchill and Coster 2001). For example, if a natural disaster, such as a flood, occurs in a context in which an MFI operates, the borrowers of the MFIs, especially if they are entrepreneurs, may also incur devastation from the flood and may no longer be able to make regular loan payments because their store or supplies were ruined from the flood. Further, recovery from the natural disasters will likely take more time than it typically should in regions rife with institutional voids.

MFIs also face risk from the regulatory bodies in the contexts in which they operate. Regulations such as “restrictive labor laws, usury laws, contract enforcement policies, and political interference” (Churchill and Coster 2001, p. 10) can make serving borrowers and operating as a viable business more difficult for MFIs. Further, existing regulations can be inefficient. Thus, certain regulations could potentially benefit MFIs; however, because the context is plagued with institutional voids, enforcement of these regulations may be lacking (Khanna and Rivkin 2001).

Literature Review: CSR and the Microfinance Industry

Though CSR is a widely researched topic (Carroll 1991; McWilliams and Siegel 2001; Moon et al. 2005), a universal definition and understanding of the concept remain elusive. CSR is an “essentially contested concept” that is “appraisive” and “internally complex”, with an “open” application of rules (Moon et al. 2005, pp. 433–434). Foundationally, however, CSR can be examined as an “idea that it reflects both the social imperatives and the social consequences of business success, and that responsibility accordingly falls upon the corporation, but the precise manifestation and direction of the responsibility lies at the discretion of the corporation” (Matten and Moon 2008, p. 405). From this interpretation of CSR, then, organizations can adopt both explicit CSR practices, or “corporate activities that assume responsibility for the interests of society” or implicit CSR practices, defined as the “corporations’ role within the wider formal and informal institutions for society’s interests and concerns” (Matten and Moon 2008, p. 410).

CSR in Developing Countries

CSR can be viewed as the economic, legal, and ethical responsibilities of organizations around the world (Carroll 1991). Scholars have called for greater research on the ethical dimension of CSR, or how the moral principles and

values of an organization can guide the organization's behavior as it interacts within individuals, regulatory agencies, and society as a whole (Borgerson and Schroeder 2008; Jones et al. 2005; Solomon 1991). There is a need for greater understanding of the application of ethics by organizations (through corporate activities that assume social responsibility) and the organization's wider role (in addressing society's interests and concerns) in developing countries.

CSR can potentially be viewed from an ethics-based lens to better understand CSR in developing countries. For example, research has examined the role of ethics in guiding decisions about equality, justice, rights and duties, integrity, and responsibility in developing countries (Falkenberg 2004). Further, research has examined the role of business ethics in the adoption and dissemination of strategies to alleviate poverty (Singer 2006). For instance, one strategy that MFIs employ to help reduce poverty in developing countries is to promote entrepreneurship (Chakrabarty and Bass 2013a, b; Karlan and Valdivia 2011). If clients of MFIs can become successful entrepreneurs, they can create steady incomes and help themselves out of poverty.

CSR and MFIs

CSR guides MFIs to act in socially responsible ways toward stakeholders ranging from customers to communities (Moon et al. 2005; Sison 2009; Sison and Fontrodona 2011). CSR by MFIs comprises various practices that usually include “the commitment of business to contribute to sustainable economic development, working with employees, their families and the local communities” (WBCSD 2001). We provide some examples of formally stated CSR policies of MFIs in Table 1. These policies are voluntarily supplied to the Microfinance Information Exchange (MIX) by the MFIs. Such CSR policies indicate the intent of MFIs to practice social responsibility (MIX Market 2010). MFIs' CSR policies may be a proxy for proactive management and operations to serve impoverished borrowers in socially responsible ways. This in turn could lead borrowers to respond positively to MFIs' socially responsible reputations and social welfare created within the community.

The sample included in Table 1 provides a variety of MFIs from across the world and demonstrates the pervasiveness of the intent of CSR regardless of location, size of portfolio or number of borrowers served, the types of financial and/or non-financial services the MFI provides, the MFI's legal status, or whether the MFI is or is not regulated. Based on our sampling of CSR statements of MFIs as provided by MIX, we find CSR to be a voluntary commitment assumed by the MFI, that the intent of the

MFI's CSR practices are reflected in CSR policies, and that CSR can be instrumental in guiding ethical and socially responsible action (MIX Market 2010).

Because of the institutional voids in which they operate and the borrowers they serve, MFIs must operate with some level of social responsibility. However, MFIs must attend to their social responsibility without neglecting their economic responsibility (Morduch 1999). Though all MFIs attend to social and economic responsibility, they do so to varying degrees (Tchakoute-Tchuigoua 2010). Thus, some MFIs are more socially responsible than others, and some MFIs are more explicit about CSR policies than others (as depicted in Table 1 and the MFIs' publishing of formal CSR policies). We seek to better understand how the ethical underpinnings of CSR in MFIs can influence problems associated with lending to the poor in desperate contexts, specifically in mitigating risk.

This study employs the perspective that ethics can be applied to understand the moral character of an entity (such as an MFI). We expand on literature that discusses differences between collective and individual moral characters (Gomperz 1939; Katz 1977; Takala and Pallab 2000). For organizations such as MFIs, the collective moral character is derived from the “collective unity composed of multiple conscious and willing individuals who independently strategize, organize and implement its actions” (Takala and Pallab 2000, p. 112). The moral character of the firm is more than the sum of the moral characters of individuals within the firm—it is a property of the firm itself (Katz 1977; Sims and Brinkmann 2003). Thus, although we believe that the moral character of individuals that are members of the entity may be both useful and important, we focus on the ethics, and subsequent CSR, of the MFI. Our main reason for focusing on the ethics of the entity, rather than individual members of the entity, is because our outcome is at the entity-, rather than individual-level. The scope of this study is on the business ethics that underpin organizational CSR, rather than how the ethics of individuals within organizations contribute to business ethics and organizational CSR.

Extending the Literature: Theory of Ethics-Based CSR

The literature on CSR in MFIs is relatively narrow; however, we believe CSR to be an integral part of the microfinance industry, and a potential way for MFIs to mitigate portfolio risk. The lack of literature on CSR in MFIs provides the impetus to better understand how CSR is manifested in MFIs. An ethics-based perspective of CSR enables us to view how the moral principles and values of an MFI guide the MFI's actions, which can subsequently influence the risk incurred by the MFI.

Table 1 CSR in microfinance: examples of CSR statements of MFIs operating in developing countries

| Organization | Characteristics† | Mission‡ | Corporate social responsibility statement |
|-----------------------|--|--|--|
| AgroCredit | Country Georgia Gross loan portfolio USD, 2010 277,104 Number of active borrowers, 2010 61 Products and services Loans Current legal status NBFI Regulated Yes | “To be a leading microfinance company in Georgia in terms of operating efficiency and meeting social objectives” | “We focus on the economic sustainability and the impact of the projects we finance and not on the collateral. We do not fund businesses whose primary operation involves: gambling, production of tobacco and alcohol, environmentally unfriendly activities.”† |
| Akiba Commercial Bank | Country Tanzania Gross loan portfolio USD, 2010 29,918,758 Number of active borrowers, 2010 18,973 Products and services Full-scale financial services Bank Current legal status Bank Regulated Yes | “To provide appropriate financial services to micro, small, and medium enterprises in the most efficient and sustainable manner, always embracing environmental and social interest of all our stakeholders” | “Being a responsible, caring and compassionate corporate entity, Akiba Commercial Bank is committed to carrying out corporate social responsibility activities and practices. This is to create value as well as ensure sustainable development for the bank and the communities or environment within which we operate. In this regard, in 2009 the bank developed a social responsibility policy to define the scope of its activities that will give great impact and more mileage to the Bank’s image and reputation. In an attempt to contribute to the community, ACB in coordination with the Micro Insurance Agency and African Life embedded Credit Life Insurance cover for our clients as part of CSR practice. The bank also gave a donation of 50 school desks to provide comfortable seating to 150 pupils of Mbagala Kuu Primary School which was a victim of the accidental bomb explosions tragedy that occurred in Dar es Salaam. In addition, the bank contributed TZS. 3 million to Nyerere Fund project which was geared toward supporting female students with special talent in Mathematics. In line with this contribution, we donated TZS. 1 million to Somesha Mitoto wa Kike Project—SOMKI which advocates and promotes education for girls.”†† |
| Bank Danamon | Country Indonesia | “Danamon aims to become ‘The Leading Financial Institution in Indonesia’ with a significant market presence. A Customer Centric Organization which covers all customer segments, each with a unique value proposition, centered on Sales and Service Excellence supported by World Class Technology. We aspire to be the Employer Of Choice and to be respected by our Customers, Employees, Shareholders, Regulators, and the Community.” | “Peduli means ‘to care’ and is taken from Bank Danamon’s vision, ‘We care and enable millions to prosper’. Danamon Peduli’s overriding ambition is to be a professional and transparent foundation creating meaningful benefits for society. The foundation’s objective is to establish a portfolio of effective and action-oriented programs, and to achieve this, Danamon Peduli has been incorporating some of the best organizational frameworks and models from the international non-profit arena. With proven models as guidelines, Danamon Peduli is forming and launching its programs to achieve tangible and sustainable social impact.”†† |

Table 1 continued

| Organization | Characteristics† | Mission† | Corporate social responsibility statement |
|----------------|----------------------------------|---|---|
| Centenary Bank | Gross loan portfolio USD, 2010 | Not reported | |
| | Number of active borrowers, 2010 | Not reported | |
| | Products and services | Loans, voluntary savings | |
| | Current legal status | Bank | |
| | Regulated | Yes | |
| | Country | Uganda | |
| | Gross loan portfolio USD, 2010 | 173,350,541 | |
| | Number of active borrowers, 2010 | 109,421 | |
| | Products and services | Loans, voluntary savings, fund transfer services | |
| | Current legal status | Bank | |
| K-Rep bank | Regulated | Yes | |
| | Country | Kenya | |
| | Gross loan portfolio USD, 2010 | 74,182,292 | |
| | Number of active borrowers, 2010 | 65,073 | |
| | Products and services | Loans, voluntary savings, insurance, fund transfer services | |
| | Current legal status | Bank | |
| | Regulated | Yes | |
| | Country | Kenya | |
| | Gross loan portfolio USD, 2010 | 74,182,292 | |
| | Number of active borrowers, 2010 | 65,073 | |

“Centenary Bank, as a responsible and caring Bank supported many social causes in 2008 as a way of giving back to the community in which we operate. We donated to hospitals, schools, sports, the destitute and church-related development activities. The Bank focused on achieving strong sustainable financial returns to enable it realize its mission and vision, while promoting a more decent, dignified, and kinder society. Centenary Bank considers employment of its staff as one of the core aspects of its CSR. During the year 2008, the Bank employed 1,255 staff and invested heavily in its staff training and welfare.”††

“To provide appropriate financial services especially Microfinance to all people of Uganda especially in rural areas in a sustainable manner and in accordance with the law”

“The bank’s core business “microfinance” is rooted on corporate social responsibility goals, “Supporting low-income & poor entrepreneurs and households to improve their standards of living.” This notwithstanding, the bank continues to expand its CSR activities, especially among the poor communities that it operates in. The bank has deliberately focused on CSR activities that have low public relation visibility but immense impact on the community.”†††

“The mission of K-Rep Bank is to provide banking and microfinance services to low-income people on a commercially viable basis”

Table 1 continued

| Organization | Characteristics† | Mission‡ | Corporate social responsibility statement |
|--|---|--|--|
| KWFT | <p>Country Kenya</p> <p>Gross loan portfolio USD, 2010 152,136,208</p> <p>Number of active borrowers, 2010 413,040</p> <p>Products and services Loans, non-financial services</p> <p>Current legal status NBFII</p> <p>Regulated Yes</p> | <p>“To advance and promote the direct access of economically active women entrepreneurs to sustainable financial and non-financial services in order to enable them to improve their economic, social, and political status and that of their families.”</p> | <p>“Corporate Social Responsibility (CSR) is the commitment by an institution/business to behave ethically, and be mindful of the communities where operations are conducted. CSR is the approach that an institution/business adopts to ensure that all interventions have positive impact on society. KWFT believes in the overall empowerment of women and their families.”††</p> |
| Reliance Financial Services Company Ltd. | <p>Country Gambia</p> <p>Gross loan portfolio USD, 2010 3,111,390</p> <p>Number of active borrowers, 2010 1,850</p> <p>Products and services Full-scale financial services, second-tier lending to MFIs, business development services</p> <p>Current legal status NBFII</p> <p>Regulated Yes</p> | <p>“To deliver innovative, value-added products and unrivaled services to our customers using state of the art technology in an environment conducive to promoting strong organizational culture and values which enable us to attract, nurture, and retain talented staff. We will uphold the principles of good corporate governance and implement effective risk management systems with a firm commitment to delivering sustainable and competitive returns to our shareholders while changing lives in the communities we serve. Values—The manner in which we conduct our business with our customers, regulators, and other stakeholders will be governed by our corporate values namely: Creativity, Approachability, Reliability, Professionalism, Ethics, and Teamwork.”</p> | <p>“In every community, there is work to be done. For us we are more than just a financial services provider. We are a community partner focused on the socio-economic development of the neighborhoods we operate in. We help where we can as we firmly believe that the communities we serve—and the people and micro entrepreneurs that breathe life into them—should prosper. In 2008 we contributed over GMD0.3 million in support of worthy causes ranging from education, sports, science, cultural groups, and other civil society organizations.”††</p> |

Table 1 continued

| Organization | Characteristics† | Mission‡ | Corporate social responsibility statement |
|---------------------------------|---|--|---|
| SANASA Development Bank Limited | <p>Country Sri Lanka</p> <p>Gross loan portfolio USD, 2010 114,314,025</p> <p>Number of active borrowers, 2010 202,803</p> <p>Products and services Loans, voluntary savings, leasing, fund transfer services</p> <p>Current legal status NBF1</p> <p>Regulated Yes</p> | <p>“SDBL will develop and maintain a permanent customer base and delight our customers by providing high-quality, innovative, and competitive financial products and services to ensure the highest return possible in the market on shareholders’ capital.</p> <p>Specialized products/services will be provided to our special customers such as the Sanasa movement, the cooperative sector as well as CBOs and NGOs.</p> <p>We will do so by expanding our existing outreach through the available network and use of modern technology in the banking sector.</p> <p>To our credit, we shall develop and maintain a highly competent, motivated team of employees committed to the achievement of excellence in service, leading to the realization of our main goals of ensuring the financial viability of the Bank and national development.”</p> | <p>“To us, Corporate Social Responsibility is all about sustainable development. Not simply philanthropy, but a holistic development that will uplift the nation as a whole. It is important that organizations like ours are able to not only economically uplift communities, but ensure that communities are made sustainable and responsible for their actions socially as well as environmentally. Our projects, while being built on a platform of economic empowerment, have an underlying theme of addressing social issues, instilling values and pride in the country’s heritage and history, as well as making communities aware of environment impacts and what they can do to reduce these impacts.”††</p> |
| Tamweelcom | <p>Country gross loan portfolio USD, 2010 Jordan 19,010,707</p> <p>Number of active borrowers, 2010 57,102</p> <p>Products and services Loans, insurance, training and consulting</p> <p>Current legal status NBF1</p> <p>Regulated No</p> | <p>“1. Provide wide range of credit products to Microentrepreneurs and SME’s, aiming to help them enhance their businesses.</p> <p>2. Provide Credit services to clients who are viable operationally, but lack cash to further expand their operations.</p> <p>3. Help non-bankable clients, or clients who lack collateral to get enough operational cash, based on their cash flow and characteristic analysis.</p> <p>4. Indirect cause of reducing unemployment rate in Jordan, by credit business opportunities.</p> <p>5. Business Linkage Service to help clients link to others (whether clients or none clients) and create potential sources of raw materials (inputs) or direct market.</p> <p>6. Marketing Gateway Services’ to provide clients with the opportunity to sell their products within a wide reach through the permanent showroom and annual bazaars.”</p> | <p>“Leading the micro and small-sized enterprises industry in the Arab world by providing the best financial and non-financial services and entrenching sustainable values of creativity and development, as well as adopting the best practices and international standards by encouraging and raising the efficiency of a qualified staff that believes in the company’s mission.”†††</p> |

Compiled from sources obtained from mixmarket.org: † - MIX datasheet, †† - organization’s financial report, ††† - organization’s website (MIX Market 2010) NBF1 non-banking financial institution

Ethics-Based CSR Theory: Integrating Normative Ethics and CSR

We use a normative ethics lens to better understand the ethical underpinnings of CSR (Jones et al. 2005). Normative ethics describes ethics in action (Kagan 1998) and can be used to better understand applied problems, such as how ethics can help organizations to act and solve issues (Hosmer 1994). Within the philosophical lens of normative ethics, three separate forms of ethics are described—virtue, consequentialist, and deontological. In this study, we focus on these three forms and extend them to develop an *ethics-based CSR theory* to understand the ethical themes that underlie CSR.

Virtue ethics emphasizes the character of a moral agent as a driving force for ethical behavior (Koehn 1995, 1998; Moore 2005; Murphy 1999; Whetstone 2001). Thus, ethical actions of the organization (or individuals acting as part or on behalf of the organization), using virtue ethics, should be a reflection of the moral character of the organization. As an underpinning to CSR, virtue ethics should provide organizations with guidance for practices based on virtue in which the internal moral character is emphasized. Within virtuous organizations, CSR policies are viewed with the ethical intent of the organization to proactively practice CSR in socially responsible ways (MIX Market 2010).

Consequentialist, or utilitarian, ethics emphasizes the utilitarian outcomes of actions (Gandz and Hayes 1988; Kujala and Pietiläinen 2004). That is, actions are deemed ethical if the outcome is viewed as beneficial. As related to CSR, consequentialist ethics might focus CSR practices on the costs and benefits of the outcome, rather than the costs and benefits of action itself. A CSR policy to guide ethical action based on consequentialist ethics focuses on outcomes of organizational action, rather than a reflection of good moral character or high standards. For example, an organization that employs consequentialist ethics-based CSR focuses on policies and procedures that have desirable results for not only the organization and its employees, but also the clients and communities the organization serves. Unlike virtue ethics-based CSR that is a reflection of moral character, consequentialist ethics-based CSR is driven by outcomes.

Deontological ethics emphasizes ethical actions driven by adherence to institutional rules, regulations, laws, and norms (Koehn 1995; Rawwas et al. 2005). Thus, socially accepted norms help dictate and guide appropriate ethical actions in individuals and organizations. As related to CSR, deontological ethics provide guidance to ethical behavior of organizations based on institutional, legal, and social standards of acceptable behavior. Deontological ethics-based CSR invokes practices focused on the

responsibilities or duties to employees, customers, community, and society as a whole, rather than the moral character of, or outcomes desired by, the organization. Thus, a CSR policy that is reflective of the intent of the organization to act in socially responsible ways emphasizes institutional, legal, and social guidelines to guide ethical behavior within the organization and in its relationships with clients, the community, and the environment. We summarize our discussion of virtue, consequentialist, and deontological ethics and their respective underpinnings to CSR in MFIs in Table 2.

A review of the literature examining virtue, consequentialist, and deontological ethics suggests that consequentialist and deontological approaches to CSR provide boundaries within which firms act. These two forms dictate appropriate and inappropriate behaviors for the firm. CSR based on consequentialist or deontological ethics serves as a means that allows firms to act in socially responsible ways that are in line with the firm's morals and principles. In contrast, virtue ethics-based CSR incites firms to act in socially responsible ways as a reflection of the firm's internal virtues and moral standing. Rather than providing boundaries of appropriate and inappropriate firm behaviors, CSR based on virtue ethics provides a set of internal organizational qualities that inspires the organization "to pursue excellence through virtuous acts" (Arjoon 2000, p. 162) to work toward the common good of society, while taking into account the economic outcomes of such actions.

To operationalize and test the ethics-based CSR theory, we examine the impact of each of the three forms of CSR on the portfolio risk of MFIs. We define virtue ethics-based CSR (abbreviated as *virtue CSR*) as CSR employed by MFIs to reflect the virtues and moral character of the MFI. Further, this form of CSR should emphasize the inherently benevolent nature of the MFI. We define consequentialist ethics-based CSR (abbreviated as *consequentialist CSR*) as CSR practices employed to address the consequences, and specifically the well-being, of providing financial and non-financial services to the poor. We define deontological ethics-based CSR (abbreviated as *deontological CSR*) as CSR practices employed due to the duties or responsibilities MFIs feel to the community and society. We define portfolio risk of MFIs as the value of all loans outstanding with one or more installments of principal past due (MIX Market 2010).

Consequentialist and deontological CSR drive firms to act in socially responsible ways by providing boundaries of appropriate and inappropriate firm behaviors. In comparison, virtue CSR drives firm action based on the moral character of the firm. In the following sections, we suggest that while all forms of ethics-based CSR can help mitigate risk in their own unique ways, virtue CSR may be the most effective form of CSR to mitigate microfinance portfolio risk.

Hypotheses: Influence of CSR on the Portfolio Risk of MFIs

We extend and apply virtue, consequentialist, and deontological ethics-based approaches to CSR in the context of MFIs. By simultaneously applying the three approaches to CSR practices, we can better understand the extent to which each form of CSR influences the portfolio risk incurred by MFIs.

Virtue Ethics-Based CSR

Virtue CSR is a reflection of the character or moral standing of a firm, and emphasizes the virtues of the firm (Chun 2010). Virtues, or the moral excellence of the firm (Baumeister and Exline 1999; Koehn 1998; Weaver 2006), guide ethical actions of firms to act in inherently benevolent ways. Virtues, then, can help not only guide the firm in its daily activities and operations, but also increase the firm's reputation and moral standing in the society in which it operates.

MFIs that employ virtue CSR seek continuous improvement as a reflection of their own internal character and moral standing (Armstrong et al. 2003; Boatright 1995). This can help mitigate portfolio risk. By acting responsibly toward society based on its own moral standing, firms that employ virtue CSR practices may seek continuous social improvement, which can translate into positive economic benefits for the firms (such as benefits from greater admiration from customers and suppliers, brand recognition due to its reputation, etc.) and mitigate the risks associated with lending. Virtue CSR can lead to proactive pursuit of excellence in all organizational actions that the MFI pursues, such as the way the MFI serves its borrowers. MFIs view CSR as emanating from within—reflecting the virtues and moral standing of the organization and motivating the MFI to not just to do something, but to do something in excellence (Arjoon 2000). Rather than dictating appropriate and inappropriate firm behavior, virtue CSR liberates firm behavior (Somerville and Wood 2012), motivating the firms to do more, to seek more, and perform better based on the virtuous character of the firm. Thus, a firm can create a distinctive competitive advantage from virtue CSR.

There would be a consistent synergy between a firm's internal moral character and external actions. MFIs that employ virtue CSR, therefore, must be outwardly focused in that they must act in socially responsible ways to enact positive outcomes at the economic and community levels, but also be inwardly focused to do so in a way that reflects the character or moral standing of the firm. Firms that employ virtue CSR practices would proactively seek improved ways of acting responsibly (Murphy 1999;

Whetstone 2001) in the ways it serves its borrowers, such as how loans are administered, how repayment is collected, and how training is offered. Thus, CSR becomes an internally driven guiding tool—not to constrain the firm to a set of rules that dictate “dos” and “don'ts,” but rather to help the firm improve its responsibility in its activities and toward society to mitigate risk. As such, we argue that a negative association exists between virtue CSR and portfolio risk of the MFI.

Hypothesis 1 Virtue CSR helps mitigate the portfolio risk of the MFI

Consequentialist Ethics-Based CSR

As indicated above, consequentialist CSR focuses on the consequences of a CSR practice, and evaluates firm actions based on the costs and benefits of the outcomes. Thus, MFIs that employ a consequentialist CSR practice do so because it enhances the financial well-being of the aspirational poor that receive support from the MFI. Consequentialist CSR provides the boundaries within which MFIs should act, and specifically guides the actions of the MFI with regard to its contribution to sustainable economic development through its work with clientele, staff, and local communities (WBCSD 2001). Thus, consequentialist CSR practices enable an MFI to act in ways in which it produces beneficial consequences that outweigh costs, such as an improvement in the well-being of the individuals, economy, and community in which it operates.

Though consequentialist CSR can be instrumental in aiding the MFI to produce social wealth at the economic and community levels, the influence of this form of CSR on portfolio risk is tenuous. Employing such CSR practices can improve the well-being of those receiving support from MFIs, and thus may have a positive impact on prosperity at the economic and community levels. However, given its outward focus on the community rather than on the firm and its activities, we argue that there may not be a strong relationship between consequentialist CSR and the MFI's own portfolio risk. Consequentialist CSR is focused on creating beneficial outcomes, rather than internalizing socially responsible daily activities. As such, consequentialist CSR can be useful in helping the MFI fulfill its role in society, but may not help the CSR in its daily activities. From this perspective, we suggest that the association between consequentialist CSR and portfolio risk of MFIs would be weaker than that between virtue CSR and portfolio risk of MFIs.

Hypothesis 2 Consequentialist CSR helps mitigate the portfolio risk of the MFI; however, in comparison to consequentialist CSR, virtue CSR is more effective in mitigating the portfolio risk of the MFI.

Table 2 Integrating ethics and CSR: Virtue, consequentialist, and deontological ethics-based CSR

| Ethics | Emphasis | Application to CSR | Normative purpose of ethics-based CSR | Items used for measuring CSR by microfinance organizations |
|-----------------------------------|---|--|--|---|
| Virtue | Emphasizes the character of a moral agent as a driving force for ethical behavior (Koehn 1995, 1998; Moore 2005; Murphy 1999; Whetstone 2001) | CSR practices based on virtue are the ones in which the internal moral character is emphasized | <ul style="list-style-type: none"> • Guide firms to be socially responsible because the firm <i>is</i> inherently socially responsible • Go proactively beyond what is normally expected in terms of social responsibility | <p><i>Based on virtue ethics:</i></p> <ul style="list-style-type: none"> • Organization's corporate culture values and rewards high standards of ethical behavior and customer service • Organization's staff trained on gender sensitivity • Organization's staff trained on acceptable payment collection practices • Organization's staff trained on social objectives <p><i>Possibly based on virtue ethics:</i></p> <ul style="list-style-type: none"> • Organization recycles water • Organization recycles paper |
| Consequentialist (or Utilitarian) | Emphasizes the utilitarian outcomes of actions. (Gandz and Hayes 1988; Kujala and Pietiläinen 2004) | CSR practices focused on the costs and benefits of the outcome, rather than the costs and benefits of action | <ul style="list-style-type: none"> • Provide guidelines of appropriate and inappropriate behaviors • Satisfy utilitarian expectations of social responsibility | <p><i>Based on consequentialist ethics:</i></p> <ul style="list-style-type: none"> • Organization's business plan contains social performance issues • Organization provides business development services to borrowers • Organization provides business training services to women borrowers <p><i>Possibly based on consequentialist ethics:</i></p> <ul style="list-style-type: none"> • Organization provides enterprise skills development services to borrowers • Organization provides financial literacy education to borrowers |
| Deontological | Emphasizes ethical actions driven by adherence to institutional rules, regulations, laws, and norms (Koehn 1995; Rawwas et al. 2005) | CSR practices focused on the responsibilities or duties to employees, customers, community, and society as a whole | <ul style="list-style-type: none"> • Provide guidelines of appropriate and inappropriate behaviors. • Satisfy institutional expectations of social responsibility | <p><i>Based on deontological ethics:</i></p> <ul style="list-style-type: none"> • Prices, terms, and conditions of all financial products are fully disclosed to the customer prior to sale. • Maternity/paternity leave <p><i>Possibly based on deontological ethics:</i></p> <ul style="list-style-type: none"> • Transparency on benefits (salary, insurance, and pension) • Protection at work (safety and anti-harassment) • Equality (antidiscrimination and equal pay) • Contribute to the elimination of Forced labor • Contribute to the elimination of child labor |

Deontological Ethics-Based CSR

In a deontological view of CSR, ethical actions within society are driven by an obligation toward duties or adherence to rules. MFIs that approach CSR from a deontological perspective do so because of their responsibility to the government, community, or various interested parties. Despite operating in institutional voids, MFIs in a certain country may be uniquely subject to rules and obligations emanating from various parties. First, institutional voids do not necessarily imply a complete absence of government regulations—they may instead imply a relative deficiency of modern regulations and regulatory agencies needed for the microfinance industry to thrive (Churchill and Coster 2001; Khanna and Rivkin 2001). Second, for MFIs operating in institutional voids, rules and obligations can emanate from atypical sources—that is, sources that are not institutionalized in the country and therefore do not encompass all organizations/industries in the country equally. It may include scrutiny arising from international sponsors (aid donors, philanthropists, foundations, and trusts), international agencies focused on poverty eradication, social activists, and the idiosyncratic expectations of local religious and community leaders (Akula 2008; O'Rourke 2003). Thus, MFIs that employ deontological CSR practices—such as practices related to proper treatment of customers and workers—may do so to pass the scrutiny of various parties who have special interests in the MFI industry in a given country (Somerville and Wood 2012; WBCSD 2001). As such, under scrutiny, MFIs would accept responsibility to provide their services in consonance with certain rules and obligations.

Deontological CSR, like consequentialist CSR, is outwardly focused, and as such, centered on the role of the MFI in the developing countries in which it operates. Thus, deontological CSR practices are structured based on the firm's sense of obligation of its responsibilities or duties toward society. Therefore, deontological CSR induces an MFI to act in ways in which it fulfills its responsibilities or duties to the sustainable economic development of the community and society in which it operates (Palmer 1999).

Deontological CSR promotes dutiful behavior, which rests upon reactive, rather than proactive, action of the firm. That is, firms may end up acting dutifully—in reaction to norms, regulations, and laws—but without a clear regard for behaviors that may improve efficiency or effectiveness of the firm itself. Thus, a firm is unlikely to obtain much of a competitive advantage over other firms from deontological CSR. Deontological CSR can guide the MFI in terms of its role in society; however, it may not be instrumental in guiding the firm to be proactive in its social responsibility. Thus, deontological CSR may mitigate risk associated with not following rules, but do little to mitigate

risk arising from the borrowers the MFI serves. In sum, we suggest that the association between deontological CSR and portfolio risk of MFIs would be weaker than that of the association between virtue CSR and portfolio risk of MFIs.

Hypothesis 3 Deontological CSR helps mitigate the portfolio risk of the MFI; however, in comparison to deontological CSR, virtue CSR is more effective in mitigating the portfolio risk of the MFI.

Methods

Sample and Procedure

Data on the MFIs in our sample are collected by the MIX, a non-profit private organization that promotes information sharing and transparency for the microfinance industry on financial and social performance for MFIs (MIX Market 2010). Financial indicator data are directly submitted to the MIX by each MFI, by the affiliated network that files on the MFI's behalf, or gathered from public documents published by the MFI, such as annual reports. The MIX supplements these data with archival documents, such as ratings, annual reports, donor/investor reports, and audits to capture market dynamics as well as more integrated performance data of individual MFIs. Data are validated by more than 100 quality checks and standardized by the MIX in accordance with International Financial Reporting Standards (IFRS), then made publicly available through the MIX website (MIX Market 2010). This is supplemented by organizational data voluntarily provided to the MIX by the institution or affiliated network. Organizational data are submitted through the data submission form if a first-time submitter, or the profile update form if the institution has previously submitted data to the MIX. Both forms are publicly available by the MIX and provided on the MIX website. The MIX began collecting organizational data of MFIs in 2008. MIX works with external partners such as The Smart Campaign and the Consultative Group for Assistance to the Poor (CGAP) to validate the organizational data provided.

Since the study focuses on ethics-based approaches to CSR and portfolio risk, only MFIs that report such data are utilized for this study. For the purpose of this study, a dataset is created by merging the MIX data with the World Bank Development Indicators data. The sample size is dictated by the extent of overlap among the merged databases and the availability of non-missing data for the variables of interest. The merged panel dataset allows a sample size of 310 MFIs.

Table 3 provides the sample characteristics. The MFIs included in this sample are distributed across 63 countries,

with MFIs from the Latin American region having largest representation. The World Bank defines high-income countries as those with GNP per capita greater than \$12,275 (World Bank 2011). None of the MFIs in our sample operate in high-income countries. Furthermore, we verified that the MFIs in our sample function primarily in the poorer regions within their respective countries (the MIX website provides contact information for each MFI and displays the regions in which the MFI operates). Sixty-four percent of the MFIs in our sample are non-profit organizations and 44% are non-governmental organizations (NGOs). The sample means of financial and operational data suggest that an average MFI is relatively small in size (in terms of total assets and number of employees), with a very strong focus on the microfinance business (more than 90% of operations is in microfinance).

Measures of Variables in Hypotheses

To establish the inter-rater reliability for the three independent variables in the hypotheses, we undertook the following process. First, five external raters (anonymously surveyed scholars with exposure to ethics research) were given information on the three forms of ethics and ethics-based CSR. Each form of ethics and ethics-based CSR was defined. Additionally, information on the context of this study—institutional voids—was provided. After completing this step, the second step in the process involved each of the raters individually categorizing a provided list of items as virtue, consequentialist, or deontological ethics-based CSR. Finally, we calculated inter-rater reliability using Fleiss' kappa statistic (κ), because it is suitable for the items used to calculate the ethics-based CSR measures in our study (our items are of binary data type and we use more than two raters) (Fleiss 1971; Landis and Koch 1977; Shrout and Fleiss 1979). Inter-rater reliability for each of the measures of ethics-based CSR and the overall inter-rater reliability are provided below.

MFI Virtue Ethics-Based CSR

Using data obtained from the MIX annual survey database, this variable is measured as the aggregate number of CSR practices that comprise virtue ethics-based CSR. We use two measures of virtue ethics-based CSR: an expanded measure and a reduced measure. The expanded measure uses items listed in Table 2 under both “based on virtue ethics” and “possibly based on virtue ethics.” The reduced measure uses items listed in Table 2 under “based on virtue ethics” only (i.e., excludes items under “possibly ...”). The inter-rater reliability statistics for the virtue ethics-based CSR category were acceptable for both the expanded measure (Fleiss's kappa $\kappa = 0.64$ indicating

substantial agreement) and the reduced measure ($\kappa = 0.73$ indicating substantial agreement) (Fleiss 1971; Landis and Koch 1977; Shrout and Fleiss 1979).

As listed in Table 2, the practices focus on virtue ethics-based CSR in terms of whether (i) the MFI's corporate culture values and rewards high standards of ethical behavior and customer service, (ii) the MFI's staff is trained on gender sensitivity, (iii) the MFI's staff is trained on acceptable payment collection practices, (iv) the MFI's staff is trained on social objectives, (v) the MFI recycles water, and (vi) the MFI recycles paper. The MIX database provides a binary rating (yes = 1, no = 0) for each of these six practices.

The first four practices clearly reflect virtue ethics-based CSR. They are practiced because an MFI is internally driven by a strong moral character—with intent to go out of its way to behave ethically. Further, given the *institutional voids* context of this study, the last two practices “possibly” reflect virtue ethics-based CSR. In many developed countries, recycling of water and paper is often an institutional norm (Bratt 1999), backed by appropriate laws and regulations that encourage recycling. Hence, in developed countries, recycling can be deontological. However, this study is set in developing countries, which often suffer from institutional voids (Khanna et al. 2005; Mair and Marti 2006). That is, they lack (or are weak in enforcement of) the institutional norms/regulations that are usually enforced in developed countries. The practice of recycling, for instance, often does not have sufficient institutional backing in developing countries (Bhatti and Ventresca 2013). Given that microfinance organizations tend to operate in impoverished regions within developing countries, institutional backing for recycling practices is even more unlikely in such regions. Hence, in this study we assume that recycling activities by MFIs is possibly based on virtue ethics because MFIs would need to go above and beyond to recycle (virtue ethics-based CSR) rather than fulfilling a societal obligation (deontological ethics-based CSR).

In sum, the value of the expanded measure can range from 0 (MFI does not undertake any form of virtue ethics-based CSR) to 6 (all six practices comprise the MFI's virtue ethics-based CSR). Similarly, the value of the reduced measure can range from a score of 0 to 4. Overall, the practices listed in Table 2 for virtue ethics-based CSR reflect an MFI's inherent moral character. In aggregation, they provide a holistic measure of the extent of virtue ethics-based CSR.

MFI Consequentialist Ethics-Based CSR

Using data obtained from the MIX annual survey database, this variable is measured as the aggregate number of CSR

Table 3 Characteristics of sample

| Average financial and operations data of MFI | Mean |
|---|-----------------|
| Total assets, in millions of dollars | 54.77 |
| Gross loan portfolio, in millions of dollars | 42.65 |
| Number of employees | 433.99 |
| Number of offices | 40.73 |
| Years since MFI was established | 14.21 |
| % Operations comprised by microfinance | 92.49 |
| Distribution of MFIs by profit status | Freq (%) |
| Non-profit organization | 63.5 |
| Profit Seeking organization | 36.5 |
| Distribution of MFIs by regulated status | Freq (%) |
| Unregulated (informal) organization | 46.13 |
| Regulated (formal) organization | 53.87 |
| Distribution of MFIs by legal status | Freq (%) |
| Bank | 7.10 |
| Credit union/cooperative | 9.68 |
| Non-banking financial institution (NBFI) | 35.81 |
| Non-governmental organization (NGO) | 43.55 |
| Rural bank | 3.23 |
| Other | 0.65 |
| Geographic distribution of MFIs in sample...distributed across 6 regions and 63 countries | Freq (%) |
| AFRICA (Burkina Faso, Cameroon, Chad, Congo (Democratic Republic of), Ghana, Kenya, Mali, Rwanda, Senegal, South Africa, Togo, and Uganda) | 5.16 |
| EAST ASIA AND THE PACIFIC (Cambodia, China, Indonesia, Philippines, and Timor-Leste) | 10.65 |
| EASTERN EUROPE AND CENTRAL ASIA (Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Georgia, Kazakhstan, Kosovo, Kyrgyzstan, Macedonia, Mongolia, Romania, Russia, Serbia, Tajikistan, Ukraine, and Uzbekistan) | 20.65 |
| LATIN AMERICA AND THE CARIBBEAN (Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, and Venezuela) | 47.42 |
| MIDDLE EAST AND NORTH AFRICA (Egypt, Iraq, Jordan, Lebanon, Morocco, Palestine, Tunisia, and Yemen) | 5.48 |
| SOUTH ASIA (Bangladesh, India, Pakistan, and Sri Lanka) | 10.65 |

Sample size is $n = 310$ firms, where data is from the year 2009

practices that comprise consequentialist ethics-based CSR. We use two measures of consequentialist ethics-based CSR: an expanded measure and a reduced measure. The expanded measure uses items listed in Table 2 under both “based on consequentialist ethics” and “possibly based on consequentialist ethics.” The reduced measure uses items listed in Table 2 under “based on consequentialist ethics” only (i.e., excludes items under “possibly ...”). The inter-rater reliability statistics for the consequentialist ethics-

based CSR category were acceptable for both the expanded measure ($\kappa = 0.62$ indicating substantial agreement) and the reduced measure ($\kappa = 0.71$ indicating substantial agreement).

As listed in Table 2, the practices focus on consequentialist ethics-based CSR in terms of whether (i) the MFI’s business plan contains social performance issues, (ii) the MFI provides business development services to borrowers, (iii) the MFI provides business training services to women borrowers, (iv) the MFI provides enterprise skills development services to borrowers, and (v) the MFI provides financial literacy education to borrowers. The MIX database provides a binary rating (yes = 1, no = 0) for each of these five practices.

The first three practices clearly reflect consequentialist ethics-based CSR—they are practiced with a business-related motive. Further, given the *industry* context of this study, the last two practices “possibly” reflect consequentialist ethics-based CSR. When other (non-financial) industries reach out to people in impoverished regions and provide enterprise skill development and financial literacy services, the practices could be considered as being virtue based. This is because there is very little to gain from such outreach for organizations in the other industries. However, this study is set in the microfinance industry. Microfinance organizations stand to directly gain when borrowers have the enterprise skills and financial acumen necessary to make effective use of the microfinance loans and thereby pay back the loan at the high interest rates (Karlan and Valdivia 2011). Hence, in this study we assume that any enterprise skills and financial literacy services provided by MFIs are possibly based on consequentialist ethics. That is, when MFIs offer enterprise skills and financial literacy services to borrowers, they are doing so because these borrowers may be more successful at creating viable microenterprises, and as such be better able to repay loans to MFIs.

In sum, the value of the expanded measure can range from 0 (MFI does not undertake any form of consequentialist ethics-based CSR) to 5 (all five practices comprise the MFI’s consequentialist ethics-based CSR). Similarly, the value of the reduced measure can range from 0 to 3. Overall, the practices listed in Table 2 for consequentialist ethics-based CSR focus on the business or utilitarian outcomes. In aggregation, they provide a holistic measure of the extent of consequentialist ethics-based CSR.

MFI Deontological Ethics-Based CSR

Using data obtained from the MIX annual survey database, this variable is measured as the aggregate number of CSR practices that comprise deontological ethics-based CSR. We use two measures of deontological ethics-based CSR: an

expanded measure and a reduced measure. The expanded measure uses items listed in Table 2 under both “based on deontological ethics” and “possibly based on deontological ethics.” The reduced measure uses items listed in Table 2 under “based on deontological ethics” only (i.e., excludes items under “possibly ...”). The inter-rater reliability statistics for the deontological ethics-based CSR category were acceptable for both the expanded measure ($\kappa = 0.63$ indicating substantial agreement) and the reduced measure ($\kappa = 0.74$ indicating substantial agreement).

As listed in Table 2, the practices focus on deontological ethics-based CSR in terms of whether (i) prices, terms, and conditions of all financial products are fully disclosed to the customer prior to sale by the MFI (including interest charges, insurance premiums, minimum balances, all fees, penalties, linked products, third-party fees, and whether those can change over time), (ii) the MFI’s human resource (HR) policy emphasizes maternity/paternity leave, (iii) the MFI’s HR policy emphasizes transparency on benefits (salary, insurance, and pension), (iv) the MFI’s HR policy emphasizes protection at work (safety and anti-harassment), (v) the MFI’s HR policy equality (antidiscrimination and equal pay), (vi) the MFI contributes to the elimination of forced labor in its community, and (vii) the MFI contributes to the elimination of child labor in its community. The MIX database provides a binary rating (yes = 1, no = 0) for each of these seven practices.

The first two practices clearly reflect deontological ethics-based CSR. This is because, for these practices, the adherence to the related institutional norms and rules are more easily documented and/or scrutinized (prices, terms, and conditions in product/contract documents, and maternity/paternity leave in employer/employee/medical records). The last five practices “possibly” reflect deontological ethics-based CSR, under the recognition that adherence to the related institutional norms and rules could be harder to scrutinize. In the absence of third-party scrutiny, the third practice (transparency on benefits) could be motivated by consequentialist ethics directed at the outcome of the action, whereas the last four practices (related to humane treatment of workers) could be motivated by virtue ethics centered on the benevolence of the organization. However, third-party scrutiny for the last five practices has increasingly become a reality in developing countries (O’Rourke 2003). Apart from the scrutiny from each country’s government, there is substantial scrutiny by both social activists and by international organizations such as the United Nations (UN). For instance, there is extensive scrutiny by the International Labor Rights Forum (ILRF, a major advocacy group) and the International Labor Organization (ILO, a specialized agency of the UN) on propagating and verifying the adherence to the employment/labor-related best practices across the world (International

Labor Organization 2013; International Labor Rights Forum 2013). Hence, given that organizations across the world are under the scrutiny of such third-party observers, in this study we assume that the last five practices by MFIs are possibly based on deontological ethics. That is, MFIs exhibit such behaviors because of rules, duties, or obligations, rather than because of a desired outcome, or as a reflection of the moral character of the firm.

In sum, the value of the expanded measure can range from 0 (MFI does not undertake any form of deontological ethics-based CSR) to 7 (all seven practices comprise the MFI’s deontological ethics-based CSR). Similarly, the value of the reduced measure can range from 0 to 2. Overall, the practices listed in Table 2 for deontological ethics-based CSR reflect the adherence to institutional norms and rules. In aggregation, they provide a holistic measure of the extent of deontological ethics-based CSR by an MFI.

The overall inter-rater reliability statistics for all categories combined were acceptable for both the expanded measures (total of 18 items, 3 categories, overall Fleiss’s kappa $\kappa = 0.63$ indicating substantial agreement) and the reduced measures (total of 9 items, 3 categories, overall $\kappa = 0.73$ indicating substantial agreement) of ethics-based CSR (Fleiss 1971; Landis and Koch, 1977; Shrout and Fleiss 1979).

Portfolio Risk

The dependent variable, portfolio risk, captures the extent to which an MFI’s loan portfolio is at risk over a period of 30 days, due to problems such as non-performing assets, write-offs due to loan non-recovery, impairment loss, risk of default, etc. It is calculated as [(outstanding balance and portfolio overdue > 30 days + renegotiated portfolio)/adjusted gross loan portfolio]. The numerator is the value of all loans outstanding that have one or more installments of principal past due more than 30 days. This includes the entire unpaid principal balance, including both the past due and future installments, but not accrued interest. The numerator also includes loans that have been renegotiated (restructured or rescheduled). The denominator is the value of all outstanding principals due for all outstanding client loans (this includes current, delinquent, and renegotiated loans, but not loans that have been written off; it does not include interest receivable). Data are obtained from the MIX financial indicators database.

Control Variables

Dummy Variables for Global Regions

Our sample consists of MFIs from Eastern Europe and Central Asia, East Asia, and the Pacific, Africa, South Asia,

Latin America and The Caribbean, Middle East and North Africa. We include dummy variables for each of these global regions to control for the natural and other macro issues that characterize these regions. Data are obtained from the MIX financial indicators database.

Dummy Variables for Local Target Markets

We include dummy variables to control for whether an MFI has target clients in rural areas, has target clients in urban or semi-urban areas, has no specific target market or population, or has some other target market. These dummy variables help control for rural versus urban populations as target markets and help control for issues that might affect such markets. Data are obtained from the MIX annual survey database.

MFI Size

Firm size is included as a control because a larger MFI is likely to have a greater influence among its stakeholders and have more opportunities to diversify its loan portfolio. Larger MFIs, therefore, might be more effective in mitigating portfolio risk. Firm size is measured as the log of total assets, where total assets is reported in dollars. Data are obtained from the MIX financial indicators database.

MFI Reach

Reach is measured by the number of staffed points of service and administrative sites used to deliver or support the delivery of services to microfinance clients. It is included as a control because MFIs with wider reach (in terms of access and connection points) might be able to better diversify their geographic exposure and, therefore, be more effective in mitigating their portfolio risk. Data are obtained from the MIX financial indicators database.

MFI NGO Status

This is a dummy variable with a value of 1 if the legal status of the MFI is that of a non-governmental organization (NGO), and 0 otherwise. An NGO is a non-governmental organization that is registered as a non-profit (for either tax purposes or some legal reason). An NGO, typically, is not regulated by a supervisory banking agency and its financial business is usually restricted (e.g., often excludes deposit taking). Data are obtained from the MIX financial indicators database.

MFI Profitability

Profitability is measured as the profit margin. It is the ratio of an MFI's net operating income to its financial revenue. It helps control for variation in performance. Results are similar when return on assets (ROA) or nominal yield on gross portfolio are instead used as the proxies of profitability. Data are obtained from the MIX financial indicators database.

Country Prosperity

Country prosperity is an indicator of economic wealth and quality of life, and is negatively related to poverty. Country prosperity is calculated as gross national income (GNI per capita) in thousands of U.S. dollars, and converted using the World Bank Atlas method, divided by the midyear population for the country. GNI is measured as the sum of value added by all resident producers plus any product taxes (less subsidies) not included in the valuation of output plus net receipts of primary income (compensation of employees and property income) from abroad (World Bank 2011). The World Bank Atlas method used for conversion applies a conversion factor that averages the exchange rate for a given year and the two preceding years, adjusted for differences in rates of inflation between the country and countries in the Euro area, Japan, the United Kingdom, and the United States (World Bank 2011). It is included as a control because countries with a more prosperous population are less likely to default on loans, which would mitigate the portfolio risk of the MFIs operating in the country. In contrast, in countries with poorer populations, MFIs are likely to face greater portfolio risk due to write-offs of non-recoverable loans. Data are obtained from the World Bank Development Indicators database.

Country Total Population

The population of the MFI's country is included as a control. It counts all residents regardless of legal status or citizenship (except for refugees not permanently settled in the country of asylum) (World Bank 2011). Data are obtained from the World Bank Development Indicators database.

Results

Table 4 provides the descriptive statistics and correlations for our study. Ordinary least square (OLS) regressions are used to test the hypotheses, the results of which are

provided in Table 5 (using the expanded measures of ethics-based CSR) and Table 6 (using the reduced measures of ethics-based CSR). For the regressions, all the independent variables were standardized (with mean set to zero) to avoid multicollinearity problems and to obtain standardized parameter estimates. The independent variables were lagged behind the dependent variables by 1 year, to indicate the longitudinal direction of the effects being tested. Overall, the findings were similar irrespective of whether we used the expanded measures (Table 5) or the reduced measures (Table 6) for the three ethics-based CSR variables, suggesting a satisfactory level of construct validity.

Hypotheses Tests

Consistent with hypothesis 1, the expanded measure of virtue ethics-based CSR has a significantly negative influence on portfolio risk ($\beta = -0.17$ with $p < 0.05$ in model A2 and $\beta = -0.18$ with $p < 0.05$ in model A5 in Table 5). Similarly, the reduced measure of virtue ethics-based CSR has a significantly negative influence on portfolio risk ($\beta = -0.17$ with $p < 0.05$ in models B2 and B5 in Table 6).

In comparison, the influence of the expanded measure of consequentialist ethics-based CSR on portfolio risk is non-significant ($\beta = -0.08$ with $p > 0.10$ in model A3 and $\beta = -0.01$ with $p > 0.10$ in model A5 in Table 5). Similarly, the influence of the reduced measure of consequentialist ethics-based CSR on portfolio risk is non-significant ($\beta = -0.07$ with $p > 0.10$ in model B3 and $\beta = -0.02$ with $p > 0.10$ in model B5 in Table 6). That is, consistent with hypothesis 2, virtue ethics-based CSR, in comparison to consequentialist ethics-based CSR, is more effective in mitigating the portfolio risk of the MFI.

Further, the influence of the expanded measure of deontological ethics-based CSR on portfolio risk is also non-significant ($\beta = -0.07$ with $p > 0.10$ in model A4 and $\beta = -0.02$ with $p > 0.10$ in model A5 in Table 5). Similarly, the influence of the reduced measure of deontological ethics-based CSR on portfolio risk is also non-significant ($\beta = -0.03$ with $p > 0.10$ in model B4 and $\beta = -0.01$ with $p > 0.10$ in model B5 in Table 6). That is, consistent with hypothesis 3, virtue ethics-based CSR, in comparison to deontological ethics-based CSR, is more effective in mitigating the portfolio risk of the MFI.

In sum, the results of our econometric analysis suggest that MFIs that pursue higher levels of virtue ethics-based CSR are less likely to suffer from portfolio risk. The findings are illustrated in Fig. 1—while each of the three types of ethics-based CSR can help mitigate portfolio risk, virtue ethics-based CSR has the greatest impact in helping mitigate portfolio risk.

Post-Hoc Analysis

We had measured the portfolio at risk over 30 days because using the 30-day breakpoint is standard and common in the microfinance industry. Nevertheless, as a reviewer noted, it would be interesting to see whether the measure would hold if portfolio at risk were to be measured over a longer number of days. Hence, we carried out post-hoc analysis by measuring portfolio at risk over 90 days, calculated as [(outstanding balance and portfolio overdue > 90 days + renegotiated portfolio) / adjusted gross loan portfolio]. We found that the correlation between 30-day measure of portfolio risk and 90-day measure of portfolio risk is high ($r = 0.84$ with $p < 0.001$). Moreover, as illustrated in Fig. 2, we found that while each of the three types of ethics-based measures of CSR help mitigate the 90-day portfolio risk (such that risk is higher when CSR is low and risk is lower when CSR is high), the mitigation is greatest with virtue ethics-based CSR. Further, we find that while results remain largely consistent when using the 90-day measure of portfolio risk, the importance of virtue ethics-based CSR in mitigating risk is most visible with the 30-day measure of portfolio risk.

Discussion

MFIs incur risk from serving impoverished borrowers with financial, and sometimes non-financial, services in developing countries rife with institutional voids (Chakrabarty and Bass 2013a, b). Adopting an ethics-based perspective, our results suggest that the form of CSR employed by MFIs may influence the portfolio risk of MFIs. We propose that while all forms of ethics-based CSR can potentially help in mitigating risk, virtue ethics-based CSR is likely to have the strongest impact in mitigating the portfolio risk of MFIs. We use operational and financial data of MFIs operating in various developing countries for our study. This allows a broad test of the impact of various forms of ethics-based CSR on the portfolio risk of MFIs.

Our findings have important contributions. First, our study establishes three forms of normative ethics (virtue, consequentialist, and deontological) as foundational bases for CSR. Though other researchers have applied the normative ethics framework to study CSR, we provide one of the few empirical studies that differentiate between virtue, consequentialist, and deontological CSR. Firms that employ consequentialist CSR may be specifically focused on the costs and benefits of doing so at the economic or community level. Firms that employ deontological CSR do so because they feel it is their duty or responsibility to society. Thus, both consequentialist and deontological CSR

Table 4 Correlations: operational and financial data of sample of MFIs

| | Mean | SD | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) | (12) |
|---|----------|----------|-------|-------|-------|-------|-------|-------|------|------|------|------|------|------|
| 1. Portfolio risk (30-day) | 7.21 | 12.43 | 1 | | | | | | | | | | | |
| 2. MFI size | 16.31 | 1.84 | -0.05 | 1 | | | | | | | | | | |
| 3. MFI reach | 40.73 | 99.57 | -0.02 | 0.41 | 1 | | | | | | | | | |
| 4. MFI NGO status | 0.44 | 0.50 | -0.02 | -0.20 | -0.01 | 1 | | | | | | | | |
| 5. MFI profitability | 2.86 | 48.50 | 0.05 | 0.18 | 0.08 | -0.07 | 1 | | | | | | | |
| 6. Country prosperity | 3316.00 | 2236.00 | -0.15 | -0.05 | -0.16 | 0.05 | -0.12 | 1 | | | | | | |
| 7. Country total population | 1.15E+08 | 2.82E+08 | 0.07 | 0.14 | 0.30 | -0.09 | 0.05 | -0.22 | 1 | | | | | |
| 8. Virtue ethics-based CSR (E) | 3.13 | 1.73 | -0.16 | 0.29 | 0.22 | 0.02 | 0.00 | -0.10 | 0.12 | 1 | | | | |
| 9. Consequentialist ethics-based CSR (E) | 2.32 | 1.57 | -0.07 | 0.09 | 0.14 | 0.26 | -0.02 | -0.09 | 0.12 | 0.42 | 1 | | | |
| 10. Deontological ethics-based CSR (E) | 4.90 | 1.19 | -0.07 | 0.29 | 0.18 | -0.04 | 0.01 | -0.08 | 0.13 | 0.54 | 0.26 | 1 | | |
| 11. Virtue ethics-based CSR (R) | 2.18 | 1.36 | -0.14 | 0.17 | 0.15 | 0.03 | 0.01 | -0.15 | 0.13 | 0.88 | 0.36 | 0.49 | 1 | |
| 12. Consequentialist ethics-based CSR (R) | 1.55 | 0.93 | -0.05 | 0.06 | 0.10 | 0.21 | 0.02 | -0.10 | 0.09 | 0.36 | 0.92 | 0.27 | 0.31 | 1 |
| 13. Deontological ethics-based CSR (R) | 1.74 | 0.51 | -0.03 | 0.13 | 0.08 | 0.04 | -0.03 | -0.04 | 0.03 | 0.36 | 0.18 | 0.63 | 0.33 | 0.19 |

Sample size $N = 310$ firms. Data for variable 1 are from the year 2010, whereas data for variables 2 to 10 are from the year 2009

'(E)' refers to the Expanded measures for the ethics-based CSR variables, that is, measured using items listed in Table 2 under both 'Based on Virtue Ethics' and 'Possibly Based on Virtue Ethics', both 'Based on Consequentialist Ethics' and 'Possibly Based on Consequentialist Ethics', and both 'Based on Deontological Ethics' and 'Possibly Based on Deontological Ethics'

'(R)' refers to the Reduced measures for the ethics-based CSR variables, that is, measured using items listed in Table 2 under 'Based on Virtue Ethics', 'Based on Consequentialist Ethics', and 'Based on Deontological Ethics' (excludes items under 'Possibly ...')

have an outward focus on the societies in which they operate.

Virtue CSR differs from consequentialist and deontological CSR in several ways. First, firms that employ virtue CSR do so because it is a reflection of their own moral standing or character. Thus, virtue CSR guides these firms to be socially responsible because the organization *is* inherently socially responsible, not because the outcome is socially responsible, or the organization feels it is its duty or responsibility to act socially responsible. Second, virtue CSR drives firm action based on moral character, rather than socially prescribed appropriate and inappropriate behaviors. Thus, rather than adhering to rules or norms to display social responsibility, firms emanate social responsibility in every action and in their societal role. Third, virtue CSR is motivation for firms to go proactively beyond what is normally expected in terms of social responsibility. Whereas consequentialist and deontological CSR are mechanisms for organizations to satisfy utilitarian and institutional expectations of social responsibility, virtue CSR is a motivating internal driver for organizations to go beyond the routine expectations of social responsibility.

Second, using the ethics-based CSR theory we are able to examine and differentiate among the three forms of

normative ethics-based CSR in relation to firm outcomes. Since the setting of our study is the microfinance industry, and since risk is a growing concern for microfinance, we chose to examine these three forms of CSR as related to risks incurred by MFIs. Thus, we tested each of the forms of CSR as related to portfolio risk of MFIs. The results suggest that both consequentialist and deontological CSR tend to negatively impact portfolio risk of MFIs, but the impacts were not significant. In comparison, we find that the negative influence of virtue CSR on portfolio risk of MFIs is highly significant. This finding has important implications for research on the role of ethics-based CSR practices, especially in developing countries. Though all three forms of CSR can help firms create value, we find that virtue ethics-based CSR has the strongest impact on mitigating microfinance portfolio risk. This finding paves the way for future research on the distinctive role of the three forms of CSR.

Implications for Research

Positioning our findings in the extant literature, we provide implications for research on CSR in developing countries and the microfinance industry. First, MFIs face two

Table 5 Microfinance portfolio risk (30-day): influence by types of ethics-based CSR (expanded measures)

| | MFI's portfolio risk as dependent variable (year $y + 1$) | | | | |
|---------------------------------------|--|---------|--------|--------|---------|
| | Standardized parameter estimates | | | | |
| | A1 | A2 | A3 | A4 | A5 |
| Controls (year y) | | | | | |
| Dummies for global regions | ✓ | ✓ | ✓ | ✓ | ✓ |
| Dummies for local target markets | ✓ | ✓ | ✓ | ✓ | ✓ |
| MFI size | -0.05 | -0.02 | -0.06 | -0.04 | -0.02 |
| MFI reach | -0.04 | -0.02 | -0.03 | -0.03 | -0.02 |
| MFI NGO status | 0.02 | 0.01 | 0.01 | 0.02 | -0.00 |
| MFI profitability | 0.04 | 0.03 | 0.04 | 0.04 | 0.03 |
| Country prosperity | -0.14* | -0.15** | -0.14* | -0.14* | -0.15** |
| Country total population | 0.06 | 0.07 | 0.07 | 0.06 | 0.07 |
| Predictor (year y) | | | | | |
| Virtue ethics-based CSR (E) | | -0.17** | | | -0.18** |
| Consequentialist ethics-based CSR (E) | | | -0.08 | | -0.01 |
| Deontological ethics-based CSR (E) | | | | -0.07 | -0.02 |
| R^2 | 0.0308 | 0.0578 | 0.0361 | 0.0357 | 0.0582 |
| p value | 0.143 | 0.011 | 0.130 | 0.135 | 0.033 |
| ΔR^2 | | 0.0270 | 0.0053 | 0.0049 | 0.0274 |
| p value | | 0.004 | 0.204 | 0.220 | 0.036 |

** $p \leq 0.01$, * $p \leq 0.05$, † $p \leq 0.10$ (conservative two-tailed tests). Sample size = 310 firms. Variables are centered and standardized. Independent variables are lagged behind the dependent variable by 1 year. Dependent variable is from the year 2010, whereas independent variables are from the year 2009. Independent variables winsorized at 0.5 and 99.5 percentiles to limit outliers (results are very similar without winsorizing). Max VIF = 1.84 in the above steps, indicating no evidence of multicollinearity

“(E)” refers to the Expanded measures for the ethics-based CSR variables, that is, measured using items listed in Table 2 under both “Based on Virtue Ethics” and “Possibly Based on Virtue Ethics,” both “Based on Consequentialist Ethics” and “Possibly Based on Consequentialist Ethics,” and both “Based on Deontological Ethics” and “Possibly Based on Deontological Ethics”

struggles: they operate in institutional voids, and they must constantly balance pursuit of social and economic value creation in serving impoverished borrowers. With regard to the former struggle, developing countries are often embryonic in terms of hard and soft infrastructure and are rife with institutional voids. MFIs must find mechanisms that can guide the organization to act in socially responsible ways, but ensure their own viability in these adverse environments. With regard to the latter struggle, an MFI is an interesting type of firm because its mission is to create both economic value and social value simultaneously, yet MFIs often struggle with this dual pursuit (Copestake 2007; Mersland and Strom 2010; Morduch 2000). Thus, MFIs must find a mechanism that allows for the pursuit of both social and economic value creation in serving impoverished borrowers. This study allowed us to examine how differing forms of CSR practices can influence an MFI's viability. Our findings extend the literature on CSR in developing countries by suggesting that a virtue ethics-based approach to CSR can significantly help MFIs in their struggle to create social and economic value creation, even in the worst contexts.

Second, we address a growing concern within the microfinance industry—the risks incurred by MFIs in providing both financial and non-financial services to the aspirational poor in developing countries. Though previous research categorizes and provides insights to the varying forms of risk that MFIs incur, to our knowledge, few studies provide theoretical or empirical evidence of tools available to MFIs to mitigate such risks. To understand the impact of CSR on portfolio risk, we utilize a normative ethics lens to distinguish between different forms of ethics-based CSR actions. In comparison to consequentialist and deontological forms of CSR, we suggest that virtue CSR may be the most appropriate form for MFIs to adopt to mitigate portfolio risk. Thus, we address the growing concern about risks in facing the microfinance industry by providing evidence of a firm-specific facet—virtue ethics-based CSR—in mitigating the risk faced by MFIs. We move from theorizing about risks faced by MFIs to empirically understanding the mechanisms that MFIs can put into practice to mitigate these risks. We extend the literature by suggesting that MFIs that enact CSR based on the philosophical paradigm of virtue ethics may in fact

Table 6 Microfinance portfolio risk (30-day): influence by types of ethics-based CSR (reduced measures)

| | MFI's portfolio risk as dependent variable (<i>year y + 1</i>) | | | | |
|---------------------------------------|--|---------|--------|--------|---------|
| | Standardized parameter estimates | | | | |
| | B1 | B2 | B3 | B4 | B5 |
| Controls (<i>year y</i>): | | | | | |
| MFI size | -0.06 | -0.04 | -0.06 | -0.06 | -0.04 |
| MFI reach | -0.04 | -0.03 | -0.03 | -0.03 | -0.03 |
| MFI NGO status | 0.02 | 0.01 | 0.01 | 0.02 | -0.00 |
| MFI profitability | 0.03 | 0.04 | 0.04 | 0.04 | 0.04 |
| Country prosperity | -0.14* | -0.16** | -0.14* | -0.14* | -0.16** |
| Country total population | 0.06 | 0.07 | 0.06 | 0.06 | 0.07 |
| Predictor (<i>year y</i>) | | | | | |
| Virtue ethics-based CSR (R) | | -0.17** | | | -0.17** |
| Consequentialist ethics-based CSR (R) | | | -0.07 | | -0.02 |
| Deontological ethics-based CSR (R) | | | | -0.03 | -0.01 |
| R^2 | 0.0309 | 0.0571 | 0.0349 | 0.0316 | 0.0582 |
| F value | 1.61 | 2.61 | 1.56 | 1.41 | 2.06 |
| p value | 0.1431 | 0.0125 | 0.1467 | 0.2019 | 0.0331 |
| ΔR^2 | | 0.0262 | 0.0040 | 0.0007 | 0.0273 |
| F value | | 8.37 | 1.24 | 0.20 | 2.89 |
| p value | | 0.0041 | 0.2664 | 0.6564 | 0.0357 |

** $p \leq 0.01$, * $p \leq 0.05$, † $p \leq 0.10$ (conservative two-tailed tests). Sample size = 310 firms. Variables are centered and standardized. Independent variables are lagged behind the dependent variable by 1 year. Dependent variable is from the year 2010, whereas independent variables are from the year 2009. Independent variables winsorized at 0.5 and 99.5 percentiles to limit outliers (results are very similar without winsorizing). Max VIF = 1.81 in the above steps, indicating no evidence of multicollinearity

'(R)' refers to the Reduced measures for the ethics-based CSR variables, that is, measured using items listed in Table 2 under 'Based on Virtue Ethics', 'Based on Consequentialist Ethics', and 'Based on Deontological Ethics' (excludes items under 'Possibly ...')

experience lower portfolio risk (MacGregor and Fontrodona 2011; Porter and Kramer 2006).

Implications for Practice

Our study provides important practice implications for firms that operate in developing countries and enact CSR practices. Among the various kinds of firms and industries that operate in developing countries, the risks inherent to the microfinance industry are a rising concern. MFIs face difficulties in managing these risks because of the poverty of the borrowers and the institutional voids in which they operate. As long as MFIs continue to provide financial and non-financial support to the desperate poor in developing countries, they will continue to incur risk by participating in these activities. We believe that microfinance is a valuable and transformative industry. Therefore, rather than give up their pursuit of providing services to the poor, MFIs should instead find ways to mitigate the risks.

We suggest that to mitigate risk, MFIs should consider which ethics-based CSR approach they should prioritize. As a start, firms must become aware of the differences in ethical assumptions underlying various CSR practices and

the variation in the impact of such practices. Managers may tend to prioritize consequentialist or deontological ethics-based CSR practices. However, our study shows that virtue ethics-based CSR is the most effective in mitigating the portfolio risk of MFIs. Hence, while there is no harm in managers continuing to follow consequentialist or deontological ethics-based CSR practices, they must remember that virtue ethics-based CSR would be significantly more effective in mitigating portfolio risk. Hence, if they have to prioritize, the highest priority should be given to the virtue ethics-based approach. At a managerial-level, we suggest those operating MFIs should not just ask "Will the benefits of this outcome outweigh the costs?" or "Are we doing what is expected of us?" but also ask "Is what we are doing reflective of the values and moral character of our organization?"

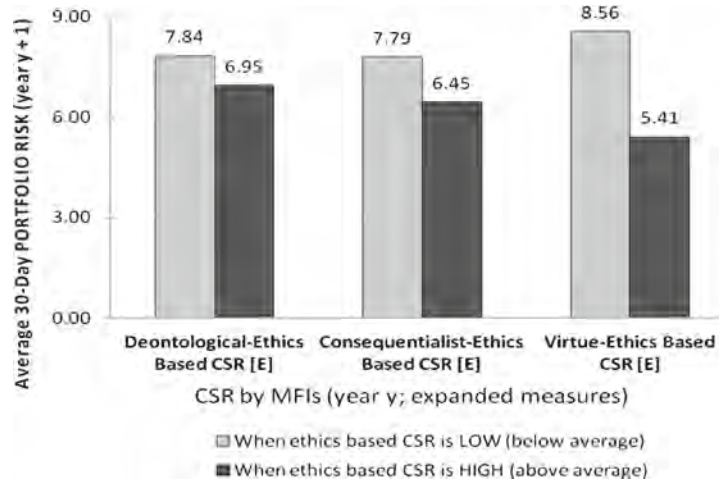
Limitations and Future Research

Our data allow us to investigate the relationship between differing forms of CSR on portfolio risks of MFIs. Our study presents some limitations that can be addressed by future research. First, we chose to explore the impact of

Fig. 1 Portfolio risk (30 days): Impact of virtue, consequentialist, and deontological CSR. “(E)” refers to the Expanded measures for the ethics-based CSR variables, that is, measured using items listed in Table 2 under both “Based on Virtue Ethics” and “Possibly Based on Virtue Ethics,” both “Based on Consequentialist Ethics” and “Possibly Based on Consequentialist Ethics,” and both “Based on Deontological Ethics” and “Possibly Based on Deontological Ethics”. “(R)” refers to the Reduced measures for the ethics-based CSR variables, that is, measured using items listed in Table 2 under “Based on Virtue Ethics,” “Based on Consequentialist Ethics,” and “Based on Deontological Ethics” (excludes items under “Possibly...”)

Using Expanded [E] Measures:

Virtue ethics-based CSR has the Strongest Negative Influence on 30-day Portfolio Risk



Using Reduced [R] Measures:

Virtue ethics-based CSR has the Strongest Negative Influence on 30-day Portfolio Risk

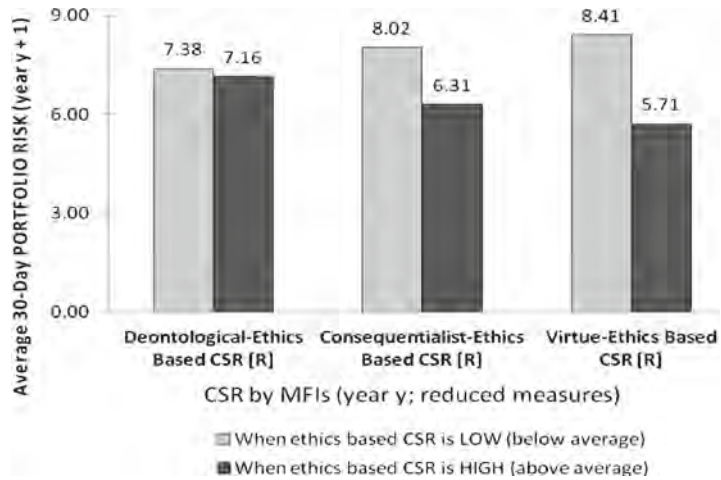
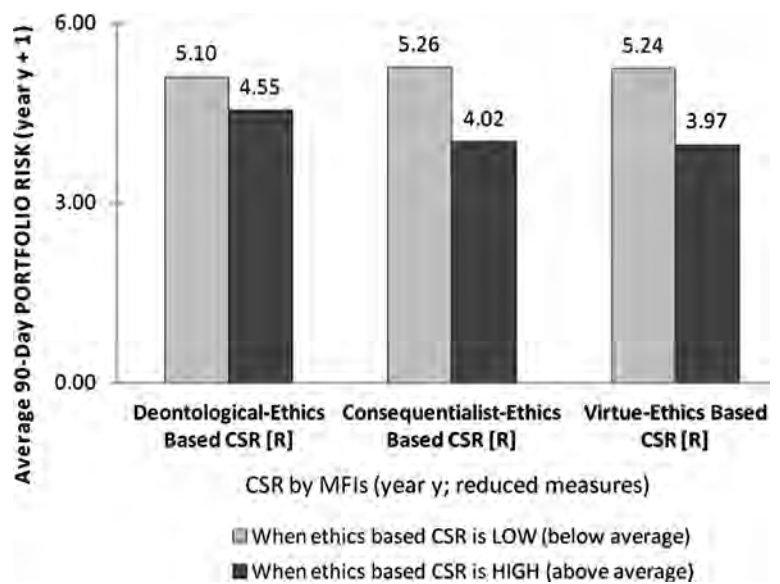


Fig. 2 Post-hoc analysis using 90-day portfolio risk: impact of virtue, consequentialist, and deontological CSR. “(R)” refers to the reduced measures for the ethics-based CSR variables, that is, measured using items listed in Table 2 under “Based on Virtue Ethics,” “Based on Consequentialist Ethics,” and “Based on Deontological Ethics” (excludes items under “Possibly...”)



differing forms of CSR on a firm-level outcome, specifically the portfolio risk of MFIs. We chose portfolio risk because of its rising concern in the microfinance industry. As such, portfolio risk seemed to make pragmatic sense in searching for forms of CSR that can mitigate such risk. Though we believe that our study provides important insights to practice, we suggest that future research examine alternative outcomes (Chakrabarty and Whitten 2011; Whitten et al. 2010; Zardkoohi et al. 2011). After all, CSR practices can impact individuals, the community, and society as a whole. Thus, future research on the ethics-based CSR theory can investigate whether CSR practices employed by firms, especially operating in developing countries, could result in differing outcomes at the individual, community, and societal levels. Further, at the organizational level, other outcomes of the differing forms of CSR could be examined. Thus, future work on the ethics-based CSR theory could examine how the three forms of CSR impact firm financial outcomes, such as profitability, and firm operational outcomes, such as employee turnover.

Second, our data rely on operational data from archival/secondary sources, which constraints our ability to measure various underlying explanatory phenomena. For instance, the indicators for virtue ethics may be picking up not only normative values but also level of managerial competence (MFIs that have a policy on recycling are likely to pay attention to detail in other matters, for example). Further, our study focuses on the normative ethics and moral character of entities (MFIs) rather than individuals (members of the MFIs) (Katz 1977; Sims and Brinkmann 2003). Future research on the ethics-based CSR theory could examine the moral character of individuals that are members of the entities. For instance, a fruitful avenue for future research may be to examine the congruence between the moral character of the entity and the moral character of the individuals that are members of the entity. Finally, future research could compare matched pairs of firms (of similar size in similar regions) but with and without CSR policies and compare them on some performance outcomes. After all, CSR policies may be a proxy for great management and proactive stances toward serving the poor. In sum, future research could address the questions raised in this study using alternative methods, such as qualitative methods, experimental methods, and surveys. The findings from the use of alternative methods might help explain many of the underlying phenomena.

Third, research studies have shown that friends and family/community provide funds so an individual borrower can repay a loan. That is, borrowers can rely on social capital and community relations (Armendáriz and Morduch 2000; Crabb and Keller 2006; Lehner 2009; Morduch 1999; Rosenberg 2009). A limitation of this study is that it

does not have access to data that can empirically differentiate by type of loan given to each borrower. This might be important because an MFI's portfolio risk might be affected by the types of loans given to each of its borrowers. Since this study uses firm-level data and not individual-/group-level borrower data, it falls short of testing alternative explanations—such as those related to individual versus group borrowing. Hence, future research would benefit from access to data at various other levels of analysis.

Fourth, the empirical setting of this study was limited to MFIs operating in developing countries. Though we find evidence that various CSR practices employed by MFIs may produce differing results in the relationship between CSR and portfolio risk, we believe that the ethics-based CSR theory could be applied to other settings. For instance, future research can study the various forms of CSR outside of the microfinance industry. In addition, future research can examine the theory in the context of developed, or wealthier, countries. Developed countries provide a context that is dissimilar to that of developing countries in terms of social, economic, and institutional factors (Chakrabarty 2009, 2013; Chakrabarty and Wang 2012, 2013). Further, our operationalization of the measures of the three forms of ethics-based CSR are specific to our context of developing countries. We acknowledge that CSR actions might be differently interpreted and categorized in other contexts. Therefore, future research may consider using alternative measures when applying and testing the theory of ethics-based CSR.

Conclusion

Portfolio risk is a growing concern in the microfinance industry. Though efforts have been made to better understand the risks faced by MFIs operating in developing countries, little is known with regard to the processes firms can employ and actions they can take to mitigate risk (Chakrabarty and Bass 2013a, b). We argue that MFIs that operate in developing countries may benefit from employing a specific form of CSR—virtue CSR—to mitigate some of the risk. While all forms of CSR—virtue, consequentialist, or deontological—can help create value in the developing countries, we find that virtue ethics-based CSR may be the most effective in helping MFIs manage the risky portfolios that arise from serving the poor in desperate contexts. The moral standing and character of MFIs that are reflected in the virtue ethics-based approach to CSR are very important, and these virtues may be especially influential in mitigating the problem of portfolio risk, which is an unattractive but an inescapable facet of the microfinance industry.

Overall, the ethics-based CSR theory provides insight regarding the various forms of ethics-based CSR employed by firms and the differences in impacts of each of these forms of CSR. Further development and extension of this ethics-based CSR theory can help inspire greater future research regarding virtue, consequentialist, and deontological ethics-based approaches to CSR.

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