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## **Towards a plural history of microfinance**

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## **Towards a Plural History of Microfinance**

James Copestake, Mateo Cabello, Ruth Goodwin-Groen, Robin Gravesteijn, Julie Humberstone, Susan Johnson, Max Nino-Zarazua, Matthew Titus

### **Abstract**

This paper is concerned with the recent history of microfinance, both for itself and as a case study of the evolution of development ideas and activities. Doing justice to this history, and to all those involved in it will not be easy. Rather than aiming for a full narrative this paper asks what kinds of histories might be told, and with what evidence. The paper contrasts two dominant but oppositional narratives: a mainstream account rooted in neo-classical economics that has applauded the successes of microfinance in expanding financial market opportunities; and a political economy critique that highlights new opportunities for exploitation. We illustrate the differences with particular reference to recent developments in India, before turning to the potential for a more inductive and plural account. A more plural history of microfinance emphasises geographical variation in the expansion of financial services, the influence of prior social relations among users, the organisational culture of suppliers and the political economy of regulation. It is also consistent with the variability and contestability of available empirical evidence about the impact of microfinance over space and time. We illustrate this by drawing on a selection of doctoral research studies, and conclude by cautioning against universal narratives of either successful financial inclusion or adverse incorporation.

### **Keywords**

microfinance, financial inclusion, adverse incorporation, international development, social relations, organisational culture, financial regulation

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# 1 Introduction - The Evolution and Independent identity of MF

The purpose of this paper is not to write a history of microfinance, but to share some thoughts on how it should be written. Any account needs to explain what we mean by microfinance, what caused it to emerge and grow, and what lies behind the recent demise in support for it. Microfinance is widely used to refer to a relatively recent phenomenon: among its iconic champions Grameen became a bank in 1983, BancoSol in 1992 and K-Rep 1987 (as an NGO) and in 1999 (as a bank). However, if defined as financial services for relatively poor people then of course it has a much longer history. For example, its recent history echoes a nineteenth century proliferation of financial initiatives and innovations - from friendly societies to Raiffeisen cooperatives - to help poor working people in the aftermath of European and North American industrialisation (Roodman, 2012). Microfinance also evolved out of earlier forms of government sponsorship of credit for small businesses and farms, and shares many characteristics with them (Anderson and Khambata, 1985; Von Adams and Von Pischke, 1992). However, literature explicitly using the word microfinance is of much more recent origin. For example, Fouillet et al (2013) find very few journal references to it before 1994. This paper is concerned primarily with this more recent experience, lasting not much more than thirty years.

Whether or not the tide of activity associated with the term microfinance is now diminishing is more contentious, but also partly a matter of semantics. The rate of growth of academic publications about microfinance does appear to have slowed since the 2008 financial crisis (Fouillet et al. 2013). Its distinctiveness as a discrete field of activity has also diminished as it has been “mainstreamed” (Copestake, 2007) into the financial sector, thereby qualifying as a leading “bottom of the pyramid” commercial and impact investment opportunity (Prahalad, 2004). But this demise also reflects a shift in the language and leanings of leading international development agencies from microfinance to financial inclusion (Johnson, 2009). While the first Microcredit Summit in Washington of 1997 can be viewed as symbolic of the arrival of microfinance as a global phenomenon, the G20 adoption of the Global Partnership for Financial Inclusion in Seoul on 10 December 2010 can be viewed as heralding its eclipse. Rhyne (2014) puts it as follows:

“Through microfinance, hundreds of millions of clients who had previously been ignored by the mainstream financial institutions have access to products that most of us take for granted in our daily lives. Now, building on the success of microfinance, the financial inclusion movement has created a vision of a world where everyone has financial services to help them achieve their goals... new providers and new technologies are making it possible.”<sup>1</sup>

What, then, has the term microfinance signified during the last thirty years? To answer this question it is useful to make a short digression into epistemology. The field of international development famously comprises “battlefields of knowledge” (Long and Long, 1994) prone to “competing paradigms” (Hunt, 1989), and to “buzzwords and “fuzzwords” (Cornwall and

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<sup>1</sup> See also recent World Bank policy prescriptions (e.g. 2015a, 2015b).

Eade, 2010). It can be viewed as organised less through established knowledge hierarchies or canons of great thinkers, and more as a struggle between overlapping and multi-layered “knowledge lineages” (Abbott, 2000) and “mental models” (Denzau and North, 1994). In the face of the overwhelming social system complexity, this apparent chaos constitutes an open system through which different views of the world (and methodological approaches to understanding it) compete on the basis not only of their usefulness to different social groups and classes, but also of their resilience in the face of public scrutiny, criticism and debate. Copestake (2008; 2011; 2015) suggests that such resilience depends in part upon how mental models of development offer a coherent rationale for meaningful action by explaining a social system as it currently is, as it should be and as it could be.

In this paper, we address microfinance as a sub-field of international development in three steps. First, we enquire into core elements of a mainstream and dominant version of microfinance. This is broadly positivist and progressive: viewing microfinance as having the power to promote both financial inclusion and poverty reduction. Second, we explore a critical narrative of microfinance that emphasises its role in the adverse incorporation of often vulnerable people into polarising, discriminatory and often exploitative relationships. Starting with a familiar cast of heroic individuals and organisations in Bangladesh, the Andes, Indonesia and elsewhere these two narratives take up antithetical perspectives on what is in other ways a shared interpretation of microfinance as an inexorable process of global financial development (to use a more positive term) or financialisation (to use a more negative one). Third, we ask what this combined global narrative hides as well as reveals. More specifically, we suggest that it might downplay the chaotic diversity and plurality of ideas, policies, practices and experiences associated with microfinance during this period. Table 1 uses this framework to develop the distinction between these three narratives of microfinance - mainstream, critical and plural.

The rest of the paper is set out as follows. Section 2 explores mainstream and critical perspectives in more detail, with particular reference to the important example of microfinance in India. We then ask how far both views reinforce a tendency to think about microfinance in a top-down and deductive way, within frameworks that emphasise universal and global processes over diverse national and local experiences. This suggests an alternative and more plural view, shown in Table 1 as a third column. To illustrate, Section 3 briefly reviews a selection of six microfinance doctoral theses undertaken at the University of Bath that offer diverse but in-depth vignettes of different aspects of microfinance history across the world. Section 4 concludes by arguing that the challenge facing future historians of microfinance will be to capture such variety of experience at the country level and below, thereby potentially both enriching and confounding grander and more global narratives. To do so they will need to find ways to complement narrowly framed and deductive analysis of data with the richer empirical evidence available from more open and in-depth studies, including doctoral research of the kind presented in Section 3.

**Table 1: Mainstream, alternative and plural interpretations of microfinance**

	Mainstream	Critical	Plural
Historical dimension (how the world is)	Widespread poverty traps, excluding most poor people from regulated services delivered through competitive markets.	Reproduction of poverty through adverse incorporation into markets, particularly through over-indebtedness.	Context specific and path dependent patterns of poverty and financial ecosystem evolution.
Normative dimension (how it should be)	Universal access to financial services offered through competitive and regulated markets as a means to promote self-employment, liquidity smoothing and risk management.	A stronger voice and better terms for financial service users, partly through solidarity economy alternatives to commercial suppliers.	Services that combine innovation with adaptation to diverse local contexts and social norms.
Gap closing or action dimension (how it could be)	Accelerated innovation and financial integration through selective state activism (smart subsidies) and enabling regulation.	Civil society and state mobilisation to promote fairer and more democratic services.	Largely endogenous adaptation of services to meet locally specific needs & opportunities
Possible advocates	CGAP; mainstream financial institutions; neoclassical economists	UNRISD; civil society activists; heterodox social scientists	Locally rooted practitioners; social anthropologists.

## 2 Mainstream and critical narratives of microfinance, with particular reference to India

The literature on microfinance encompasses many disciplinary perspectives and can be subdivided in numerous ways: according to its relationship to poverty or allocative efficiency, to emphasis on state activism and market competition, and to demand-led or supply-driven innovation, for example (Copestake 2015; Goodwin-Groen, 2012; Gravesteyn, 2014). However, introductions and overviews to the topic tend to stress the same points. Starting with the demand side, poverty is closely associated with lack of material assets, including collateral against which to borrow. This prevents poor individuals from operating many businesses on a sufficient scale to be competitive, condemning them to a poverty trap (e.g. Banerjee and Duflo, 2011). Potential suppliers of credit desist from lending to them because the costs per loan of screening, monitoring and contract enforcement are too high relative to risk adjusted prospective interest earnings. The microfinance story then unfolds through a series of innovations in lending practices that offset these core constraints. Pride of place is attached to group based lending guarantees. Built into routine lending procedures these enable microfinance institutions specialised in them to grow rapidly. The mainstreaming of microfinance is then attributed to the diffusion of this and other innovations, subject to necessary reforms in the enabling environment, including

liberalisation of interest rates and granting of sufficient creditor rights to lure investors into the sector in pursuit of profits without fear of seeing their activities hijacked or undermined by overzealous regulators (Fergusson, 2006).

While literary tastes differ, there is something very appealing about the parsimony, precision and apparent universality of this account. From a relatively small number of incisive generalisations about human nature a whole gamut of insights emerge into how and why credit does and does not move to a significant proportion of the world's population, loosely referred to as 'the poor'. But it is the seductively simple explanatory power of this story that makes it so dangerous! By firmly entrenching the core problem facing poor people as being their lack of assets, and the core solution being innovation to reduce credit market failure, it shifts attention away from other possibilities: that poverty is also borne of rampant inequality and of rotten relationships that are rife with coercion, discrimination, exploitation and powerlessness, for example. By implicitly pointing towards contractually agreed solutions to problems of credit market failure the dominant narrative also downplays the important influence of power struggles. And by emphasising a universal problem it detracts from the potential implications of immense diversity in the history and context of poverty around the world.

To take the argument one step further, once we start perceiving the world as a series of constrained optimisation problems, cost reducing innovations and opportunities for Pareto gain it becomes increasingly hard to see it in other ways too. Anchoring understanding to this mental model also tacitly suggests a research agenda based on the premise that truth and understanding can best be advanced through empirical validation or rejection of theoretical hypotheses deduced from universal theory. We are not suggesting this is wrong, in the sense of being based on faulty logic. But we are suggesting that it is perhaps a narrow and restrictive way of looking at microfinance, and of course the world more generally.

To reinforce this point, consider a second version of the mainstream story, this time based on a brief summary of recent experiences in India. The scale of microfinance in India is so huge, and the pace of its growth has been so spectacular, that this is also more than an arbitrary illustration. In the 1980s, the term microfinance was virtually unknown in India. Lending to poor people was the business of widely reviled informal moneylenders and of publicly owned and controlled financial institutions who were required to lend to priority sectors and the poor at sub-market interest rates. This model of public policy confounded the most basic tenets of allocative efficiency at the heart of the mainstream model of microfinance sketched out above. Instead, microfinance evolved into a gigantic mechanism for redistribution: officially, as one component of an ambitious strategy of economic and social transformation; unofficially, as a powerful mechanism for dispensing patronage for political purposes.

While room for policy manoeuvre then seemed rather limited, at least two impressive policy transformations have taken place since, and we are now possibly in the flood tide of a third. The first was the gradual redirection of subsidised credit towards self-help groups: India's distinctive and home-grown version of the group lending model of microfinance, and one that uniquely involved collaboration between government departments, banks and NGOs in a simultaneous process of social and financial intermediation under variants of the SHG-Bank linkage model. The second was the establishment and growth of independent specialist



microfinance institutions (MFIs) registered as non-bank finance companies (NBFCs). By 2014 the SHG and MFI programmes together served 181 million clients, with credit outstanding of Rs.76.4 crores (US\$ 12.74 billion), and savings of nearly Rs.10 crores (US\$ 1.89 billion).<sup>2</sup>

The SHG model remains heavily subsidy-dependent, while growth of MFIs entailed the mobilisation by the Reserve Bank of India (RBI) of large sums of public and private capital.<sup>3</sup> At the same time, its growth has entailed the mobilisation of large sums of private capital. A critical precondition for leveraging private funds to fuel the growth of the NBFCs was liberalisation of interest rates for lending to them. Rates for government schemes for lending to poor households were previously not only fixed but typically three to four percentage points below the prime lending rate of banks, with the difference met by government subsidy. Banks not only had to manage the lending operation, but were burdened by the onerous paperwork required to claim the subsidy portion. By then allowing banks to lend to microfinance providers, the RBI also allowed them to decide on the channel, and to spread risk across institutions and geographies.<sup>4</sup>

The initial lending in the first phase was slow, but demonstrated the relatively high quality of microfinance assets – both in terms of returns and low default rates. This experience was further ratified by the rise of third-party reports, audits and ratings that further strengthening the comfort level of banks. In 2008 and 2009 it reached unheard of proportions. Deal sizes by some of the big agencies reached US\$100 million with development finance institutions undertaking debt syndication for even larger sums. An interesting feature of this period, illustrated by Figure 1, is that growth was led by the largest organisations for whom operating expenses were lowest.

The growth of the NBFCs in India during the decade to 2010 can be regarded as a crowning achievement of mainstream microfinance, bringing potentially self-sustaining if basic credit services to millions of poor borrowers for whom capital had previously been available (if at all) only through informal lenders and heavily subsidised government schemes. This was achieved in a relatively short period by autonomous, competitive, profit-oriented, innovative and ambitious microfinance institutions. They were nurtured and supported by government, chiefly through its central bank, in a direction that represented a significant departure from a tradition of state subsidised credit provision. At the time it appeared largely to vindicate the mainstream position and the simple version of it briefly rehearsed above.

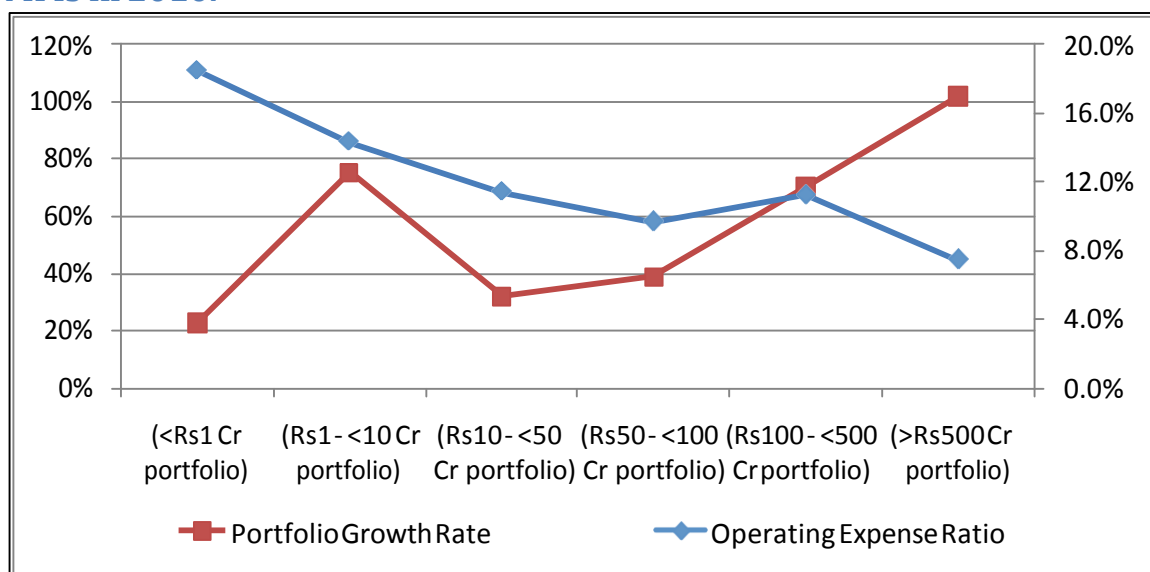
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<sup>2</sup> The data on the sector mentioned above are from Sa-Dhan (2014), page XVII. For broader historical reviews see Mahajan et al. (2000) and Copestake (2013).

<sup>3</sup> All banks are required to lend 40% of their total assets to priority sectors as defined by the RBI. In 2004 refinancing microfinance was classified as priority sector lending, and this was retained when the list was significantly narrowed down a few years later (RBI, 2004, Master Circular, dated 30<sup>th</sup> June 2004. RBI/2004/12/ BPD(PCB) MC NO. 1 09.09.01/2004-05). As economic growth in India accelerated so bank balance sheets expanded, and microfinance became a convenient channel for enabling banks to meet their priority sector targets. Emerging leaders include ICICI Bank, HDFC, LT Finance Holdings and Muthoot. The former was converted from being a development finance institution into a bank in 1994, with a first year target to make US\$4.5 billion of lending.

<sup>4</sup> RBI Circular on Micro-Credit. No: RPCD.NO.PL.BC.62/04.09.01/99-2000 DATED 18 Feb 2000.

**Figure 1: Portfolio growth rates and operating expense ratios of Indian MFIs in 2010.<sup>5</sup>**



In 2008, the global sub-prime crisis cast a shadow over this benign view of the road to poverty reduction through financial inclusion.<sup>6</sup> This heralded the Indian microfinance sector’s own perfect storm in 2010 in the form of the Andhra Pradesh crisis, which threatened to completely derail the success of the NBFCs. The version of this event that is consistent with the mainstream view of microfinance puts much of the blame for it on the State government. Riled by the success of NBFCs in stealing market share from its own SHG-linkage model of microfinance, the State Government issued an edict - the Andhra Pradesh Micro Finance Institutions (Regulation of Money Lending) Act – that imposed much tighter controls over both the interest NBFCs could charge and over their loan recovery practices. The MFIs experienced a sharp decline first in loan collection, and then in disbursement. Losses mounted, and by the time the dust had settled, the outstanding amount that had to be written off by banks and microfinance institutions amounted to Rs.7,200 crores (US\$1.2 billion).<sup>7</sup>

The virtual collapse of microfinance in Andhra Pradesh was a massive blow to the sector and posed a major risk of spreading to other States. The RBI responded in time-honoured fashion by setting up a task force, called the Malegam Committee.<sup>8</sup> This recognised the case for requiring MFIs to operate within a price band linked to the price at which they borrowed and their size of operation. It also called for stronger guidelines on product transparency, consumer protection and financial capability to guard against sharp selling practices and over-indebtedness, particularly in relation to vulnerable and illiterate clients. Third, it

<sup>5</sup> Source: Sa-Dhan (2015).

<sup>6</sup> The then Governor of the RBI sought to downplay this by emphasising India’s more paternalistic and cautious approach to bank regulation (Reddy, 2009) - a view somewhat undermined by the subsequent Andhra crisis.

The current Governor is more cautious in his assessment of microcredit, observing that “although it has promise on a small scale, history suggests that when scaled up, and especially when used as an instrument of government policy it will likely create significant problems.” (Rajan, 2010:45).

<sup>7</sup> See CGAP (2010); Mahajan and Navin (2012).

<sup>8</sup> Report of the sub-committee of the Central Board of Directors of Reserve Bank of India to study issues and concerns in the MFI Sector, January 2011.

reinforced the drive to strengthen credit bureaus to guard against multiple lending (Microcredit Ratings Ltd, 2011; Priyadarshie and Ghalib, 2011). Four years later, advocates of the mainstream view of microfinance can claim that Andhra's setback brought some timely corrective action to the expansion of more socially responsible forms of microfinance elsewhere in India, which is again expanding rapidly, particularly in Northern States.

However, others have interpreted the crisis quite differently, and this provides a suitable juncture to switch from reviewing the mainstream to a more critical narrative history of microfinance both in India and more widely (e.g. Augsburg and Fouillet, 2010). For its advocates, the Andhra experience was 'smoking gun' evidence in support of their prior position that commercially oriented microfinance represented a sinister refinement of exploitative moneylending rather than being a benign substitute for it. The Andhra State Government's action against them may have been motivated in part by their wish to protect its own more benign SHG model, but it was also precipitated by overly aggressive loan expansion practices and recovery techniques.

The Andhra case is not, of course, an isolated example of a microcredit bubble leading to damaging over-indebtedness through some combination of irrationality, irresponsibility and failed coordination on the part of borrowers, lenders and regulators (e.g. Bateman, 2012, Roodman, 2012; Sinclair, 2012; Schicks, 2013 ). Indeed some of the most powerful empirical evidence of the damage that over-exuberant microcredit can do to its customers comes from Bangladesh and its poster-children of the mainstream microfinance model – ASA, BRAC and Grameen Bank (Maitrot, 2014).<sup>9</sup> Maitrot documents a process she calls "implementation drift" whereby large MFIs that combine standardised procedures with a high degree of operational decentralisation officially espouse social performance goals (poverty reduction, gender empowerment etc) while at the same time cultivating ignorance of the informal practices of their own staff, and the malign effect of these on many of their clients. Evidence of the capacity of microcredit to do harm combined with the failure of the industry to generate positive evidence of its impact is one factor behind its damaged image as a development mechanism.

Its critics go further by suggesting that such consequences are integral to the mainstream model of microcredit: indicative not just of temporary episodes of Schumpeterian creative destruction along the path towards financial integration, but symptomatic of deeper and more durable processes of adverse incorporation (Rogaly, 1996; Weber, 2004; Roy, 2010; Bateman, 2012; Sinclair, 2012; Maitrot & Hulme, 2014).<sup>10</sup> In so doing, they also emphasise its global political economy: the dominance of a model of microfinance orchestrated from Washington and dominated by a free enterprise ideology in favour of market competition over political struggle.<sup>11</sup> More radical still is the view of microcredit as an instrument for

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<sup>9</sup> For a contrasting mainstream progressive assessment of the Bangladesh experience see Khandker and Samad (2014).

<sup>10</sup> The term adverse incorporation is explored in detail by Wood (2003). It serves as a reminder that inclusion (whether into hierarchies, markets or communities) does not necessarily have benign effects because it exposes those being integrated to various forms of coercion and exploitation. It is one thing to prefix 'socially responsible' to 'financial inclusion' as a goal (e.g. Malmberg, 2014) but not so easy to ensure that doing so is meaningful.

<sup>11</sup> This allows for aid and 'smart' subsidies as long as they can be justified on 'infant industry' grounds that they are a transitional means to building financially self-sustaining financial services. It is also broad enough

softening up social systems and cultures resistant to incorporation into global capitalism to the detriment of collective values, honesty and trust (c.f. Weigartz, 2012).

This critical perspective on microfinance also contributes to a theoretical critique of the neoclassical version of microfinance with which this section began.<sup>12</sup> Such contestation of bourgeois economics owes much to Marx (Howard and King, 2001) but can also be connected to Polanyi (1944) and his treatise on the “great transformation” of capitalism in the middle of the Twentieth Century. Commodification and the policies to promote it (what we now call neo-liberalism) can sustain its own cultural superstructure in the reproduction of most goods and services, but the commodification of people (as labour), nature (as primary resources) and financial entitlements (through money and credit) inevitably prompts cultural, social and political reactions. With respect to microfinance this suggests that there is nothing new to episodes of capitalist excess prompting political resistance with at best ambiguous effects on the wellbeing of those who live through them, with no guarantee of a long-term trajectory towards greater equality (Piketty, 2014).

It is illuminating to conclude this section by returning to India, as it pursues its own pathway from the politics of caste discrimination and colonial domination to an uncertain modernity subject to competing pressure for more neoliberal and egalitarian policy turns. One question we left unanswered was whether the Andhra experience has fundamentally changed the mainstream thinking, and if so for how long. It is too soon to tell whether the Modi government will be able to liberalise the economy as fast as the generous private sector paymasters of his election expect. A pessimistic view is that recent reforms, are enticing the larger NBFCs into another frenzied race to grow and expand sufficiently to qualify for registration as Small Banks, leaving those NBFCs and NGO-MFIs who fail to retreat into client status as Bank Correspondents or SHG promoters.<sup>13</sup> Against this tendency stand RBI supervised checks and balances set out by the Malegam committee discussed above.

The continued vigorous growth of microfinance in India is also germane to the question whether or not it is appropriate to talk about its demise as a distinctive field of development ideas and activity. In signalling their comprehensive reintegration into the fully regulated financial system, the bifurcation of MFIs suggested above does at least point to an end-game. Still more significant to the transition from microfinance to financial inclusion is the shift in emphasis from meeting micro-credit demand to directing MFI and NGO capacity towards the e-monetization of India’s informal economy through the push for universal access to bank accounts and debit cards, linked also to the switch to cash based direct benefit transfers (Patel, 2014). This moved to centre stage politically in August 2014 soon after Modi’s election as Prime Minister, when he announced a target to open 75 million Jan Dhan bank accounts by January (rediff.com, 2014). Whether this impressive feat does constitute a tipping point towards wider financial inclusion and monetary integration of

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to accommodate minority interests in alternative models of microfinance: Washington being home to the World Council of Cooperative Credit Unions as well as CGAP, for example.

<sup>12</sup> This is not to deny that neoclassical economics can also assist in powerfully illustrating how institutions evolve to reinforce and sustain inequality. For example, credit bundling or inter-linkage with other markets both lowers screening, monitoring and enforcement costs and entrenches monopoly. Group lending with dynamic incentives in the form of escalating loan sizes operates as an ‘efficient’ (i.e. cheap to the lender) mechanism for screening out borrowers with insufficient debt-capacity by passing on the costs of such screening to the group.

<sup>13</sup> RBI Master Circular, dated 1st July 2014, RBI/2014-15/43 DNBS. (PD) CC. No. 395/03.10.38/2014-15.

India’s informal economy remains to be seen. But its prominence certainly undermines the value of any analysis of microfinance in isolation from its role within the wider financial system.

### 3 Towards a plural history of microfinance

The previous section rehearsed a narrative of microfinance as a stepping stone towards global financial integration, with a mainstream version welcoming this as progress opposed by a more critical view. In this section we step back from grand generalisation and consider the scope for telling a more diverse and fragmented history of microfinance. This is illustrated with reference to a sample of six doctoral studies conducted by students at the University of Bath, and listed in Table 2. These add up to more than half a million words, and all we can hope to do here is offer a very partial interpretation of some of the insights they afford. We have organised them loosely into three pairs, according to whether their primary focus was on the institutions governing the use, supply or regulation of microfinance services. Johnson and Nino-Zarazua focus on the demand side (use) and how it is embedded in localised socio-cultural norms and practices. Gravesteijn and Humberstone focus on the supply side, starting with the mainstream framework for thinking about performance management within microfinance, but illustrating how it remains subordinate to local values, priorities and organisational culture. Cabello and Goodwin-Groen also emphasise social embeddedness, but through an analysis of path dependent variation in microfinance regulation.

**Table 2: Six doctoral theses on microfinance**

Author	Title	Date
Susan Johnson	“Moving mountains”: an institutional analysis of financial markets using evidence from Kenya	2003
Max Nino-Zarazua	Financial services in a low-income area of Mexico City: from physical access to effective use.	2006
Robin Gravesteijn	Models of social enterprise? Microfinance organisations as promoters of decent work in Central Asia	2014
Julie Humberstone	Managing for organisational self-reliance and social impact in Indian microfinance: alternatives to the mainstream	2015
Mateo Cabello	Bridgehead or barricade? Institutional reforms and microfinance regulation in Central America	2007
Ruth Goodwin-Groen	Financial inclusion does not come easily: an institutional analysis of the development of the microfinance markets in Bosnia and Uganda between 1997 and 2007.	2012

#### *Microfinance use and social embeddedness*

Johnson’s thesis was motivated by an interest in exploring how markets are moulded by social relations, particularly those linked to age and gender. It sought to map the financial landscape around Karatina in Kenya through a sample survey of rural and urban users, complemented by key informant interviews with financial service suppliers. She used probit analysis to measure variation in who used which services, and qualitative interviews to explore explanations for observed differences. This generated a rich and complex picture of segmented use, including as a result of gender and age. It examined the cultural meaning

and importance of land such that its use as collateral was avoided, and demonstrated that NGO sponsored microfinance turned out to be very limited in breadth of outreach compared to mutualist services provided through savings and credit cooperatives (SACCOs) and rotating associations (ROSCAs).

A key reason for the preference for mutualist organisations was the potential for voice in how these operate and hence the flexibility this brought to the terms and conditions involved, that is, their inherent “negotiability”. Subsequent research in Karatina, and more widely in Kenya, has enabled her to monitor rapid changes in the use of financial services over time. In particular, observing the rapid adoption of the M-Pesa mobile money service in recent years, she has gone beyond narratives that see this development as simply a route for domestic remittances facilitated by lower transactions costs, to analyse this for its affinity to an already long established tradition among Kenyans of inter-personal exchange. This, she argues, operates within a fiduciary culture of entrustment and obligation that has at its core relationships of equality, again allowing for negotiability similar to the case of mutuals, but in significant contrast to the tendency of banks to behave more hierarchically. (Johnson 2014). These deep insights have clear implications for would-be replicators of financial technology: seemingly identical products will have very different take-up according to how they resonate with prior social relations. More fundamentally, where financial service use is linked to participation in creation of supply, her work questions how far supply and demand can be analysed independently of each other.

Social embeddedness was also central to Nino-Zarazua’s doctoral research into the financial landscape in a peri-urban settlement on the edge of Mexico City. He followed a similar research methodology to Johnson, despite the practical difficulties of identifying willing respondents in a context characterised by a high level of generalised mistrust. His research area was purposively selected from a district that offered a high density and diversity of informal, semi-formal and formal financial providers. Some respondents belonged to a group-based microfinance institution called CAME, then second only to Compartamos in its breadth of outreach. He found that a relatively small proportion of variation in use of financial services could be explained by respondents’ age, gender, education, economic status and other socio-economic characteristics. Instead most people seemed to have acquired either what he called “a culture of finance” or a mental model of suspicion towards almost any financial service (Nino-Zarazua and Copestake, 2009). Variation in what we now refer to as financial capability was a highly social process, often passed by older women introducing younger relatives into their CAME group, for example. The material impact of the CAME programme on members’ wellbeing, he concluded, was quite possibly less important than such cognitive and relational impact. While a switch in microfinance provision from group-based to individual loan products might improve access by lowering service delivery costs it might also weaken these non-material benefits. In short, like Johnson he found that the social relations within which microfinance products were embedded exerted a powerful influence over product uptake and hence impact.

### *Microfinance supply, performance management and organizational culture*

The starting point of both Gravesteyn (2014) and Humberstone (2015) was to examine how feasible it is for MFIs to pursue social and financial objectives simultaneously. They thereby examined a key condition for the social business model endorsed by Yunus (2007) that also



underpins the quest for shared or blended value through impact investment (CGAP 2013). Gravesteyn's thesis was linked to a wider programme of action research into the scope for strengthening the impact of microfinance on employment quality or "decent work" (ILO, 2012; 2015). Selected MFIs were given the opportunity to pilot an organisational or product innovation, and to assess its effect using a difference-in-difference impact evaluation design (ILO, 2015). Gravesteyn added an extra dimension to the research by conducting participant observation into how the research affected the organisational culture of two MFIs over a five year period (2008 to 2013).<sup>14</sup> Bai Tushum in Kyrgyzstan launched a new loan product for small and medium enterprises (SMEs) to boost job creation. IMON International in Tajikistan launched a combined start-up loan and entrepreneurship training package for women.<sup>15</sup> At the start of the research in 2009 both MFIs were leaders within relatively young national microcredit markets. They were already financially sustainable, with nearly 30,000 borrowers and a record of strong portfolio growth. The primary social goal of Bai Tushum was job creation through SME promotion. It had an outward looking commercial organizational culture, and staff were mostly motivated by career development and strong remuneration packages. Bai Tushum's motivation for participating in the ILO project was primarily to promote its record of business promotion and job creation to investors, donors, politicians and other external stakeholders, thereby improving its competitive position. Staff mostly assumed that easier access to larger loans would create more jobs in their clients' enterprises. IMON's primary goal was women's empowerment. It had a more inward looking organizational culture, with most employees more intrinsically motivated. It used the ILO project to pilot a new package of financial and non-financial services intended to help it refocus on its goal of promoting women's entrepreneurship.

The impact studies delivered a significant reality check to both MFIs into how far they were achieving their social goals. But they reacted very differently. Bai Tushum found that loan size was at best only weakly correlated with job creation, and that only a small portion of their borrowers owned SMEs. The management considered the results to be a temporary aberration and did not make many changes to its operations. The IMON pilot study indicated that the entrepreneurship training had positive effects on self-employment and business start-up, mixed effects on client's business practices, but no effect on women's empowerment. It responded by investing more in its capacity for social performance management, raising staff awareness of barriers to women's entrepreneurship and actions to try to reduce them.<sup>16</sup> At the same time, both MFIs modified and then mainstreamed the pilot interventions, even though some of the client outcomes were arguably small.

Gravesteyn concluded that the way the MFIs managed the pilots was strongly influenced by their organisational culture and openness to change. IMON accepted the need to build

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<sup>14</sup> Organisational culture refers to the shared motivations, perceptions, norms and values of people in an organisation, and how they are institutionalised in its core operating practices (see also Cameron 2008:431).

<sup>15</sup> In both cases the impact assessment relied on a panel comprising three surveys with combined 'treatment' and control group samples of 900 clients for IMON and 1,500 for Bai Tushum. Qualitative data included 61 semi-structured interviews with MFI staff, combined with reports, informal conversations and field notes. These examine how the MFI staff experienced the piloting process, including their prior assumptions about who their clients were, what they learned from doing the evaluation, and how this learning translated into organisational actions.

<sup>16</sup> They modified the product by reducing loan documentation requirements and involving family and local municipalities in the product delivery. Significant investments were made in human resources to start a business development services department offering various non-financial services.

capacity for social performance management as an antidote to internally articulated fear of mission drift.<sup>17</sup> Bai Tushum was less motivated to act on findings of the study because senior staff were mostly interested in presenting positive results to external stakeholders. For IMON the ILO's technical support speeded up organisational change because they shared the same agenda. In contrast, the ILO project had little influence on the Bai Tushum because the decent work agenda did not sufficiently resonate with internal interests. The general implication is that organisational culture limits the influence that external agencies such as the ILO have on MFIs. While the case studies demonstrate that it is organisational culture that matters most for social performance management this is not widely acknowledged, for example, by the SPTF standard (SPTF 2012).<sup>18</sup>

Humberstone (2015) focuses on assessment of social performance among MFIs in India. Noting that most studies refer either to the SHG-Bank Linkage programme or to large NBFCs she purposively selected two MFIs that have remained NGOs: ASSEFA and Crusade. She found that both kept formal performance measurement to the minimum necessary to meet regulatory requirements, preferring instead to rely on more personalised feedback mechanisms. This reflected the organisations' strong commitment to staying close to the users of its services, and to avoiding an overly impersonal, rigid and reductionist culture of management. Indeed they self-identified less with microfinance than with belonging to a wider Gandhian tradition of development. Her thesis and Gravesteijn's both illustrate the importance of origins and founding values to MFI's organisational culture, resulting in path dependency that is resistant to the efforts of external agencies to promote a more uniform approach to performance assessment. A strict adherence to results oriented management was treated with some suspicion as a potential threat that to their organisational autonomy, values and identity.

### *Microfinance regulation and path dependence*

In June 2003 the Consultative Group to Assist the Poor (CGAP) published standard guidelines for the design and implementation of national legal frameworks for the regulation and supervision of microfinance (CGAP, 2003). Cabello's thesis explored variation in implementation of these guidelines across three Central American countries during the period up to 2007. In two of the countries he studied, El Salvador and Guatemala, the drafting of microfinance laws and regulations remained exclusively the preserve of the government, central bank and financial authorities. Microfinance practitioners were hardly involved. The outcome was a highly restrictive framework, requiring MFIs to meet fiduciary standards similar to those expected of commercial banks, thereby undermining incentives to invest and to grow. In contrast the microfinance regulation bill in Honduras was primarily drafted by the Covelco Network, a body that effectively represented Honduran MFIs themselves. This created more opportunities for microfinance to grow and to begin to address extreme inequalities in access to financial services between richer and poorer

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<sup>17</sup> This corroborates an extensive literature that emphasises the importance of intrinsic motivation (Osterloh and Frey 2000), internal commitment (Senge 2006) and endogenous drivers (Boettke et al. 2008) in bringing about institutional change. They all argue that performance management driven by internal factors will create more commitment to invest resources, to learn, to build capacity and to take ownership of performance (see also Denzau and North 1994:8-10).

<sup>18</sup> The Social Performance Taskforce Standards set up through CGAP has agreed 98 indicators for SPM, but these largely ignore implicit internal organisational culture on the grounds that they are too difficult to assess (SPTF, 2012). As a result the standards then becoming a technocratic 'tick box exercise' conducted to comply with externally imposed standards, but lacking internal support.



sections of society.

Cabello's thesis explored the processes leading to these divergent policy outcomes. Key informant interviews revealed that the financial authorities viewed microfinance regulation in a radically different way to microfinance practitioners. These views were linked to differences in the prevailing political culture of the three countries. In El Salvador and Guatemala, the long history of armed conflict between ruling elites supported by the army (on one side) and leftist guerrillas defending the interests of poorer segments of population (on the other) severely restricted receptiveness to institution building that bridged the regulated financial system and informal economy (Cabello, 2008). Honduras shared with them a history of sharp inequality and elite resistance to any reforms that might weaken their control of the state. But in the absence of such a strong legacy of conflict it was open to a somewhat more progressive strategy for promoting microfinance.

More generally, the thesis makes clear that, far from being a technical issue, microfinance regulation is unavoidably political. This anticipated the subsequent emergence of a political economy analysis literature to guide international agencies in understanding and negotiating contextual, political and social factors shaping economic policy and its reform (Copestake and Williams, 2014). This is reflected in the revised version of CGAP's Guide to Regulation and Supervision of Microfinance, published in 2012, opening up opportunities for donors to think and work, including recognising the case for greater policy diversity.

The role of external agencies in promoting institutional change that broadens access to financial services is also central to Goodwin-Groen's thesis. She asks two questions: how did rules and norms governing post-conflict Bosnia-Herzegovina (BiH) and Uganda change between 1997 and 2007, and how did international development agencies contribute to these changes? Moving beyond mimicry of institutional blue-prints she focuses on regulatory functions, and how their form reflects local social norms and other contextual factors. Comparing the two, and drawing on theory developed by Mahoney and Thelen (2010) and Boettke (2008) she finds that external aid agencies were much more effective in promoting microfinance in BiH. She attributes this relative institutional stickiness not to their power to enforce aid conditionality, but to greater congruence between the entrenched norms regulating local behaviour and those underpinning donor prescriptions.

## 4 Conclusions

The purpose of this paper has been to review a range of possible historical accounts of microfinance as a distinct field of development thinking and action over the past thirty years. Section 2 described a mainstream narrative of progressive inclusion of poor people and their livelihoods into a globally integrated and regulated financial system, largely in the private sector but also strategically subsidised by government and aid agencies. We also identified a critical counterpoint to this narrative that emphasises the negative effects of market incorporation on poverty and inequality. In relation to Indian experience we noted that the spectacular growth of commercial microfinance appeared to vindicate the mainstream view. But this is weakly supported by empirical evidence of its positive impact on poverty, and also contested by a more critical view of microfinance in India that emphasises over-exuberant profit orientation. We also acknowledged in passing the existence of an alternative national

microfinance model based on state, bank and NGO sponsorship of self-help groups: a model that also grew very fast and has been sustained over time. Finally we noted that these experiences may indeed prove to be stepping stones towards an era of far greater financial inclusion through an expanded and electronically enhanced regulated banking system.<sup>19</sup>

A more systematic review of the mixed empirical evidence on microfinance impact is beyond the scope of this paper, but it is interesting to reflect on what future historians will make of it.<sup>20</sup> Some research studies will doubtless merit reference (Pitt and Khandkher, 1998, and Banerjee et al. 2009, for example) not only for what they claimed to reveal but because of the iconic status they acquired in ensuing debate. However, despite the substantial investments that have been made in impact assessment (e.g. see Banerjee et al., 2015; Duvendack et al., 2011; Stewart et al., 2012; Pande et al., 2012) it seems unlikely that agreement will ever be secured on the overall balance of direct winners and losers from microfinance, not least because the diversity of microfinance products, programmes and contexts is so enormous.<sup>21</sup>

Future historians are also likely to be as interested in the longer-term institutional effects of microfinance as they are in its contribution to global trends in poverty and inequality. This brings us to a third and alternative narrative of the history of microfinance – one that does not so much contest the premises and stylised facts of either the mainstream narrative or its critics, as offer a richer and more nuanced understanding of variation in microfinance experiments, experiences and outcomes. Throwing light on the institutional diversity of microfinance requires an exploratory and inductive approach to research that avoids imposing a restrictive universal framework of progressive inclusion on very different country-level experiences. In an era when grant funded research increasingly requires such framing, individual doctoral studies constitute a useful source of evidence for these more subtle histories.

The three pairs of examples reviewed in Section 3 illustrate this argument. First, Johnson and Nino-Zarazua showed how use of financial services is not uniform but influenced by localised socio-cultural norms and practices, particularly those needed to overcome distrust in anonymous institutions capable of exerting power (e.g. to allocate funds, enforce recovery, pay out on insurance) that users cannot negotiate in ways permitted by more decentralised and reciprocity-based institutions. An agenda for further research here is how future patterns of financial service use, including mobile phone based services, respond to, reinforce or are undermined by prior social relations. For example, it is possible to envisage mobile phone enabled bank linkages both strengthening and weakening group-based savings and loans institutions in India. The politics of age, gender and education are likely to be important in determining who gets access to smart phones to do what, and to benefit whose

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<sup>19</sup> Reddy (2009:183) provides a relevant overview that emphasises India's plural position: aiming "... to ensure the inclusion of all segments in mainstream institutions while taking advantage of the flexibility of multiple models in delivering a wide range of financial services."

<sup>20</sup> See Copestake (2013) for a discussion of the different kinds of evidence available for India, and Duvendack et al. (2011) for a broader and more systematic review.

<sup>21</sup> Big data and the benefits of hindsight vision may enable some empirical issues to be answered with more confidence. To give a historical example, Burgess and Pande (2005) arguably did more to justify state activism in promoting rural bank branch expansion across India during the 1970s and 1980s than more detailed empirical studies were able to do at the time.

vision of wellbeing.

Second, Gravesteyn and Humberstone explored how microfinance institutions hold onto values, norms and practices in the face of external pressures to codify these as key performance indicators and standardise organisational practices in other ways. The point here is not to set up a false dichotomy between modern and indigenous ways of management. For regardless of their source shared values, norms and mental models that build trust and underpin collective action can confer competitive advantage, including capacity for institutional learning (Cameron 2008; Senge 2005). The research agenda here (both forward looking and historical) is to document and explore the performance implications of the different ways in which mainstream thinking about best practices, products and technologies blend with path dependent configurations of individual and collective organisation that are deeply rooted in local organisational culture.

Third, Cabello and Goodwin-Groen explore path dependent variation in the regulation of microfinance at the national level, in ways that reflect distinctive political cultures and institutions. Again we can envisage a global history that identifies interesting national departures from mainstream best practice, and analysis of how these affected the terms of financial inclusion, as well as path-dependent patterns of privilege and discrimination over the control and distribution of national rents.

As a result of this analysis, we emphasise the diversity of national and sub-national outcomes, of the tension between mainly business-oriented pathways to financial inclusion, and those influenced by a broader view of human well-being. This distinction concerns not only normative goals, but also the means to achieve them, including the tension between (a) centralising power and driving efficiency through standardized performance measurement, and (b) devolving power over performance management to accommodate more complex and varied contexts, traditions and practices. As an antidote to heroic global narratives of microfinance and their antithesis it is important to uphold the role of networked collective action involving both scholars and practitioners in generating a more inductive and plural history, institution by institution and country by country.

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