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Lending to women in microfinance: Role of social trust

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ABSTRACT

Microfinance institutions' (MFIs) preference for women borrowers varies internationally and the MFI focus on women borrowers is generally attributed to two reasons: women borrowers are more trustworthy and have greater social impact. However, the role of social trust with regard to this gender preference has not been adequately investigated. We document that MFIs favor women more in low trust countries and in countries where social trust formation is primarily behavioral. We interpret these findings as consistent with gender targeting being used as a substitute for social trust. Our results should be of considerable interest to policy-makers, managers, and scholars.

1. Introduction

Microfinance institutions (MFIs) have been widely shown to be an important global innovation as they have increased access to finance among the poorest, making major contributions to economic development. In recognition of the importance of microfinance, the 2006 Nobel Peace Prize was given to Mohammad Yunus, the pioneer who founded one of the first MFIs, the Grameen Bank of Bangladesh. However, in spite of the hundreds of millions of people lifted out of poverty in recent decades in the Chinese, Indian, and other rapidly growing economies, over 2.5 billion people are still estimated to live on less than $2 a day (Chen & Ravallion, 2008). While these and other somewhat less poor people represent a vast potential market (Prahalad, 2006), more than half of the world's population, especially the very poor, are without access to formal banking institutions (Beck, Demirguc-Kunt, & Peria, 2008). While there are still many unanswered questions about the efficacy of MFIs, they have proliferated in recent decades, and interest in MFIs has also increased as the unbanked poor are seen as one of the largest and potentially most lucrative groups of potential consumers.

MFIs are similar to banks and traditional financial intermediaries. They intermediate funds between savers and borrowers. However, unlike traditional banking, MFIs generally do not depend in any significant way on consumer deposits. MFIs also differ from bank lending in other ways. For instance, microfinance involves small loans to the poor and relies on social networks and frequent and early repayments to reduce costs of default, monitoring, and collection. Unlike traditional banking, nearly all microfinance organizations exist to fulfill the dual objectives or "double bottom line" of assisting the poor while achieving sustainable financial performance.

Further, while all financial intermediation must solve the usual problems of asymmetric information, moral hazard, and payment collection, these issues are especially distinctive among MFI clientele who are generally very poor, have limited experience and understanding of finance, are often uneducated, have weak legal

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and political rights, and have low and irregular incomes. Thus, MFI clientele are unlike banking clientele and face especially high levels of information asymmetry. Given the incompleteness of contracts and the reliance on social, moral, and ethical practices, it is reasonable to expect that the focus and structure of microfinance institutions will differ from traditional financial intermediation and be influenced more by their national social, cultural, and economic environments.

Nevertheless, international differences in microfinance seem to be an understudied area, even though such differences continue to be of considerable interest (e.g., Bruton, Khavul, & Chavez, 2011; Mersland, Randøy, & Strøm, 2011). For example, while Kar and Swain (2014), and Rosenberg, Gonzalez, and Narain (2009) note that women may be especially targeted by MFIs and MFIs have been very successful in serving women borrowers especially in some countries, little is known about international differences in the microfinance focus on women borrowers.[1] Further, while it may be reasonable to accept the experience of the Grameen Bank and other microfinance institutions that women have a much higher tendency to pay back uncollateralized microfinance loans, this reasoning has largely remained an untested conjecture. Recently, Boehe and Barin Cruz (2013) find that whether a higher level of women borrowers improves MFI efficiency depends on institutional characteristics.

More specifically, in this paper we examine the association of the targeting of women borrowers by MFIs with social trust as an underlying national institutional characteristic. We also examine the role of how social trust is formed in a country in explaining international variations in the MFI focus on women borrowers. Thus, the purpose of this paper is to examine the influence of the national institutional and cultural environment on the targeting of women borrowers by MFIs. In doing so, we fill an important gap in the literature. In summary, the focus of this paper is the question, why do MFIs focus more on women borrowers in certain countries, and how can this international variation in the MFI focus on women borrowers illuminate the nature of microfinance?

We contend that the MFI focus on women borrowers is influenced by social trust and its nature. More specifically, we first hypothesize that as women are perceived to be more trustworthy, there should be a negative association between social trust and the percent of women among MFI borrowers in a country. This should be so as there is greater utility with regard to targeting the perceived more trustworthy female gender when social trust is low. Second, we also conjecture that women are better re-payers not necessarily because of a higher ability to pay back loans but due to an enhanced willingness to pay back MFI loans, especially in countries where social trust is primarily behavioral. Using the theoretical framework of Doney, Cannon, and Mullen (1998) associating the nature of social trust with national culture, we distinguish between countries where trust is primarily behavioral versus countries where trust is primarily economic.

In this paper we do indeed document that the MFI focus on women borrowers increases in lower trust countries, suggesting that the targeting of women borrowers is a substitute for lower levels of social trust. We also document that the nature of trust formation affects this relationship between gender targeting and trust, finding that more behavioral (rather than economic) trust formation is associated with a higher percentage of borrowers being women. We interpret this latter result as being consistent with women borrowers being more susceptible to social pressure in countries where social trust is primarily behavioral.

In terms of our other (control) variables, we find a positive association between the proportions of women MFI borrowers with the extent to which the MFI targets the poor. We interpret this result as consistent with the social mission of microfinance institutions. In addition, we find a negative association between the percent of female borrowers and the total number of MFI borrowers, and average loan size. We also find a positive association with the Asian region, indicating that MFIs are more successful in targeting women borrowers in Asia. These results are significant and robust to alternative estimation procedures.

The findings presented here should be of great interest to policy makers and scholars interested not only in the design and operation of microfinance institutions, but also in gender issues, 'bottom of the pyramid' customers, economic development, and the role of culture in financial intermediation. In short, this research contributes by illuminating the nature of MFIs and the importance of the role of gender and culture in finance. More generally, we believe our robust results will be of considerable interest to scholars and policy makers interested in the role of women in microfinance and social development, and more generally to those interested in the role of gender differences in financial intermediation. We leave it to others to explore more fully these and other implications of our findings.

2. International variations in microfinance and gender

Prior literature finds that the MFI focus on women borrowers is generally attributed to two reasons: women borrowers are more trustworthy and have greater social impact. But, as noted earlier, the MFI focus on women borrowers varies internationally. However, the reasons for the international variation in the MFI focus on women borrowers have not been explored adequately in the literature. This paper is an attempt to fill this gap in the literature.

2.1. Supply and demand for microfinance

The channeling of funds from savers to investors, or financial intermediation, is a necessary function in all countries and is generally undertaken primarily through financial institutions and financial markets. Either financing channel must resolve the issues of asymmetric information, adverse selection, and agency costs involved in financing contracts that cover the monitoring and collection of funds provided by savers to borrowers. Given the practical limits in specifying all possible contingencies, all optimal contracts are incomplete in practice. Thus, the efficiency of overcoming contracting costs depends not only on the behavioral expectations shaped by the economic, legal, ethical, social, and cultural environment, but also on the nature of the borrowers served. MFI borrowers are likely to be less educated or knowledgeable about financial matters, and so they face greater asymmetric information and other transactions costs.[2]

While all financial intermediation must solve the usual problems of asymmetric information, moral hazard, and loan collection, these issues are especially important among institutions that serve the poor who have limited means, little experience or understanding of finance, have irregular and low incomes, are often uneducated, and have weak legal and political rights (Armendariz & Morduch, 2005; Collins, Morduch, Rutherford, & Ruthven, 2009; De Soto, 2000; Garmaise & Natividad, 2010; Karlan & Morduch, 2009; Karlan & Zinman, 2009; Webb, Tihanyi, Ireland, & Sirmon, 2009). All of these characteristics mean high costs and risks in loans to the poor.

Thus, received wisdom has long been that lending to poor households is doomed to failure: Costs are too high, risks are too

[1] For example, our sample of 1019 microfinance institutions has an average of 67% of female borrowers (Table 1).

[2] For instance, Soderberg, Krishna, and Bjorn (2013) note the importance of trust in the engagement of software venders with bankers and intermediaries.