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Does microfinance impede sustainable entrepreneurial initiatives among women borrowers? Evidence from rural Bangladesh

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ABSTRACT

Across the world, microfinance (MF) has been recognized as an effective instrument for simultaneous reduction of poverty and long-term growth through creation of entrepreneurship. Available research does suggest that MF experiment in most cases was successful to reduce poverty, especially among poor women. However, evidence-based research on impact of MF initiatives on nature of entrepreneurial activities and on the psychological capital or potential of the entrepreneurs remains under-studied. This paper attempts to bridge the gap and seeks to diagnose the entrepreneurial behaviour of MF users in comparison to a comparative set of non-users in the same socio-economic climate in an emerging economy and the haven of MF, Bangladesh. The outcome variables considered are not just participation in income generating process, but specific qualitative attributes of entrepreneurship, including ability to innovative, bricolage, risk taking, marshalling etc. and also some quantitative indicators in the form of frequency of repeated loans and income generated there from that may offer proxy measures of scaled up and sustainable entrepreneurship. Data exploration posits that transformative entrepreneurship, which indicates sustainability of the venture to usher in prosperity, is rare among MF users. Small loan sizes, quick repayment cycles and repeated loans of MF institutions constrict the borrowers to opt for low-risk ventures, with women borrowers facing additional barriers as their gendered role force them to be less risky and follow traditionally accepted business modes, rather than making big headway. Using propensity score matching technique, the paper finds that easy access to credit through MF initiatives could not inculcate the psychological potential to bear risk and bricolage among the borrowers. Self-employment in micro enterprises, without much innovation and risk taking, has been the characteristics of overall income generating process of the model.

1. Motivation

In terms of endogenous growth theory, entrepreneurship represents the crucial and scarce input, which a *prime mover* finds necessary to initiate the development process by mobilizing supply of other pre-requisites. This paper is motivated from the fundamental understanding that entrepreneurship is an important mechanism for economic development through employment, innovation and welfare effects (Schumpeter, 1934; Acs and Audretsch, 1988; Baumol, 2002). Thus, entrepreneurship development resulting in innovative new ventures and employment generation is identified as one of the most efficient avenues to increase competition, shape market, thereby stimulating long-term growth, and escape from poverty (Knight, 1921; Schumpeter, 1942; Singer, 2006). However, it would be over-simplified to understand entrepreneurs as homogenous actors that are uniformly innovative and respond similarly to the enabling environment conditions

and policy interventions. They can be divided into two distinct groups: *subsistence entrepreneurs* who become entrepreneurs as a means of providing subsistence income, and *transformational entrepreneurs* who aim to accept risk and innovate to create large, vibrant businesses that grow much beyond the scope of an individual's subsistence needs and provide jobs and income for others (Schoar, 2010). The transformational entrepreneurs continue the business in a far more sustained way and thus are expected to increase income beyond their subsistence need for avoiding consumption poverty. However, the vast majority of the entrepreneurs lie in the subsistence mode, trapped in a “*necessity, survival and maintenance*” cycle and their activity does not affect national economic development (Acs, 2006). Such entrepreneurship seeks to help people simply meet their basic needs and this very focus on *basic needs* substantially undervalues what entrepreneurship can really achieve in any economy (Viswanathan et al., 2014). Thus, any development policy, which focuses on long run sustainable growth process, should

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target creation of the second type of entrepreneurs, beyond just nurturing a group of subsistence entrepreneurs, which would take off an economy into the path of a vibrant and sustainable development. Along with government's initiatives that mostly support poverty eradication and subsistence, certain market-institutions may augment people's initiative by creating favourable opportunity structures that direct the poor's drives for entrepreneurship (Sridharan et al., 2014) and micro-finance is one such institution.

Across the world, microfinance (MF) initiatives aim to alleviate poverty by stimulating economic growth through the avenue of boosting entrepreneurship (Khavul, 2010), clearly hinting towards its subsistence nature. It represents the idea of attempting to reduce poverty in developing countries through the provision of loans by specialized financial institutions to microenterprises. It offers collateral-free finance to those poor customers, primarily women, otherwise excluded from the formal financial initiatives, for fulfilling the *credit need* for entrepreneurial ventures. In most cases, microfinance is offered to those who want to become micro-entrepreneurs but cannot access formal credit, complementing the other state-initiated development policies offering subsidies and conditional cash transfers. In ideal situation, MF initiatives aim to transform the lives of the people not only by helping them escape from abject poverty of consumption of essential goods, but also by setting them on a path of transformational entrepreneurship and hence sustainable development.

Politically, it appeals to the left as being redistributive and a direct approach to alleviating poverty, and to the right as facilitating the emergence of an independent, self-sustaining 'penny capitalism' (Mosley and Hulme, 2009). Microfinance sector is based on the assumption that the poor possesses the capacity to implement income-generating economic activities, but are limited by lack of access to and inadequate provision of savings, credit and insurance facilities. This means providing opportunities for the poor to unleash their hidden entrepreneurship potential and enabling them to actively participate in capitalist development. The poor is reconfigured as '*new entrepreneurs*' (Fernando, 2004). It may represent a sequence in which the very poor, by initially borrowing for consumption, are able to reduce gradually their income-vulnerability and thereby get themselves into a position, where they can contemplate riskier investments in working capital, hiring of extra-family labour and fixed capital (Hulme and Mosley, 1996). However, literature identifies that the poor are probably more risk-averse (Lipton, 1968; Weeks, 1971), and an upward slope of the impact curve of MF reflects a tendency for the willingness to take risks and to invest in new technology to increase with income. Thus, a debate was grounded in two worldviews: the first group believed that the core business of MF was poverty reduction; while the other thought that MF was simply a variation on commercial activity that should seek a profit for borrowers and bankers to attract mainstream financiers without sustained social impact agenda (Counts, 2008).

Though one group of researchers posit MF initiatives are instrumental in reducing the burden of poverty through fuelling entrepreneurship, others cast doubts on this premise. The heterogeneity in results emanates primarily from the *definition* adopted for entrepreneurship, its nature and also the various ways in which the MF institutions operate. The aspect of transformational entrepreneurship in relation with microfinance is not identified so far in existing literature. The present paper attempts to contribute to literature both from certain conceptual innovations and from methodological perspective about the impact of MF. For the first time, at least to the knowledge of the authors, it quantitatively substantiates the recently evolving views that the MF has failed to breed sustainable and transformational entrepreneurship among women, in developing economies in general and in Bangladesh in particular, supposedly the haven of MF experiment. Conceptually, the authors introduce the debate of subsistence versus transformative entrepreneurs, while analyzing the impact of MF on their sample. Though the aim is not to give priority of *penny capitalism* over redistribution as a development policy, the paper targets to

identify if both these are simultaneously achieved by MF, as it is claimed by its proponents. The paper also attempts to contribute in the existing literature by suggesting a combination of quantitative measures (like frequency of loan turnover, income earned and nature of the business) along with some qualitative measures (like innovation, risk-loving and bricolage) for the purpose of diagnosing the type, nature and sustainability of enterprises created by MF. Empirically it identifies that creating access to small credit is neither a necessary, nor a sufficient condition for developing the potential of entrepreneurship.

A brief summary of existing literature on the evolution of definition of entrepreneurship and impact of microfinance on it is put forward in Section 2. Section 3 deals with specific objectives of the paper, while data and methodology are discussed in Section 4. Results and discussions are outlined in Section 5. Section 6 summarizes the findings and proposes the way forward.

2. Literature survey

2.1. Evolution of literature on definitions and nature of Entrepreneurship

After the seminal works by Schumpeter (1911, 1934, 1939), there has been an avalanche of writings on the theory of entrepreneurship and its linkage to economic growth. Schumpeter mentions an entrepreneur must introduce any convex combinations of '*a new good, a new method of production, a new market, a new source of supply of raw material or half-manufactured goods, and a new organization of an industry*' (Schumpeter, 1934:66). According to his theory, entrepreneurship is something that covers a very special kind of change, namely the type of change that can only arise *from within* the economic sphere and this is what he refers to as *development*. Ordinary neoclassical economic theory deals with *static* phenomena, according to Schumpeter, while there does not yet exist a theory that is capable of explaining dynamic process of developing into an entrepreneur. According to him, two factors determine whether a person would be in a state of statics or in development: their *sociological enabling environment* and his *psychological state of mind* (Schumpeter, 1911:118). People react negatively to deviance because they feel psychologically threatened; they are used to always do things in their own habitual and *safe* way. Schumpeter identifies that what kills entrepreneurship is other people (Swedburg, 2000). His entrepreneur, the '*Man of Action*', does not have the same inner obstacles to change as static people or people who avoid doing what is new. As opposed to the static person, who goes into his business because he wants to satisfy his needs (similar to need-based entrepreneurship as outlined by Zali et al., 2013) and stops once his goal has been accomplished, the leader has other sources of motivation and makes his way forward to prosperity. This theory has been extended in the later studies whereby in the longer run, entrepreneurial firms are credited with accelerating the speed of innovation and the dissemination of new technologies and products in the economy (Acs and Audretsch, 1988; Kortum and Lerner, 2000). Following this, the literature in management theories note that a business person might be different from an entrepreneur, as the latter believes in making his own path (Shane and Venkataraman, 2000; Jesselyn Co and Mitchell, 2005). Any businessperson enables the process to increase economic growth, employment generation and national income, but entrepreneurs specifically contributes to all these by creation of innovation and relatively higher growth rate (Mustafa and Ismailov, 2008; Mitra and Abubakar, 2011).

However, following Schoar 2010 and Lerner and Schoar 2010, it was identified that the flavours of entrepreneurship differs among subsistence and transformational entrepreneurs in ushering the economy on to a sustainable growth process. Many regulations that allow transformational entrepreneurs to grow faster, such as financial market and labor market deregulation, tend to crowd out the survival of subsistence entrepreneurs and hence the policy initiatives must identify what is the priority of the economy. The best solution would have been

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