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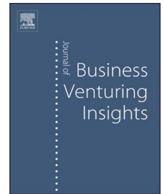

'Bang for buck' in microfinance: Wellbeing mentorship or business education?

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ABSTRACT

Within the microfinance literature, there is a growing interest in institutional logics. This paper explores ways that microfinance institutions can overcome the logic-tension of offering developmental programs and maintaining financial stability. First, I conduct a randomized control trial in Uganda to examine the financial and non-financial outcomes of *loan recipients*. Second, I use results from the field experiment, in a resource allocation model, to optimize the goals of a *lending institution*. I find that wellbeing mentorship, rather than business training, is the best 'bang for buck' when considering the interests of both the women entrepreneurs and the microfinance lending institution.

1. Introduction

Approximately one-half of the estimated 910 million people in Sub-Saharan Africa live in extreme poverty, which is defined as living on less than US $1.25/day (The Grameen Foundation, 2014). On a day-to-day basis, the vicious cycle of extreme poverty is one of constrained resources to meet basic family needs, such as providing food, education, and medical treatment for children. One espoused approach to reducing extreme poverty is comprehensive development, which includes both social and economic arrangements (Nickel, 2005; Sen, 1999). In a microfinance context, comprehensive development may include efforts to provide entrepreneurs with business training and wellbeing mentorship, in addition to credit opportunities, as mechanisms to build capabilities and to establish elementary freedoms (Sen, 1999). The difficulty with this approach is that it may create unintended organizational conflicts.

Within the microfinance literature there is an emerging interest in the tensions and potential conflicts created by multiple institutional logics (Battilana and Dorado, 2010; Cobb et al., 2016; Zhao and Lounsbury, 2016; Zhao and Wry, 2016). For instance, a microfinance institution (MFI) may want to offer comprehensive services to entrepreneurs, but are then faced with the stark economic realities of their financial position. When considering the benefits of different and often costly social and economic arrangements, MFIs may be forced to hybridize their logics. Hudon and Sandberg (2013) frame this as a critical ethical dilemma in microfinance. Therefore, the primary contribution of this paper is to advance knowledge of institutional logics and organizational choice by providing empirical tests of Sen's (1999) viewpoint on comprehensive development. This research sets out to provide answers to how MFIs can improve entrepreneur's financial and non-financial outcomes while simultaneously meeting their financial and social goals. Overall, the thrust of this paper is to understand what approach maximizes the MFI's 'bang for buck', given multiple institutional logics.

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2. The hypotheses: improving entrepreneur outcomes

When Muhammad Yunus and the Grameen Bank won the Nobel Peace Prize in 2006, there was a wave of interest in how MFIs might combat global poverty and inequality. A decade later, various forms of microfinance now serve 7.4 million borrowers in Africa alone and approximately 200 million borrowers worldwide (Microcredit Summit, 2015). Despite the endorsing support for microfinance as a tool for development, "there is still much to be learned about what works in enterprise-based solutions to poverty" (Klinger and Schündeln, 2011). The following four hypotheses aim to explore the impact of program arrangements on entrepreneur's risk behaviors, loan delinquency, and financial worry.

2.1. What might impact entrepreneur outcomes?

There is a long list of program arrangements that could plausibly impact entrepreneur outcomes (Chliova et al., 2015). I examine business training and wellbeing mentorship. Even though training and mentorship are typically not a part of microfinance/ microcredit definitions (e.g. Banerjee et al., 2015b; Chliova et al., 2015), scrutinizing their impacts may be beneficial (McKenzie and Woodruff, 2013). Some studies have investigated business training in different contexts and to different extents (see Karlan and Valdivia, 2011 for a review of RCTs that involve training). However, as demonstrated by prior scholarly work on training, the extent to which business training affects microfinance outcomes is modest and in many cases mixed (Glaub and Frese, 2011; McKenzie and Woodruff, 2013). Mano et al. (2012) question whether the benefits of training programs exceed the costs of such training.

Recent research from Goodman (2017) emphasizes the importance of appreciating different livelihood strategies and not focusing exclusively on loan productivity. My early dialogues with the MFI management team in this study echoed such point. They viewed business training as a way to enable current livelihood strategies at reduced levels of risk. In the context of this MFI, the dominant view was that business training would be a valuable platform for the MFI staff to communicate the importance of saving ('for a rainy day') and diversifying ('not putting all their eggs in one basket').

Even though it is not entirely clear whether business training helps entrepreneurs manage risk, there are reasons to believe that business training may be an opportunity to frame and discuss risk reduction/management mechanisms (i.e. savings and diversification) (Knight, 2012). In many developing countries, loan risk is magnified due to the uncollateralized nature of the loan (Chakrabarty and Bass, 2015). In fact, lending to entrepreneurs is a risky proposition for both the lender and the borrower (Field et al., 2013). One form of risk mitigation is saving. Morduch (2000) suggests that a savings program may be an essential feature of both subsidized and sustainable microfinance programs. Diversification of loan expenditures, by the borrower, may provide another form of risk mitigation. Portfolio theory holds that if investment returns are not perfectly correlated, diversification across investments will reduce risk. If a loan is paired with business training (training that includes instruction on the basic idea of saving and diversification), some of the loan risk may be reduced. As such, the following hypotheses are presented:

H_1: *Business training will be positively associated with higher levels of savings.*

H_2: *Business training will be positively associated with more diverse loan expenditures.*

Beyond a focus on the impact of business training, there is a need to understand the social impacts of microfinance programs on the lives of participants (Banerjee et al., 2015b; Morduch, 1999; Sen, 1999). Nickel (2005) frames this as non-financial dimensions. For example, women entrepreneurs who receive wellbeing mentorship – guidance on HIV/AIDs, family relations, sanitation, and food/water security – may develop a deep trust for the MFI. Given that women in southwestern Uganda are dealing with a long list of survival uncertainties, wellbeing mentorship may facilitate this trust development. Mayer et al. (1995) describe trust as confidence and predictability between two parties. The purpose of wellbeing mentorship is to positively address a range of social needs such as health, education, water, nutrition, and interpersonal relations in a way that is predictable and interpersonal (Kim et al., 2009). Wellbeing mentorship, therefore, sends a strong signal to women who borrow that their health and wellness matter to the MFI and that the MFI aims to be predictably accessible and available to meet their personal needs.

The extent to which borrowers perceive a MFI as benevolent and trustworthy may translate into better repayment rates (Banerjee et al., 2015a). This is similar to Blattman et al. (2016) who found that interactions with staff members was associated with participants' development of social capital, ultimately contributing to more positive economic outcomes. Therefore, I hypothesize that exposure to wellbeing mentorship builds trust, which in turn will be associated with lower levels of loan delinquency. While I am not explicitly testing for the mediating role of trust in the current analyses, and it is possible that alternative explanations might explain loan delinquency rates (e.g. Goodman, 2017), I hypothesize that:

H_3: *Wellbeing mentorship will be negatively associated with delinquency rates.*

It is conceivable that there may be a darker side to training. In addition to objective measures of financial outcomes (e.g. savings, diversification, and delinquency), training may subtly and negatively impact subjective outcomes. One's sense of satisfaction with their own financial status is influenced, in part, by their sense of worry and stress about meeting basic expenses (Gerrans et al., 2014). While the act of making financial adjustments and employing new strategies to improve one's financial wellbeing may contribute to greater financial solvency among low-income individuals, such adjustments have also been linked with an increase in perceived financial distress among low-income individuals (Prawitz et al., 2013). The amount of knowledge a person has about financial and business decision-making may also be linked with their level of financial distress.

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