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THE UNIVERSITY OF CHICAGO

THE SOCIAL DETERMINANTS OF ECONOMIC GROWTH:
MICROENTERPRISE AND MICROFINANCE IN LATIN AMERICA

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Abstract

In this dissertation, I examine the social processes of economic development through the lens of microenterprise and microfinance. In the first empirical chapter, I demonstrate how the strength of officer-client relationships in a microfinance bank influences officers' tendency to persist in working with problem clients. In the second empirical chapter, I show how the challenges of working with the poor affect officers' tenure at a microfinance institution. In the third empirical chapter, I examine how household-level financial constraints make it difficult for poor entrepreneurs to keep novel products and services on the market. Beyond advancing our understanding of entrepreneurship and entrepreneurial finance, this dissertation extends the sociology of economic development by connecting micro-level processes with their meso- and macro-level outcomes.

Executive Summary

This dissertation seeks to answer two central questions. First, it asks: How do interactions between street-level organizational agents and their clients affect organizational outcomes? Much of the work on street-level agents examines how state-employed bureaucrats use personal discretion to implement abstract policies (Evans 2010; Lipsky 1980; Watkins-Hayes 2009). This project extends that literature by demonstrating how agents' personal experiences with clients affect performance in a for-profit firm. Second, this dissertation asks: How do resource-constrained entrepreneurs contribute to market diversity? The entrepreneurship literature suggests that poor entrepreneurs should be infrequent innovators since they lack the necessary human and financial capital to bring novel products to market (Acs et al. 2009; Edminston 2008; Kortum and Lerner 2008; Sherraden, Sanders, and Sherraden 2004). This dissertation, however, demonstrates how low-income entrepreneurs overcome the theorized barriers to innovation, yet ultimately struggle to sustain novel businesses on the market.

Empirically, this dissertation is unified by its focus on micro-entrepreneurs and the financial institutions that lend to them. While scholarship in management and sociology has traditionally focused on larger ventures and larger lending institutions, this project takes a decidedly micro approach. Micro-entrepreneurs are, in fact, the most populous entrepreneurial group on the globe (de Soto 2000). Nevertheless, they receive only a fraction of scholarly attention, probably because scholars do not anticipate that micro-businesses have same potential to contribute to economic growth as entrepreneurs who own larger businesses. This project takes micro-entrepreneurship seriously not only as a potential driver of economic growth, but also as a worthy site of sociological investigation. Moreover, it investigates a novel organizational form in the financial sector: the commercial microfinance institution. Commercial microfinance blends

goals and practices from traditional microfinance institutions with those of the financial sector (Matin, Hulme, and Rutherford 2002; Rhyne 2001). Commercial microfinance thus offers a unique site to explore the incursion of market principles into practices aimed at poverty alleviation.

This project uses three levels of analysis to examine small business development and financing. The first chapter focuses on *relationships*, examining how ties between microfinance loan officers and their clients affect officers' reactions to delinquent clients. The second chapter examines how inconsistencies in *institutional logics* at a microfinance bank affect the lived experiences of organizational actors and their tenure within the organization. The third chapter focuses on *entrepreneurs*. It asks: How does living in poverty affect small business innovation and survival?

Given the range of data it spans, this dissertation offers a unique understanding of micro-entrepreneurship and microfinance. At the organizational level, this project draws from a proprietary database of lending history from a commercial microfinance bank. Such data allow for analyses of the long-term, wide-ranging effects of processes uncovered through qualitative methods, such as ethnographic observations collected at the bank. The dissertation also incorporates interviews with loan officers and bank managers to delve more deeply into actors' experiences of their work. In a different vein, the dissertation draws from national- and individual-level data about entrepreneurship. The final chapter uses a nationally representative survey to establish trends in innovative entrepreneurship and then mobilizes interviews with low-income entrepreneurs to interpret unexpected findings in the survey data. Pulling together these diverse data sources, this dissertation offers a uniquely varied and comprehensive view of micro-entrepreneurship and microfinance in Central America.

Chapter Overview

Chapter 1. In the first chapter, I examine relationships between organizational actors and their clients. Specifically, I look at how loan officers respond when clients fail to abide by the terms of their contractual agreements. I use interviews with loan officers and ethnographic observations from the bank to show how officers develop relationships with their "embedded" clients and why they feel greater responsibility for these clients. I also use this data to highlight the relational tools that officers utilize when they work with delinquent, embedded clients, as compared to the delinquent clients they inherit from other officers.

Based on these data, I hypothesize that officers will be more likely to persist in working with the clients for whom they feel personally responsible. Traditionally, scholars have viewed such persistence as a decision error (Beshears and Milkman 2011; Guler 2007; Ross and Staw 1993). I hypothesize, however, that those officers who are most likely to persist are also most likely to get their struggling clients back on track. The key point of departure from previous theory lies in officers' personal relationships with their clients-as-investments. I anticipate that delinquent clients who work with their original officers will be more likely to resume loan payments than delinquent clients who work with inherited officers. I test (and find support for) these hypotheses using the bank's database.

This paper challenges and extends the familiar understanding of investing persistence in the management literature. Rather than viewing persistence as necessarily a decision error, this paper introduces the concept of "strategic persistence" and outlines the conditions under which we can expect persistence to generate favorable outcomes for both the agent and his or her organization. It suggests that persistent investors can outperform their less-committed peers when they have soft information about and relational leverage over their investments. Overall, it encourages a view of relationally embedded persistence as advantageous, rather than problematic.

Chapter 2. In the second chapter, I examine how conflicting logics in the microfinance industry become manifested in loan officers' work. While early proponents of microfinance touted it as a tool for poverty alleviation and women's empowerment, new players argued that microfinance can and should be profitable. Proponents of the commercial approach argued that microfinance would reach more people more efficiently if organizations did not rely on donor funding. As a result of this debate, commercial microfinance organizations—like the one under investigation in this study—self-identified as financial institutions driven by social missions.

I examine how the conflicts inherent in that hybrid identity affect the work performed by organizational actors. Specifically, I investigate how loan officers struggle to abide by the often-inconsistent logics of social service and financial performance. Institutional logics are the "rule of the game" that guide actors' beliefs and behaviors and help organizations establish legitimacy (Friedland and Alford 1991; Thornton, Ocasio, and Lounsbury 2012). I draw on ethnographic observations and interviews with loan officers to demonstrate how these conflicting logics become manifested in officers' work, and the tensions that officers experience when they draw from dual logics in their work with poor clients. I then use the bank's database to examine the effects of inconsistent logics on officers' tenure with the bank. I show that officers have a higher risk of exiting the bank when their work requires them to span conflicting logics, as compared to when they work primarily within a single institutional logic.

This paper makes three contributions to the literature on institutional logics. First, it documents how logical inconsistencies originating in field-level debates become manifested in the personal struggles of organizational actors. Using qualitative data, I show that actors experience personal—rather than political—struggles when logical inconsistencies are embedded within a single organizational role. Second, this paper quantifies the effects of logical boundary spanning on workers' longevity. When actors exit the organization, they experience financial instability, and they also create instability within the organization. Third, this paper encourages us to consider the darker side of boundary spanning in organizational life. While an extensive body of work elucidates the benefits that actors incur as they span logics, cultures, and social networks, this paper highlights how boundary spanning can hinder actors in their work.

Chapter 3. This chapter focuses on the relationship between poverty and small business innovation. As compared to the first two chapters, this chapter focuses directly on entrepreneurship rather than on the financial institutions that cater to entrepreneurs. In this paper, I challenge the commonly espoused perspective in the entrepreneurship literature that low-income entrepreneurs are infrequent innovators. I first use data from a nationally representative survey about entrepreneurship in Panama to show that poor entrepreneurs found novel businesses at rates similar to their higher income counterparts. However, poor entrepreneurs are much less likely to sustain their novel businesses. These data suggest that poor entrepreneurs have the tools to found novel businesses, but lack the tools to sustain them.

Given this finding, I then use interviews with low-income entrepreneurs to understand how they gain access to the knowledge used to found novel businesses. I argue that necessity-driven migration plays an important role in this process. Then, I examine why poor entrepreneurs struggle to sustain the novel businesses they found. I suggest that poor entrepreneurs falter when the new business provides the only source of household income and when they cater to consumers who are also poor.

This paper helps explain the business isomorphism that exists in low-income areas. While previous research suggests that risk aversion and low levels of human capital hinders poor entrepreneurs in founding novel businesses, this paper suggests that poor entrepreneurs' barriers to innovation exist in sustaining, rather than founding, novel businesses. Moreover, it shows how living in poverty both encourages and constrains poor entrepreneurs in attempts at business innovation.

Extensions

This work points to the importance of street-level (Lipsky 1980) agents in shaping how organizations affect economic change. These agents cross physical boundaries between the organization and "the field." That is, they span both the organization and the physical, social, and legal space outside the organization. These agents serve as the link between clients—or any kind of service recipients—and organizations. They not only carry information between the organization and the world beyond; they also interpret, transform, and shape that information in ways that favour their personal experiences and goals.

Chapters 2 and 3 reveal how the personal experiences of street-level agents aggregate to produce cumulative organizational effects. Chapter 2 demonstrates how microfinance loan officers who have close relationships with their clients show more leniency and are better able to help clients recover from delinquency. Officers are the primary point of contact for clients and serve as the "face" of the organization. Thus, the bank affects different kinds of economic change as a function of officer-client relationships. Clients with personal ties to their loan officers receive more support, develop better credit scores, and are more likely to have access to credit in the future. These factors—support, credit scores, and access to credit—are important in helping small-scale entrepreneurs to sustain and expand their businesses. When officers and clients have strong relationships, the bank better facilitates small business growth and, by extension, regional economic development.

Chapter 3 demonstrates that officers who work with impoverished clients have higher turnover rates than officers who work with wealthier clients. This chapter highlights the strain officers experience when organizations blend conflicting institutional logics. Agents trained according to a financial performance logic experience stress when their work entails enacting a different logic of social service. As a result of officer turnover, poor clients are less likely to work with the same officer over time. As the previous chapter demonstrates, clients transferred between officers have less successful borrowing experiences. Poor clients—who might experience the greatest leaps in their local economic contributions with the help of a microloan—are most at risk of having disrupted relationships with loan officers. Because of the stress officers experience when they work with poor clientele, the organization as a whole is less likely to encourage economic growth among poor entrepreneurs.

Together, Chapters 2 and 3 demonstrate how agents' lived experiences influence the organization's impact. Beyond this, the findings from these chapters also address a gap in the sociological literature on development organizations. Previous work on development organizations has tended to overlook the role of street-level development agents. Instead, such work focuses on inter-organizational ties among development institutions (Bebbington 2005; Pritchett and Woolcock 2004), the relationship between development organizations and the state (Babb 2009; Fisher 1997), and the impacts that development organizations have (or do not have) on beneficiaries (Englund 2006; Mebrahtu 2002; Sen 1999). In conceiving of development organizations as monolithic structures, such works fail to account for the linkages between agents' on-the-ground experiences and the ways that development organizations shape their environments. Indeed, this approach helps to complicate the common view of development organizations as bodies whose motives, practices, and outcomes benefit the poor. It fleshes out the emerging vision of development organizations as confronting "a profound contradiction between the global visions of transformation that animate them and the complex, obdurate material and social realities they encounter on the ground" (Watkins, Swidler, and Hannan 2012:286).

As a second contribution, this dissertation (begins) to offer an alternative vision of the role the poor can play in fostering economic development. Chapter 4 demonstrates that poor entrepreneurs have the potential to act as engines of growth in their local markets and reveals how this potential is curtailed by household economic constraints. It shows poor entrepreneurs have the tools to conceive of and found novel businesses, although they struggle to maintain those businesses on the market. Such work elucidates poor entrepreneurs' unrealized capacity to contribute to economic growth and market diversity.

This understanding of the poor lies in contrast to much of the work on income inequality and economic development. Existing work tends to depict the poor as actors who respond to development initiatives, protest against economic shifts, and found businesses that reproduce familiar products. In this view, the poor are described as reacting to economic changes and financially sustaining their own households; they are not depicted as having the capacity to create dynamic local and regional economies.

First, the poor are portrayed as recipients of services designed to foster economic and social development. In the most passive depictions, poor individuals are discussed in terms of their demographic characteristics when they receive some kind of developmental aid (Lee and

Lim 2014; Nanda 1999; Pitt and Khandker 1998). Such studies are often interested in the questions: Who receives development programs and services? And what, if any, impact do these programs have?

Second, scholars depict poor individuals as responding to and creatively reinterpreting services and policies designed to foster economic growth. Some scholars view the process of economic development as emancipatory for poor populations in developing countries (Sen 1999; Welzel 2014; Yunus 2006; Yunus and Jolis 1999). Others, however, suggest poor individuals experience economic change as constraining at best, and violent at worst (Englund 2006; Goetz and Sen Gupta 1996; Mayoux 2001; Tsing 2005). Additionally, the poor are seen as active organizers against unjust economic change. They rally against exploitative corporate practices, changes to land distribution, and neoliberal economic policies (Jaffee 2012; Prempeh 2006; Schejtman 1997). As scholars focus on the poor as social movement participants, they depict them as actively responding to economic change. While this view emphasizes their political empowerment, it nevertheless suggests that the poor *respond* to economic changes rather than catalyze them.

Finally, as entrepreneurs, the poor are seen as replicating familiar services rather than introducing innovative products with the potential to drive economic growth. Scholars emphasize that entrepreneurs who innovate benefit from large social networks (Davidsson and Honig 2003; Ozgen and Robert 2007; Ruef 2002), work experiences in high-tech fields (Audretsch and Kelibach 2011; Feldman and Avnimelech 2011), and access to capital from the financial sector (Florida and Kenney 1988; Kortum and Lerner 2000; Lynskey 2004). Since the poor generally do not have access to these tools, they are seen as reproducing the products and services extant in their market environments (Edminston 2008; Sherraden et al. 2004). Thus, current research suggests that the poor have little capacity to contribute to growth in their local economies.

Research on microfinance programs offers a more optimistic vision of the poor as entrepreneurs. Indeed, much of the appeal of microfinance lies in its ability to empower the poor to shape their economic situations (Armendariz de Aghion and Morduch 2005; Yunus 2006; Yunus and Jolis 1999). Research on microfinance suggests that, as the poor use micro-loans, they can improve their own financial lives as well as their families (Nanda 1999; Pitt and Khandker 1998). While such work depicts the poor as successful economic agents, it nevertheless implies that their economic power is limited to the household. That is, work on microfinance focuses on how the poor can lift themselves and their families out of poverty (Berger et al. 2006; Chowdhury, Ghosh, and Wright 2005; Goldmark 2006). By comparison, Chapter 4 of this dissertation suggests that the poor have the potential to do more than alter their own economic situations. It suggests that they also have the potential to promote economic growth in their local and regional economies through the introduction of novel products and services.