Journal of Business Venturing 28 (2013) 759–773

Contents lists available at ScienceDirect

Journal of Business Venturing

Bankers at the gate: Microfinance and the high cost of borrowed logics

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ARTICLE INFO

Available online 17 May 2013

Field Editor: G. Bruton

Keywords:
Microfinance
Institutional theory
Poverty

ABSTRACT

In this paper we examine how the interaction between influences of commercial banking and poverty alleviation shaped the evolution of modern microfinance. Using institutional theory as a lens, we observe that the commercial banking logic increasingly displaced the microfinance field's foundational poverty alleviation and development principles over time. We argue that this process of displacement can occur inadvertently as organizations that embody multiple logics draw disproportionately on only one of those logics when developing legitimating accounts of their activity to stakeholders. Furthermore, we introduce the concept of permeability – the extent to which the elements of a logic are ambiguous and loosely coupled – to explain why some logics may be more or less open to the influence of other logics. We conclude by discussing implications for entrepreneurship and poverty alleviation more generally.

1. Introduction

Microfinance today is a major industry with thousands of organizations serving around 155 million clients worldwide (Armendariz and Morduch, 2010). In its modern form, the field was conceived by poverty alleviation practitioners as a tool to provide sustainable financial services to populations typically excluded by mainstream banking institutions (Dichter, 1999; Yunus, 2007). Besides the impressive growth of microfinance, recent observations suggest that the poverty alleviation practitioners are grappling with the rise – both structurally and ideologically – of increased commercial banking in the field (Evans, 2010; Hermes et al., 2011; Hoque et al., 2011; Khavul, 2010). The purpose of this paper is to explore this paradox: how is it that poverty alleviation practitioners find themselves being displaced by the very same commercial principles which had caused mainstream financial institutions to avoid poverty lending in the first place? We believe insight into this turn of events is important not only for understanding the state of microfinance today, but also the long-term trajectories of other industries which exist at the intersection of multiple institutions.

Our research suggests microfinance underwent three important shifts in its underlying principles. First, modern microfinance was established when poverty alleviation practitioners re-imagined financial principles as a mechanism for sustainable poverty alleviation. In doing so, they reinvigorated hope and attracted global attention to development work. Second, the merger of poverty alleviation with financial principles enabled microfinance organizations to track their success for donors, government, and media through either financial or development metrics. Here we find practitioners' preference for financial metrics and the subsequent refinement of practices enabling organizations to perform well on these metrics. Third, when observers brought challenges to the efficacy of microfinance, practitioners were unable to adequately harness evidence demonstrating their success in alleviating poverty. By contrast, microfinance organizations could still justify their success to observers through their financial performance. We claim this shift to financial principles accompanied the loss of status among poverty alleviation practitioners, limited the latter's ability to define legitimate patterns of behavior in the microfinance field, and created a space for commercial bankers to establish influence.

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0883-9026/$ – see front matter
http://dx.doi.org/10.1016/j.jbusvent.2013.03.002

In order to understand the rise and fall of various principles, patterns of behavior, and the groups committed to them in an organizational sector, we turn to the literature on institutional logics (Friedland and Alford, 1991; Thornton and Ocasio, 2008). The theoretical ideas we advance in this paper follow from our comparisons of this literature, especially on field-level complexity (Greenwood et al., 2011), to patterns we see emerging in the field of microfinance. The material on microfinance we present in this paper comes from a review of empirical research; archival data such as news reports and editorials, public statements by microfinance actors, and industry guidelines; as well as discussions with academic and practitioner experts.

Beyond the context of microfinance, our study contributes to theory on field dynamics and institutional logics. First, we draw attention to and provide a mechanism through which institutional fields are shaped by unintended consequences rather than directed social action. Second, we introduce the notion of *permeability* to denote that some institutional logics may be more susceptible to the influence of other logics by nature of their nomological structure (Suddaby, 2010), and that organizational fields constituted of logics with asymmetric levels of permeability may be prone to instability. For practice, our review of the evolution of microfinance points to the need for entrepreneurial efforts to attend to the origins of legitimacy of these ventures (Hargadon and Douglas, 2001) in order to limit the unintended consequences of their actions. We caution that techniques, metrics, and values that are borrowed from other fields to serve as a vocabulary of legitimation can ultimately lead to the displacement of entrepreneurs' original goals.

In the sections below we begin by providing an account of the microfinance context. We then develop and use our theoretical lens to gain insight on the evolution of microfinance, in the process advancing theoretical understanding of field dynamics and institutional logics. Finally, we discuss practical implications for poverty alleviation and conclude with suggestions for future research.

2. Executive summary

The objective of alleviating poverty around the world has long been in existence. From foreign aid to philanthropy, a variety of traditional approaches to poverty alleviation have generally been regarded as outright failures (Armendariz & Morduch, 2010; Dichter, 1999). It is with this backdrop that today's incarnation of microfinance, the provision of financial services to populations typically excluded by mainstream banks, emerged as a potentially sustainable means of stimulating entrepreneurial growth in the world's poorest regions. Following the entrepreneurial efforts of Yunus in the 1970s (Yunus 2007), microfinance in its modern form has grown into a major industry with thousands of organizations serving around 155 million clients worldwide (Armendariz & Morduch, 2010). Accompanying this growth however, are large scale shifts in the structure of the microfinance field and challenges to its legitimacy as a mechanism for poverty alleviation following the rising influence of commercial banking in the field (Chowdhury, 2009; Armendaiz & Morduch, 2010; Epstein & Yuthas, 2010; Roodman, 2012).

In this paper, we explore this puzzling development: how is it that the poverty alleviation practitioners who established modern microfinance are being pushed to the periphery of their field – economically and ideologically – by the very same commercial financial institutions that had earlier avoided poverty lending (Evans, 2010; Khavul, 2010; Hoque, Chishty & Halloway, 2011; Hermes, Lensink & Meesters, 2011)?

We believe that insight into this question is important more broadly for understanding the processes through which the underlying principles of a growing field or industry may change and displace those organizations founded on them.

To understand these trends in the field of microfinance, we draw upon archival data and analyze these through the lens of institutional logics: the organizing principles that underpin stable patterns of social behavior in organizational fields (Friedland & Alford, 1991; Thornton & Ocasio, 2008).

Our proposal is that while poverty alleviation practitioners were initially able to balance development and banking influences on the 'hybrid' field (Battilana & Dorado, 2010), an overreliance on financial metrics used to demonstrate the efficacy of microfinance to its stakeholders changed the standards of legitimacy as the field moved into maturity. Theoretically, we suggest organizations in hybrid fields seeking to attain legitimacy within a given institutional framework inadvertently change that framework, potentially leading to mission drift, weakening their ability to compete in the future, and enabling actors outside the field to enter positions of influence. We make further contributions to research on institutional dynamics by introducing the concept of *permeability*, that is, how the composition of logics themselves may make some hybrid fields more unstable than others.

For practice, our research points to the need for institutional entrepreneurs to attend to the potential for standards of legitimacy to change over time in newly established fields. We caution that techniques, metrics, and values that are borrowed from other fields to serve as signals for legitimate or effective performance can ultimately lead to the displacement of entrepreneurs' original goals. We suggest the early establishment of strong regulatory or umbrella organizations serve as a counterweight to these risks.

3. Context: poverty alleviation and the rise of microfinance

Prior to the establishment of modern microfinance, the field of global poverty alleviation was dominated by two movements born in the 1970s out of the perceived failures of post-war development assistance in reducing absolute poverty and disparities of income (Dichter, 1999). The two trends, basic human needs (BHN) and integrated rural development (IRD) were based on a view that portrayed poverty as a multifaceted phenomenon where factors such as the level of infrastructure development, availability