Social Entrepreneurship, Microfinance and Economic Development in Africa

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"I believe that 'government', as we know it today, should pull out of most things except for law enforcement and justice, national defense and foreign policy, and let the private sector, a "Grameenised private sector", a social-consciousness-driven private sector, take over their other functions'.

-- Muhammad Yunus (1998: 214)

Abstract: This paper analyzes the potential impact of social entrepreneurship, and especially microfinance, on development in Africa. Social entrepreneurship could play an important role in development. However, social entrepreneurship has limited potential for structural transformation and poverty alleviation, which calls into question the recent prioritization of social entrepreneurship. Furthermore, social entrepreneurship can undermine support for state-led development and democratic reforms that are the pre-conditions necessary for structural transformation and long term, large scale development. Thus, social entrepreneurship is best seen as a useful microeconomic strategy that can contribute in small ways to development but that cannot possibly replace a democratic developmental state.

Keywords: Social Entrepreneurship, Microfinance, Economic Development, Africa

JEL Classification Codes: G21, L31, O16

Word count: 2836 (not including title page, abstract)

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Social entrepreneurs are well-intentioned and they can improve the lives of people in poor communities. Increasingly, since the neoliberal revolution of the 1980s, social entrepreneurship, and especially microfinance, has received greater resources and more focus as a potential solution to market failures and development problems. However, to date, the results of social entrepreneurship on poverty alleviation and increased income for the beneficiaries of microfinance are at best inconclusive (Van Rooyen *et al.*, 2012).

This paper analyzes the potential impact of microfinance and other forms of social entrepreneurship on economic development, especially in Africa.[1] Social entrepreneurship could play an important role in development by facilitating the creation of organic, productive, community-centered organizations that build on local culture and institutions. However, social entrepreneurship has limited potential for structural transformation and poverty alleviation, which calls into question the recent prioritization of social entrepreneurship. Furthermore, in some cases social entrepreneurship has undermined support for the type of state-led development and democratic reforms that are the pre-conditions necessary for structural transformation and long term, large scale development. Thus, social entrepreneurship is best seen as a useful microeconomic strategy that can contribute in small ways to development but that cannot possibly replace a democratic developmental state.

The Rise of Social Entrepreneurship

Bornstein and Davis (2010, 1) define social entrepreneurship as “a process by which citizens build or transform institutions to advance solutions to social problems, such as poverty, illness, illiteracy, environmental destruction, human rights abuses and corruption, in order to make life better for many.” We are certainly not opposed to social entrepreneurship, so defined. We have participated frequently in social entrepreneurship activities ourselves, and advocated their expansion in particular circumstances.

We are quite aware of the potential benefits that arise from effective projects even when they operate at a small scale. However, social entrepreneurship is increasingly being used to promote a private-sector-oriented, market-based solution to poverty (albeit, with an underlying non-market logic) by those who advocate a neoliberal approach to development.[2]

For example, slow growth, worsening inequality, and dissatisfaction with public services forced the ANC government in South Africa to modify their neoliberal approach to development. But they simply embraced microfinance and market-based anti-poverty strategies in the Accelerated and Shared Growth Initiative for South Africa (AsgiSA). AsgiSA stressed the notion of addressing poverty and unemployment via microfinance and social entrepreneurship rather than state-led development, drawing on the lessons from the Grameen Bank (Maharaj *et al.* 2011).

The rapid rise of social entrepreneurship efforts has been striking. Much of the increase can be attributed to the perceived success of the Grameen Bank and other microfinance examples. As the premier example of social entrepreneurship, it is worth spending some time evaluating the impact of microfinance on development and poverty.

Bornstein and Davis (2010: 17) assert that the Grameen Bank and another microfinance institution, the Bangladesh Rehabilitation Assistance Committee (BRAC), "demonstrated that it was possible to mitigate poverty on a massive scale." This sort of interpretation garnered tremendous support for microfinance. The United Nations declared 2005 the International Year of Microcredit, and microfinance is promoted extensively by USAID and the World Bank. Yunus and the Grameen Bank were jointly awarded the Nobel Peace Prize in 2006. Microfinance is supported by foundations such as Google.org, the Bill and Melinda Gates Foundation and Citi along with individuals such as eBay founder Pierre Omidyar (Bruck 2006). Business schools around the world now have programs studying and promoting microfinance.[3] The result had been a veritable explosion of microfinance institutions and programs.

Roodman (2012, 229) reports that the twenty largest microcredit institutions on the Microfinance Information eXchange were serving more than 47 million borrowers in 2009 and the number of borrowers at each institution was growing at an annual rate of between 7 and 438 percent (with a mean growth rate of 65 percent and a median growth rate of 41 percent). Total microloans of the top 50 investible Microfinance Institutions (MFIs) increased from $1.5 billion in 2005 to $5.4 billion in 2010 (Roodman 2012, 232).[4] ResonsAbility (2013) reports annual growth in the loan portfolios of the 100 largest investible MFIs of 10 to 30 percent between 2009 and the first half of 2013, and a doubling in the value of loans from $12 billion to more than $25 billion. Interestingly, the recent rapid growth in MFIs has proceeded despite a series of important critiques of microfinance since 2007.

In the most comprehensive study of the impact of microfinance, David Roodman (2012, 172) comes to two main conclusions: "First, poor people are diverse, and so are the impacts of microcredit upon them. . . . And . . . there is no convincing evidence that microcredit raises incomes on average." In carefully done studies, even in the most successful programs there is an "absence of a clear statistical link between microfinance and poverty alleviation" (Roodman 2012, 176). Roodman's analysis has been supported by numerous other researchers (Duvendack *et al.* 2011, Roy 2010, Roodman and Morduch 2009, Bond 2007, Dichter and Harper 2007).

Indeed, microfinance can actually worsen poverty, as has been the case in the "microfinance meltdowns" that occurred in Bolivia, Morocco, Nicaragua, Pakistan, Bosnia and India (Bateman and Chang 2012, 16). In South African microfinance programs both rural dwellers and the urban poor proved unable to generate enough revenue to make credit payments. This, coupled with high program costs, meant that South African microfinance programs did not achieve even modest levels of success (Bond 2007, 223-4).[5]

The fact that MFIs continue to grow rapidly despite the lack of positive results is a testament to the ongoing power of International Financial Institutions and corporate interests to promote neoliberal approaches to development. And, in countries with corrupt, ineffective governments, it is tempting to bypass the state and focus on development via social entrepreneurship. In South Africa, for example, Corporate Social Responsibility and Social Entrepreneurship are being promoted as a primary method for improving human development and achieving economic development. This must be resisted given that there is no evidence to date that social entrepreneurship reduces poverty.

Key problems with Social Entrepreneurship

Social entrepreneurship efforts that target economic development and poverty alleviation are subject to a series of problems which tend to undermine their effectiveness.

1. Social entrepreneurs almost universally create microenterprises that have not been able to scale up. Microfinance and other programs aiming to develop microenterprises for the poor are, by their very nature, of limited economic potential. As Bateman and Chang (2012, 18) point out, "Africa already has more micro-entrepreneurs per capita than anywhere else on earth, and the rapidly expanding supply of microfinance is actually increasing this number year by year," however, there is no evidence that microenterprises generate sufficient economies of scale to provide a foundation for real economic development. Simple trading, retail, service and production operations, which constitute the majority of microentrepreneurial ventures, have not resulted in significant growth or poverty alleviation.

Social Entrepreneurship is an attempt to use a microeconomic solution for a macroeconomic problem: structural transformation of an economy. In order to scale up, a social entrepreneur must invariably secure the support of the very institutions—NGOs, the private sector, and the state—that have failed to solve the problems the social entrepreneur is trying to address. This requires compromises on the part of the social entrepreneur (including the prioritization of finance and limiting priorities to those that do not threaten the status quo). None of these institutions are likely to relinquish control to a social entrepreneur unless they see the project as serving their interests. In many cases, neither the state nor the private sector is interested in structural change, thus the only types of projects likely to be supported are those that reinforce that status quo. In the absence of a democratic developmental state, it is extraordinarily unlikely that microenterprises will be able to make a significant impact on economic development.

2. Social entrepreneurship diverts financial resources and talented individuals from other development initiatives. Bateman and Chang (2012) note that microfinance tends to reduce funding for larger scale enterprises that might actually develop into significant engines of job creation. The large volume of funds that microfinance draws from states and donors comes with a significant opportunity cost. And, as microfinance expands rapidly, it draws a larger and larger pool of talented individuals into staff positions, drawing human capital from the state sector in Africa in the same way that NGOs do (Nega and Schneider, 2013). In South Africa, microfinance programs have high costs because the wages of professional staff are quite high (Bond 2007, 223-4). Rippey (2007, 111) discusses how MFI staff in Guinea went on strike when they discovered their salaries were below those paid on USAID development projects. Figure 1 below shows that operating expenses are the single biggest driver of MFI interest rates.

3. The emphasis on financial sustainability creates pressures and requires compromises that undermine social entrepreneurship. The need for financial sustainability inherently limits the nature and scope of social entrepreneurship, and “financial results tend to subsume the social mission” (Sud *et* *al.*2009, 203). Many of the worst problems in microfinance began once financial sustainability became a primary focus.[6]

As Table 1 shows, in 2009 median real interest rates from MFIs around the globe ranged from 15 to 32 percent, with the sub-Saharan African rate at 24 percent. Roodman (2012, 184) states somewhat optimistically that, "Worldwide, 63 percent of MFIs, accounting for 83 percent of the loans, charge less than 30 percent over inflation." Rosenberg *et al.* (2013, 21) place nominal interest rates from microfinance loans at 26.9 percent in 2011. The profit rate on MFI loans of 2.6 percent is "slightly higher on average for microlenders than for banks in the same countries" (Rosenberg *et al.* 2013, 19). One Mexican MFI, Compartamos, charged its poor clients an annual interest rate of 195 per cent (Bateman 2012, 1388), and the leading Nigerian MFI, LAPO, charged some clients an effective interest rate of 126 percent (MacFarquhar 2010). Such high interest rates impose huge burdens on a poor, vulnerable population, and any default is likely to push borrowers deeper into poverty. For example, Rippey (2007, 114) cites a newspaper report in Uganda that, "Microfinance institutions in Busoga have robbed poor women and the youth blind. More than two thousand women who had borrowed heavily in the last six months have either had to sell off their pieces of land [or] domestic animals to repay the loans, and where some have failed, they've had to flee to nearby islands or face horrifying prison sentences." It is highly unlike that microfinance can be a significant anti-poverty program when MFIs charge such high rates of interest.[7]

4. Social entrepreneurs have a narrower vision than is required for economic development. Social entrepreneurs are, by their very nature, focused on a specific problem or a specific market niche. This is not the type of vision that will drive an effective economic development program. There may even be cases in which social entrepreneurship can undermine economic development because of its narrow focus. Sud *et al.* (2009) describe the One Laptop Per Child program, which wanted to provide $100 laptops to poor children in developing countries. They were surprised at the resistance from corporate competitors and governments in developing countries who saw this program as a potential threat to the development of their own industrial sector. It is a legitimate question as to whether a nation would benefit more from a nascent computer industry or from a population with a large number of inexpensive laptops. Social entrepreneurs have their own goals, but these goals have not been established democratically and do not necessarily reflect the goals of the larger society. As such, it would be inappropriate to expand social entrepreneurship without the broad support of the community, which is provided first and foremost by a democratically elected state.

5. In the presence of an unaccountable authoritarian state bent on staying in power, social entrepreneurship in general, and microfinance in particular can be used by the state as an instrument to control the poor for political purposes. Microfinance can be used by opportunistic regimes to mobilize donor money, and then use these resources to control the poor for narrow political ends while claiming that the process helps the empowerment of vulnerable groups such as women and the poor.

This, for example, is how the Ethiopian government uses microfinance. As the new "elixir" for all developmental problems and poverty alleviation, western donors were pouring resources for microfinance programs in Ethiopia. The main beneficiaries of these funds were ruling party-owned and regional government-supported MFIs that dominate the microfinance scene in Ethiopia. According to one survey, ruling party-owned MFIs "accounted for 89.4% and 88.9% of clients and total loan portfolio, respectively. . . . The 16 NGO-supported MFIs contributed only 11% in both respects, confirming the claim that Ethiopian microfinance services are mostly supplied by government-owned or supported institutions"(Degefe 2009, 221).

Party-owned MFIs have better institutional sustainability and financial self-sufficiency compared with NGO-based and private institutions since they have a "better collection rate of loans and good portfolio quality. . . [because] The Ethiopian government's grassroots political organs are involved in the enforcement of loan repayment" (Degefe 2009, 227). In addition to using the state's repressive organs to collect these loans, the ruling party in Ethiopia is notorious in using microfinance as an instrument to reward political supporters as well as punish opponents. Having largely relegated the supply of fertilizers and improved seeds to party-owned marketing companies, party-owned MFIs are then used to provide credit to farmers to buy these critical inputs for the majority of the poor in rural Ethiopia. Party cadres and local government officials, who also sit on local MFI committees, then pick and choose the recipients of the microcredits, and thus the agricultural inputs, strictly on political criteria. A detailed study by Human Rights Watch on the abuse of foreign aid including microfinance for political purposes in Ethiopia reported numerous cases of such abuse. In one incident,

> Individuals reported discriminatory government loan practices in the provision of microcredit in the following woredas: Loka Abaya, Yirga Chaffe, Misrak-Awassa, Kochore, and Arba Minch (SNNPR); Limukosa (Oromia); and Dangla and Dabat (Amhara). In addition, three donor officials, two former government officials, several journalists and a former parliamentarian all described routine partisan access to micro-credit loans (Human Rights Watch 2010, 38).

Another incident describes a loan recipient being pressured to join the ruling party (Human Rights Watch 2010, 40). This kind of abuse of MFIs for political purposes is also used in urban areas as the government organizes unemployed youth in "micro and small enterprises" with no other purpose than to bribe and cajole the poor to steer clear from the opposition, thus potentially undermining the possibility of establishing an accountable government in the country which is critical for long term, inclusive development.

Conclusion: The Appropriate Role for Social Entrepreneurship in Development

Despite the criticisms above, social entrepreneurship can play an important role in African development. Social entrepreneurship encourages community building between diverse groups of people, which in turn can facilitate development. Social entrepreneurship cultivates the creative problem solving of community groups when it places community needs and ideas first and prioritizes the development of community skills. SHAWCO projects in Cape Town regularly include university faculty and students, local businesses, and community members, which is typical of many social entrepreneurship endeavors. In facilitating cooperation between the state, community, educational institutions, and private sector, social entrepreneurship cultivates relationships similar to the "triple helix" partnerships that established internationally competitive new industries in developed countries like Sweden (Schneider 2007).

In addition, social entrepreneurship is inherently experimental in nature, which could serve to identify potential opportunities to scale up, *if* properly supported by the state. Given the dismal track record of development projects in Africa, generating new approaches is useful. MFIs, if prevented from charging usurious rates of interest, could cultivate promising new businesses. A democratic developmental state could take the most successful social entrepreneurship endeavors and attempt to scale them up to facilitate economic development and poverty alleviation. However, significant benefits from social entrepreneurship are unlikely to be realized unless they become part of a more systematic, state-led, inclusive development effort to establish a comparative institutional advantage in an industry with growth potential (Schneider and Nega 2013).

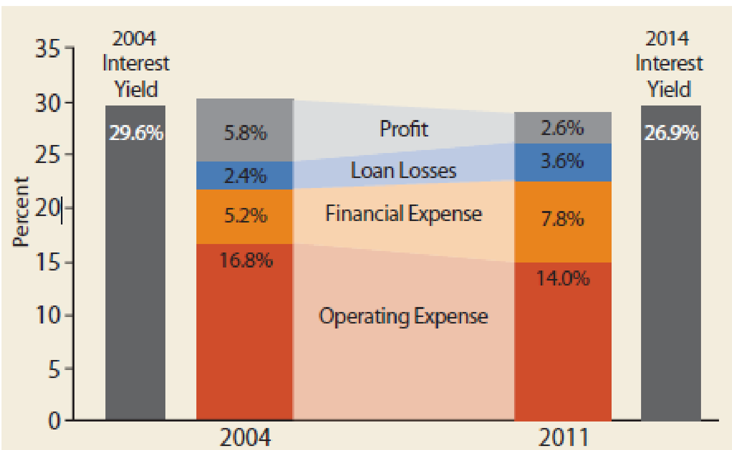
Finally, social entrepreneurship cannot ignore the political context. In the presence of a corrupt, non-developmental state, social entrepreneurs should serve as the basis for the political mobilization of poor communities. The Treatment Action Campaign, where AIDS activists forced the South African state to provide anti-retroviral drugs, is one example. Community groups banding together to solve problems not being addressed by the state or the market could become a constituency to promote political change. But, social entrepreneurs must not allow themselves to be used as a political vehicle by a corrupt government, as happened in Ethiopia. Making social entrepreneurship into a force for progressive change in Africa will require a rejection of neoliberal approaches to development, and a refocusing of development efforts under a democratic, developmental state.

Table 1. Median Real Interest Rates of Microfinance Institutions (MFIs) by Region, 2009.

Latin American and Caribbean	28%
Sub-Saharan Africa	24%
East Asia and Pacific	29%
Middle East and North Africa	32%
Eastern Europe and Central Asia	23%
South Asia	15%

Source: Roodman, 2012, 185.

Figure 1. Drivers of Nominal Interest Rate Yields, 2004-2011.



Note: This study uses portfolio yield as a rough approximation of nominal interest rates.
Source: Rosenberg *et al.* 2013, 21.

Notes

1. Due to space limitations, we focus on those forms of social entrepreneurship designed to contribute to economic development, especially microfinance. It is important to note that there are other forms of social entrepreneurship designed to address other social problems.
2. Examples of neoliberal sentiments from social entrepreneurship advocates include the quote from Yunus at the beginning of this paper. Similarly, Bornstein (2004, 269) discusses how, "The citizen sector is, in fact, beginning to resemble a *market* economy of social ideas, characterized by a rich diversity of grassroots institutions and energetic entrepreneurs crafting solutions that no one could have anticipated, let along planned for. No government could have built or legislated Childline or the Grameen Bank. . . ."
3. The growing list of universities with centers, conferences and courses on microfinance includes Tufts University, which received $100 million from Omidyar to study and promote microfinance (Bruck 2006), along with Oxford

University, London Business School, Columbia University, Duke University, Harvard University, New York University, Stanford University, the University of California at Berkeley, and many, many more around the globe (Thumbadoo and Wilson 2007, 2).

4. *ResponsAbility* (2013, 3) defines ***investable*** Microfinance Institutions as those which are “self-sustaining in economic terms and have appropriate governance, business processes and accounting standards in place.”
5. See Maharaj *et al.* 2011 for more details.
6. Bateman (2012) notes that the commercialization of microfinance by the World Bank and USAID in the 1990s and the pursuit of high profits by commercial lenders played a major role in the microfinance meltdowns that occurred regularly after 1999. The high profits have in some cases led to extremely high salaries for MFI executives. For example, in 2010 the highest paid individual in Bosnia was the Director of an MFI (Bateman 2012, 1392 n. 9).
7. Nor are non-profit institutions exempt from financial pressures. For example, in 2011 the Student Health and Welfare Centres Organisation (SHAWCO), a social entrepreneurship organization in Cape Town, South Africa, had to choose whether or not to accept sponsorship from a beer company. This would have required beer company logos to be placed on SHAWO vehicles, health clinics, or other materials. Rampant alcoholism in poor communities meant that the idea of promoting a beer company while engaging in community health and welfare programming was deeply problematic. SHAWCO had to compromise their values if they wanted to expand operations.

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