

# Who Will Finance the Financiers?

*A comparative study of microfinance initiatives in Norway, Sweden, and the United Kingdom*

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# **Who Will Finance the Financiers?**

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# Abstract

This thesis investigates the factors affecting political support microfinance. Through a comparative case study of Norway, Sweden, and the United Kingdom I provide a new approach to understanding microfinance institutions in developed countries. Using Kingdon's three streams approach, combined with Rochefort and Cobb's contribution on problem definition I identify the conditions under which microfinance ensures and sustains political support. I find that policy windows are important determinants of political support of microfinance. If a policy window is present, microfinance initiatives are more likely to receive political support. In this process I identify four policy windows that have been crucial in establishing political support for microfinance. Moreover, I find that the definitions of the various problems and target groups that microfinance is supposed to address influences political support. Finally I identify five dominant problem definitions and show how they have affected political support for microfinance initiatives in the three cases.



# Acknowledgements

There's a saying in Norwegian that goes "veien blir til mens du går deg vill." I would call this an appropriate description of the last twelve or so months. This thesis was born out of the wreck of a previous attempt to write something interesting about financial regulation. When I stumbled upon microfinance, I knew nothing about the field except that it had the word finance in it and that I like IPE. This has had the positive effect of forcing me to learn lots of new cool stuff, but it also means I had no idea of what I was going into. More than once I have found myself cursing at the screen regretting becoming a gardener or a monk. Nevertheless I am happy and proud that I managed to pull it off in the end!

First, I must thank Carl Henrik Knutsen, who has provided support far beyond what is expected from a supervisor. Thank you for taking time to answer my questions every single time I stopped by your office, often at odd hours and without any regard for your schedule. If not for your patience and support this thesis would certainly not have been finished.

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Mistakes and omissions are entirely my own fault.

Magnus Gabriel Aase

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# 1 Introduction

Since its beginnings in the late 1970s microfinance has emerged as a tool to fight poverty and exclusion in the developing world (Todaro & Smith, 2006, p. 242). Over the last few decades, however, microfinance has also gained increasing attention in developed countries as well, and today we see microfinance used as a means to combat unemployment and social exclusion across Europe. The various implementations are diverse in nature from small microfinance institutions serving poor neighbourhoods to large government-run programs (see e.g. Evers, Lahn, & Jung, 2007).

Moreover, the experience with microfinance across Europe is as diverse as the implementations of the idea, and whereas some countries have had relatively successful microfinance interventions, others have struggled to survive. The puzzle is therefore to discover why some microfinance initiatives succeed while others fail.

As it turns out, the conditions for microfinance to succeed differ considerably between developing and developed countries. The cushioning effect of the welfare state as well as the competing effect of well-structured market economies of developed countries creates new and different challenges for microfinance initiatives. The chief of these is the challenge to achieve sustainability, and in most European countries microfinance initiatives have been partially or wholly dependent on public support for survival (Evers et al., 2007, p. 23).

This provides the entry point for my thesis. If microfinance is dependent on public support, the question of success and failure changes from only dealing with profitability, sustainability, and the merits of different approaches to microfinance, into one that also deals with explaining political support. Using Harold Laswell's famous phrase, politics revolves around the questions of "who gets what, when, and how." I am therefore interested in investigating the political factors that influence support for microfinance initiatives. This brings me to my research question:

*Which factors can explain the differences in political support between microfinance initiatives across developed countries in general, and between Norway, Sweden, and the UK in particular?*

Using this research question as a point of departure I will do a comparative case study of the microfinance experiences in *Norway*, *Sweden* and the *United Kingdom*. These three cases represent three different stories of how political support has influenced microfinance initiatives. UK represents a case where the microfinance approach has seen widespread adoption. Norway and Sweden on the other hand has seen more mixed results, despite some important differences.

Two questions have guided my research. First, how did the political support for microfinance initiatives come about in the first place? Second, why was there policy support for microfinance initiatives? In order to answer the first question I have used John Kingdon's (2014) three streams approach with a particular focus on the emergence of so-called policy windows as a factor influencing political support. In order to answer the second question I have used Rochefort and Cobb's (1993) problem definition approach, where I try to identify the various definitions of policy problems, target groups, and solutions and how they have influenced political support for microfinance.

I find that policy windows are important determinants of political support of microfinance. If a policy window is present, microfinance initiatives are more likely to receive political support. In this process I identify four policy windows that have been crucial in establishing political support for microfinance. Moreover, I find that the definitions of the various problems and target groups that microfinance is supposed to address influences political support for microfinance. Other, smaller findings will be discussed throughout the thesis.

## **Outline of the thesis**

*Chapter two* provides a historical backdrop for microfinance. I discuss its roots and spread from developing to developed countries. Next I discuss the role of the European Union as a key promoter of microfinance. Finally I provide a short historical introduction to microfinance in the three selected countries

*Chapter three* presents a review of the literature on microfinance. I discuss some of the key issues, such as the performance of microfinance as a tool to address poverty and exclusion. I also discuss the issue of microfinance sustainability before I turn to some of the methodological issues that is facing the field. I end with a discussion of the limitation of the literature and provide a rationale for choosing the subject as a thesis topic.

*Chapter four* discusses the theoretical foundations of microfinance. I talk about the problems of adverse selection, moral hazard and transaction costs, and discuss their relevance in developing as well as in developed countries. I then move to the topic of the social economy and social entrepreneurship as a means to situate microfinance in a European context. Finally I present the two theories of public policy that have guided my thesis and discuss their relevance to understanding microfinance.

*Chapter five* deals with the research design. First I attempt to spell out how I will use the theoretical perspectives to analyse the case, and present a model illustrating the theoretical expectations. I then proceed to discuss the methodical aspects of my design. I discuss the nature of the research, case selection, as well as data collection and analysing methods. Throughout the section I discuss some of the strengths and weaknesses of the design.

*Chapter six* presents the analysis. First, I revisit the issue of political support for microfinance. I subsequently move on to my two explanations, presenting first the policy window variable, then the problem definition variable. Each variable includes a separate discussion of the three cases and a summary of the general tendencies. I finally conclude with a summary of all the findings.

*Chapter seven* presents the conclusion and implications of the analysis. I attempt to take a step back draw some lines between the different explanations before I say a few words of the implications of the findings.

### **Some definitions**

Clarification of some key terms is due. **Microfinance** is a term with several meanings. For example, microfinance and microcredit are technically two different terms, with the former technically including additional financial services such as insurance. I will nevertheless stick to the conventional practice of using microfinance as synonymous with microcredit. Moreover, while the EU defines it as SME loans less than €25,000, other definitions operate with a much lower ceiling. What is appropriately called microfinance differs considerably when taking price levels of the various countries into account. I have therefore chosen a more general definition that captures all types of microfinance: small business loans generally given to low-income people, not requiring collateral. Note that this definition excludes personal lending. Finally names differ across countries: in Norway microfinance goes by the name

‘Networked credit.’ In Sweden and the United Kingdom it is called ‘micro loans/credit.’ Unless otherwise specified I will nevertheless use the term microfinance.

**Microfinance Institutions** (MFIs) refers to an institution engaging in microfinance. In the UK, MFIs are called Community Development Financial Institutions (CDFIs), which also includes credit unions and community loan funds. This creates some potential for confusion, but since the norm in the data has been to refer to MFIs as CDFIs, disaggregation is not possible. **Microfinance initiatives** refer to the whole process where microfinance has been adopted in a specific context rather to a specific actor. For example, the collaboration between MFN-Cultura is a microfinance initiative.

**Political Support** refers to support for microfinance from politicians, policy makers, public servants. I use the term political support in a relatively broad sense. Rather than simply referring to support from politicians, I also include support from state-run institutions and the bureaucracy. The reason for this is that policy attention to microfinance does not always come from politicians, which are often concerned with bigger and more pressing issues. Discretion is customarily given to the various agencies that actually deal with microfinance on a regular basis.

Table 1.1: List of abbreviations

CDFI	Community development financial institution
CNRI	Credit Network for Refugees and Immigrants
IN	Innovation Norway
MFI	Microfinance institution
MFN	Microfinance Norway
MLGRD	Ministry of Local Government and Regional Development
NIRDF	Norwegian Industrial and Regional Development Fund
RDA	Regional Development Agencies
ROSCA	Rotating savings and credit association
SAERG	Swedish Agency for Economic and Regional Growth
SME	Small and medium enterprise



## 2 Historical Background

This chapter presents an overview of the historical development of microfinance. I start by tracing its roots from the subsidised credit schemes that existed prior to microfinance in the developing world. Subsequently I present a brief introduction to microfinance and how it functions, before I look at its spread throughout the developing world as well as its introduction to Europe. Finally, I present a brief historical overview of microfinance in Norway, Sweden, and the United Kingdom.

### 2.1 Microfinance in the developing world

#### **The origins: subsidised credit**

Credit is a key component in addressing poverty. With just enough money to get by, most of poor people's income is directed towards consumption rather than saving. With little or no savings, a poor person can not invest to expand economic activity thereby increasing his income beyond subsistence levels (Todaro & Smith, 2006, p. 241). The solution to this problem is to borrow. In developing countries, however, capital is relatively scarce and therefore costly. Financial markets are usually underdeveloped, and the reach of banks is limited to the larger cities. Moreover, the poor can not provide the necessary assurance or collateral needed for banks to reduce their risk. Still, shops need to stock up on inventories; farmers need to buy seeds and fertilizer for the next crop cycle; and seasonal workers need money for consumption outside of the harvesting season (see Ray, 1998, pp. 531–2).

If commercial banks are unable to serve large parts of the population, credit must come from elsewhere. The poor are therefore often forced to turn to the informal sector. The informal sector has –and continues to play– a major role in the provision of credit in developing countries. One study from Thailand showed that in 1975 informal lending accounted for 90% of total rural credit (Ray, 1998, p. 536). The informal sector is nevertheless far from an ideal option for the poor. On the one hand, informal lenders are often willing to accept alternative forms of collateral, such as labour, or produce. Moreover, their proximity to the local community might give them informational advantages that lower risk (Ray, 1998, p. 536). On the other hand, informal lenders can also claim excessive amounts of collateral or charge

usurious rates of interest. Not only does this further increase the cost of capital for the poor, it has the potential trapping them in perpetual cycles of over-indebtedness and poverty.

To curb the spread of informal credit markets, developing countries have therefore since the end of the Second World War focused on how to provide viable alternatives to informal credit markets. One common method for supplying capital for development purposes has been through development banks. Development banks are large government-owned banks that supply large amounts of long-term low-interest capital to finance development projects. These banks do not merely supply capital; they also engage in entrepreneurial, managerial, and promotional activities (Todaro & Smith, 2006, p. 751). They have, however, also typically restricted their involvement to strategic large-scale projects of national interest, such as government-led infrastructure development; import-substituting industrial conglomerates; and public health measures. Consequently, projects on a smaller scale, such as non-industrial farming or shop keeping, have been considered outside the purview of the development banks. Large parts of the population therefore falls outside the scope of development banks: they lack strategic importance, and are too costly relative to return to invest in (Todaro & Smith, 2006, p. 751). This is not without consequence, as between 40-70% of people in developing countries are employed in small-scale production and enterprise.

A popular solution to reach this large group of excluded poor has been through various forms of subsidised credit. Prior to the proliferation of microfinance, this was the most common approach used by developing countries to address financial exclusion. Especially within the agricultural sector, credit was abundantly provided in attempts to finance adoption of new technology and machinery (Von Pischke, Adams, & Donald, 1983, p. 2). By the 1970s virtually all developing countries had programs of subsidised credit. Cheap credit would be supplied by the state and lent out through agricultural banks or local intermediaries such as millers and local landowners. Sometimes the same actors as in the informal market were even used. The subsidisation, however, meant that little or no collateral were imposed, and that the interest rates were kept artificially low, making this form of credit a low-cost alternative to the moneylenders' own loans.

Nevertheless, this approach had considerable drawbacks. Adams et. al. (1984, p. 3) argue that a flawed view of credit as a policy tool were among the reasons for this was. Authorities tended to regard credit as merely an input alongside other inputs such as capital and labour, implying a relatively direct causal relationship between money supplied and output produced

existed. Consequently governments were generous in their provision of cheap credit, and conversely lax in their efforts to recover the loans. This view, however, fails to consider the complex and dynamic role of credit as an instrument of financial intermediation, which can affect behaviour and alter incentives in powerful ways. These incentive-altering mechanisms were precisely what caused the problems of the subsidised programs.

Moreover, losses were tolerated because of the social and developmental focus of the programs. Soft-constrained loans meant that the authorities did not expect full repayment, and struggling banks were instead simply propped up by the state. This created a problem of moral hazard that made people even more reluctant to default, especially since everyone else defaulted. As governments customarily recapitalised those banks that were engaged in subsidised lending, banks and other intermediaries had little incentive to bring down the number of defaults (Morduch, 2000, p. 620). Finally, the programs tended to encourage manipulation and cronyism, favouring of friends and associates of policymakers. Large-scale producers, rather than the poor farmers the programs were intended for, were often able to position themselves favourably and thus receive the bulk of the credit (Vogel & Larson, 1984, p. 57). Loans would often be awarded to the well-connected middle- and upper class, rather than to the poor who needed them.

### **Microfinance as a solution**

In the 1970s, microfinance emerged as a novel approach to the problem of financial exclusion of the poor. While there is no universal definition of microcredit, it can best be described as small loans, usually given to poor that lack collateral and access to conventional credit. It is difficult to pinpoint the exact origin of microfinance. The earliest known account was the Irish Loan Fund, set up in 1720 by the Irish pastor and writer Jonathan Swift in order to provide loans with no collateral to the poor of Dublin. Another initiative was the Indonesian Priyayi Bank for microloans, set up in 1895 (Srinivas, n.d.). Yet another example of microfinance can be found in the so-called Rotating Savings and Credit Associations (ROSCAs). ROSCAs, who have a long history of use throughout world, are informal groups coming together and pooling their resources, which they subsequently lend out on a rotating basis within the group (Bouman, 1983, p. 262). The group element of the ROSCAs were an important inspiration for the model we commonly associate with microfinance today, namely the Grameen model.

The Grameen bank (meaning ‘bank of the villages’) was born out of a 1976 research project by Mohammed Yunus, professor of Economics at the Chittagong University, Bangladesh. Yunus argued that access to credit was the main obstacle for development, and through collaboration with the Bangladesh Agricultural Development Bank he started supplying cheap credit to the poor (Todaro & Smith, 2006, p. 242). Since the late 1970s, the Grameen approach to microfinance has been in the forefront in driving the ‘microfinance revolution.’ Like ROSCAs, the Grameen model attempted to mitigate the problems of information and lack of collateral. It revolved around group loans with joint liability for the group as a whole. Groups of five – initially both men and women, later only women – were given small sums of money that were lent out and repaid within the group on a rotating basis. With Grameen, however, this was systematised on a large scale.

### **Microfinance spreads beyond Grameen**

The Grameen project proved a big success. It was formally chartered as a bank in 1983 and has since grown tremendously, counting over 8 million borrowers and 2,500 branch offices, each covering 15-20 villages in rural Bangladesh (“Grameen Bank | Bank for the poor - GB At a Glance,” 2011). Over the next decades, this success spurred a flood of microfinance institutions (MFIs), notably in other developing countries. The scale and scope of these adoptions have been diverse. On the one hand there are small, specialised banks employing just a few people and focusing exclusively on loans. On the other hand there are gigantic organisations such as BRAC, which reaches 130 million poor, employs over 100,000 people in eleven countries across three continents, and engages in a wide range of projects including education, public health, and social development. Here microfinance represents only a small part of the total service delivered (“Stay Informed: BRAC at a Glance,” 2013). Combined microfinance is now reaching a significant part of the world’s poor across all five continents. In 2007, the UN estimated that roughly 154 million people were users of microcredit across the globe (Width, 2010, p. 15).

The proliferation of microfinance has not been without controversies, and criticisms of microfinance have been levied at various times over the last few decades. Questions have been raised of whether the Grameen model merely perpetuates cycles of dependence.<sup>1</sup> Moreover, with the spread of the model new providers are entering the market, some with

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<sup>1</sup> See chapter 3 on microfinance impact for a detailed discussion on efficacy.

little regard for the original humanitarian ideal of microfinance. In 2010 it was reported that more than 77 people in the Indian province of Andhra Pradesh had been driven to suicide as a result of MFIs charging excessive interest rates, adopting coercive collection practices and engaging predatory lending towards the poorest borrowers (Ghiyazuddin & Gupta, 2012, p. 4). Despite of the uncertainties and controversies the growth of microfinance is impressive, and it has quickly become a considerable part of the effort to promote development across the globe, favoured both by Western donors and developing countries themselves.

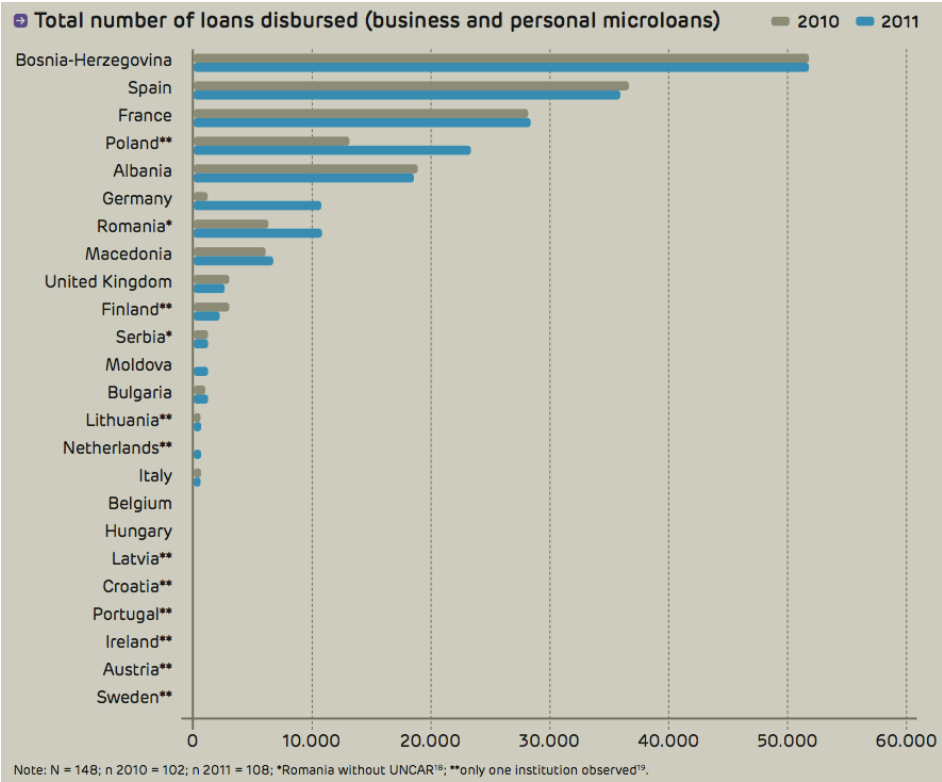
## **2.2 Microfinance in Europe**

Although microfinance was initially conceived of as a tool for poor rural developing countries such as Bangladesh and India, this has not prevented the spread of the approach to more developed countries. European countries in particular were early adopters of microcredit, with many initiatives emerging during the late 1980s and early 1990s. In Eastern Europe the driver of this development was the collapse of the Soviet Union in 1991, which left in its wake crippled, dysfunctional states and millions of unemployed. The shortage of capital was severe, but decades of command economy meant that the former Soviet republics simply had no financial markets. Considerable effort were therefore undertaken to support the reintegration of these economies into the European economy, and microfinance was a key part of this effort (Forster, Greene, & Justyna Ptykowska, 2003, p. 14).

Microfinance was also introduced among the affluent countries in Western Europe. Although developing countries might be at a particular disadvantage in providing finance to its poor, exclusion from financial markets are certainly not limited to these countries. A 2006 report by World Savings Banks Institute estimated that about 10% of the European population is financially excluded, that is, are unable to access conventional sources of credit (McDowell, 2006, p. 7). Women, visible minorities, the unemployed, immigrant populations, and other disadvantaged groups often face the same kind of exclusion from access to finance in rich Western countries as in poor developing ones, and lack of collateral as well as problems associated with proving creditworthiness are typical and relevant challenges in developed economies as well (see e.g. Rogaly, Fisher, & Mayo, 1999). The last twenty years has therefore seen microfinance initiatives emerging in new contexts, from poor African-American urban communities in the United States, to immigrant population inside the European Union, and in remote fishing villages in rural Norway.

In many ways the early European development of microcredit were built upon the same experience as that of the developing countries. Preceding the introduction of microfinance were subsidised loan funds, set up by regions and countries to combat increasing unemployment and social exclusions. Examples of these include Fonds de Participation in Belgium and First Step in Ireland (Evers et al., 2007, p. 11). But like in developing countries these funds struggled to recover their capital and were plagued by high rates of default.

As the success of microfinance in developing countries became widely known, there were initiatives undertaken across Western Europe to import the model. Today a number of organisations are engaging in microfinance in Europe, such as ADIE in France, KfW in Germany, and La Caixa in Spain. The tables below, which are taken from the European Microfinance Network sector overview for 2011, show the size of the sector in the respective European countries in terms of clients and loan value<sup>2</sup>. We see that while large countries such as France and Spain figure high up on the list, Eastern European countries also show a strong level of microfinance activity. The cases selected for this thesis, on the other hand, seem to have much lower level of activity.



<sup>2</sup> Note that these figures also include personal microfinance in addition to business microfinance. These figures only survey EU members, and do not include Norway.

Figure 2.1: Total number of loans disbursed (business and person microloans). Taken directly from EMN (2011)

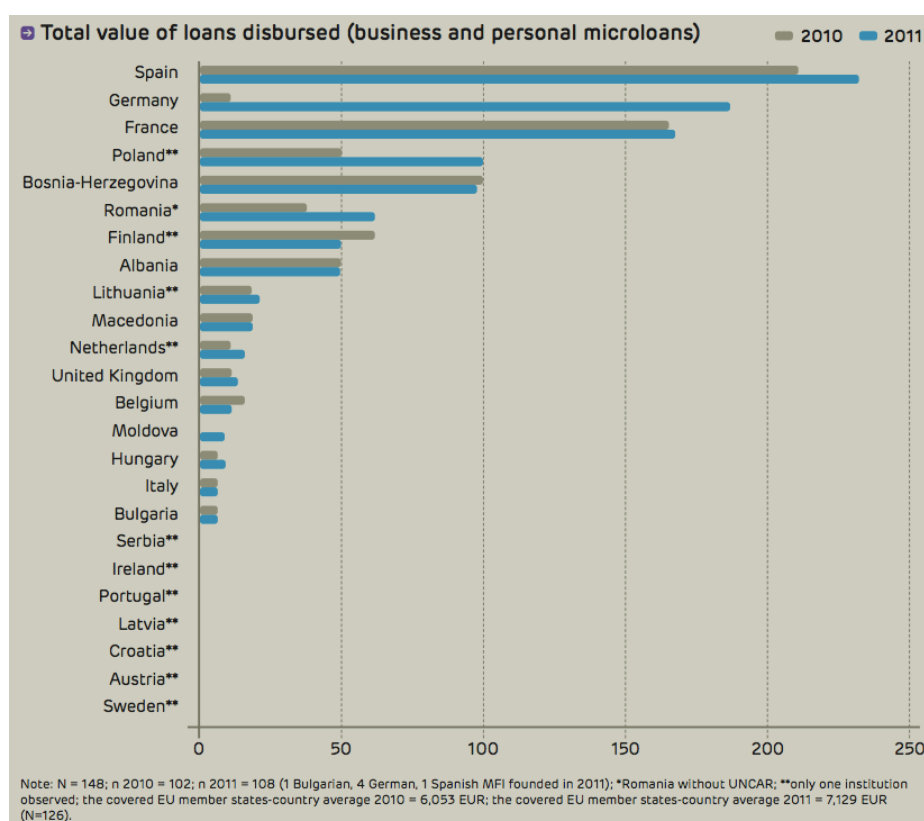


Figure 2.2: Total value of loans disbursed (business and person microloans) Taken directly from EMN (2011).

The first European MFIs were idealist organisations: they were founded by people who had personally seen the success of microfinance in developing countries, and who sought to import it to their home countries. Some of the largest MFIs today, such as the mentioned ADIE in France, as well as Enigma in Germany to name a few, were created this way (Evers et al., 2007, p. 11). These pioneers were followed by a host of small and large organisations, and the years after 2000 saw rapid growth in the number of MFIs. This period also saw ordinary banks entering the field of microfinance through collaborations with MFIs, with MFIs taking responsibility for client relations and business development services, and banks taking responsibility for providing capital and loan handling (McDowell, 2006, p. 7) The collaboration between the Norwegian Cultura Bank and the MFI Microfinance Norway (MFN) between 2008 and 2012 is such an example.

While established in Europe today microfinance plays a considerably smaller role within the European economy compared to its role in developing economies, and the size of microfinance market relative to the conventional bank market is still miniscule: adding the value of loans in Figure 2 gives a total of less than €1 billion. Moreover, the market for

microfinance itself is also shared between only a few actors: data from 2007 shows that within the European Union three MFIs – Adie in France, Finnvera in Finland, and Fundusz Mikro in Poland– accounted for 70% of all loans given (McDowell, 2006, p. 23). It is important to keep this in mind when looking at the potential that microfinance has as a measure for financial and social inclusion. Its role is not to compete with or supplant conventional markets: a successful microfinance story usually ends when that person gets a loan in a conventional bank.

### **Microfinance and the European Union**

Throughout the 1990s microcredit was something mostly undertaken by grass roots idealists and private organisations, usually with funding from various state agencies. Around the turn of the century, however, the promise of microfinance had also caught the attention of the European Union. Over the course of the decade a number of projects were launched: Between 1996 and 2001 the ‘Equal Credit Project,’ funded by the European Regional Development Fund, explored the use of microcredit to support development among rural and urban deprived groups, such as immigrant communities (Sekkesæter, 2002, p. 6). In 2000 the European Commission adopted the ‘European Multilateral Programme (MAP) for Enterprise and Entrepreneurship, in particular SMEs<sup>3</sup> (2000-2005).’ This program was the first time microcredit was recognised as a tool in the European Union’s effort to support entrepreneurship and small– and medium enterprises (European Commission, 2003, p. 5). All these programs thus provided test beds for the various applications of microcredit to foster financial inclusion. They also marked the first attempts to formally institutionalise microcredit at the EU level.

After 2007 the EU moved to consolidate these various projects into an over-arching framework for microfinance. Today, therefore, microcredit and microfinance have become considerable parts of the Union’s strategy for inclusion, sustainability, and social cohesion. Several programs were launched, aiming to provide either financial or technical assistance. These programs are summarised in the table below. With this consolidation of programs funds available has been substantially increased. For example, under the current financing window of Progress Microfinance €205 million has been provided for the period 2010-2016 (“European Progress Microfinance Facility,” n.d.).

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<sup>3</sup> Small and Medium Enterprises



Table 2.1: EU programs supporting microfinance

Name of Programme	Focus of Programme
EQUAL programme (2000-2008)	Focused on equal access to the labour markets, and included microcredit as a tool to encourage inclusive entrepreneurship.
Competitiveness and Innovation Programme (CIP) (2007-2013)	Tasked with boosting the entrepreneurial initiative and creating a productive environment where innovation capacity can grow and develop.
Joint European Resources to Micro to medium-sized Enterprises (JEREMIE) (2007-2013)	offered EU Member States the opportunity to use part of their EU Structural Funds to finance small and medium-sized enterprises (SMEs) by means of equity, loans or guarantees.
Joint Action to Support Microfinance in Europe (JASMINE) (2007-2013)	Provided European MFIs with training and technical assistance, such as quality assessments and ratings of their businesses activities similar to conventional rating services provided to conventional banks.
Progress Microfinance (2010-2016)	Provides funds for intermediary MFIs, channels these funds as microloans for the unemployed, microentrepreneurs, and others who are excluded from traditional channels of finance. Moreover, the program provides guarantee funds that MFIs can tap into in order to support their lending activities.

One can therefore claim that EU has been one of the main drivers of the development of microfinance initiatives in Europe. Because of its financial resources and willingness to fund projects that are often too experimental for domestic governments EU has acted as an enabler of microfinance. This becomes clearer as we progress into the empirical analysis. Today, the EU continues as the main driver of microfinance in Europe.

## 2.3 Microfinance in the three cases – an overview

### Microfinance in Norway

The first attempt of implementing microfinance to Norway was in 1992, in the coastal region of Lofoten. This rural region in the north of Norway is highly dependent on the fisheries outside of the coast and the income derived from the processing and export of fish. Fishing, however, is a seasonal activity, which leaves the population vulnerable outside of the season,

with little income to support other income-generating activities. The fluctuating income and lack of collateral also made it difficult to gain access to credit. A three year pilot project incorporating the municipalities of Flakstad and Moskenes and based on the Grameen model was therefore launched to test out the potential of microfinance to encourage self-employment out of season (Lotherington & Ellingsen, 2002, p. 18).

The goal of the project was threefold: In addition to providing finance, microcredit was to act as an arena tool for sharing of experiences and ideas, and as a unifying force for various grassroots activities in the community. Finally, microcredit had a gender aspect. Because of typical house ownership patterns, women would often be the ones that lacked access to collateral. Moreover, it was often women who had to leave out of season. Microcredit would be specifically used as a tool to empower women, both through providing access to credit, as well as through providing a forum for sharing of experiences and ideas (Lotherington & Ellingsen, 2002, p. 18).

The Lofoten pilot attracted considerable public and official attention, and in the subsequent years a number of additional groups were initiated. During the first years the focus was on women, particularly in rural districts in the northern parts of Norway that are dependent on fishing or farming. One project, for example, targeted indigenous Sami women in the municipality of Karasjok (Bjørnholt, 1995, p. 127). Soon, however, there were attempts to adopt the model to urban settings as well. In 1996 the Credit Network for Refugees and Immigrants (CNRI) was created and funded by the humanitarian organisation Norwegian People's Aid. The rationale for the initiative was the fact that immigrants and refugees were excluded from the formal economy instead withering away at asylum centers. Microcredit specifically targeted towards immigrant and refugee populations had been a part of ADIE's successful approach in France, but this was the first initiative where it was used to fight financial exclusion among these groups in Norway. The same year, the first attempt at consolidating the various groups was also undertaken, when the Women's Bank (Kvinnebanken Norgesnett) was founded to act as an umbrella organisation for the emerging microcredit initiatives.

The Ministry of Fisheries had already had an active role financing the pilot projects, but soon other official bodies started exploring the potential of microcredit. In 1997, the government presented a White Paper outlining microcredit as a future focus area for the Norwegian Industrial and Regional Development Fund (NIRDF) (Kommunal- og arbeidsdepartementet,

1997). NOK 10 million was earmarked for microcredit initiatives. Hereafter NIRDF, and from 2003 its successor Innovation Norway (IN), would be the primary source of government funding and oversight of microcredit initiatives in Norway. This marks the first official recognition of microcredit as a policy tool in fostering entrepreneurship in Norway. It also marked the start of a schism in the Norwegian microfinance development. Rather than receiving financing from NIRDF/IN, CNRI was sustained independently from the “official” microcredit program. Along with domestic sources of financing, CNRI was a part of the EQUAL Community Initiative mentioned above, which provided funds and guarantee instruments. (Sekkesæter, 2002, p. 6)

In 2003 the CNRI project was wound up and Norwegian People’s Aid disengaged from its involvement. Network Credit Norway (NCN, later Microfinance Norway) was subsequently founded as the project’s successor building on the experience from CNRI. In 2003, NCN in collaboration with Hordaland county municipality and Cultura Bank, created the Microinvest Foundation, a fund dedicated to financing microcredit initiatives. Hordaland county municipality would along with other supporters of the project such as the Norwegian Directorate for Immigration provided financing, Cultura acted as the financial intermediary and managed the operational activities of the fund, while the NCN coordinated lending activities and provided business training and support (Wiggen, 2005, pp. 71–75). With the end of the EQUAL Community Initiative in 2003, financing and guarantee responsibilities were taken over by the European Investment Fund under the EU MAP programme, and subsequently the CIP programme 2006 (Hektoen, 2011, p. 176).

By the mid-2000s microcredit appeared to be an established, albeit small niche in Norway. Innovation Norway administered a total of 265 groups with over 1320 members, with a total equity of NOK 53 million (Width, 2010, p. 17). Moreover, NCN and Cultura had throughout the 2000s made loans to about 173 of its members, totalling NOK 5,5 million (Interview MFN 27:00). In 2008, a White Paper on women’s entrepreneurship advocated strengthening the initiative, promising an additional NOK 10 million towards microcredit activities provided through (Nærings- og Handelsdepartementet, 2008, p. 26).

Then, however, Norwegian microcredit suddenly collapsed. First, Innovation Norway suspended their microcredit activities in favour of so-called “Entrepreneur Groups” (Gründergrupper in Norwegian) (Innovasjon Norge, 2009, p. 40). Three years later, Cultura – citing poor performance and low profitability of their microcredit portfolio – followed suit,

and disinvested from their partnership with NCN. During the years 2006-2009 there had been a large increase in activity on the lending side, but between 2009-2012 Cultura did not make any new loans (Interview MFN 19:10). While MCN and the guarantee fund Microinvest still exists, there is still no capacity to act as an independent MFI without a financial intermediary.

## **Microfinance in Sweden**

The first attempt introducing microfinance in Sweden was the project “Nätverksbanken i Dalarna,” which translates into “The Network Bank in the Dalarna region.” The project was financed by a combination of local- and EU funds. A key inspiration for the project was in fact the Norwegian Lofoten pilot created a few years earlier (“Nätverksbanken i Dalarna,” 2014). This project was followed by several other similar projects, such as “Nätverksbanken i Falun” and “Nätverksbanken i Jämtland.” The focus of all of these projects was similar to that in Norway. These rural regions all struggled with patterns of depopulation that was affecting women in particular. Thus microfinance was seen as a method to foster network building, community development, and entrepreneurship among women.

The first introduction of microfinance in government policy came somewhat later than in Norway. In 2001, the Swedish government decided to create a so-called “micro loan,” supplied through the business incubator service ALMI, the Swedish equivalent to the Norwegian Innovation Norway (Regeringen, 2001, p. 173). After a few years the loan was finally launched in 2005 under the term “miniloans.” Like in Norway, the introduction of an “official” loan led to a schism emerging between the publicly supported microfinance initiative and the grassroots initiatives, and whereas the official initiative received sustained funding, the private initiatives had to struggle to stay afloat.

2004 marked the start of a “second wave” of grassroots initiatives. That year the “Swedish Platform for Microcredit” was started by various grassroots organisations, inspired by the UN’s decision to make 2005 the international microcredit year (“Nyhetsbrev Nr 04 - mars 2005,” 2005). Over the next few years a number of microfinance initiatives were launched across Sweden, usually with a combination of local and EU funding from programs such as EQUAL. These initiatives shared the same focus on the grassroots aspect of microfinance and had an explicit focus on groups facing difficulties in accessing finance from conventional sources, such as women and immigrants.

In 2008 ALMI decided to improve the conditions on the mini loan. With the financial crisis hitting the European economy the credit conditions worsened, and many entrepreneurs and small business owners found themselves lacking access to capital. First, the ceiling from the loan more than doubled to SEK 250,000; second, the requirement for collateral or guarantors was removed. This made the loan into a more “true” micro loan, reflected in the rebranding of the loan as precisely a “micro loan.”

Today ALMI’s micro loan continues to be a popular measure with a consistent level of demand over the last few years. In 2014, ALMI as the first Swedish institution entered the PROGRESS microfinance program of the EU, allowing it to sustain and expand its microfinance initiatives over the coming years (“European Progress Microfinance Facility,” n.d.). The grassroots alternatives, however, have struggled. Most of the pilots have yielded no further results at the conclusion of the project period. The one exception, the MFI Mikrofinansinstitutet was launched in 2011. The MFI was born out of the PITEM I and II pilots that ran between 2004 and 2007, and offered microfinance services including loans and business development services. This was the first fully-fledged MFI of its kind in Sweden. Nevertheless, by 2014 MFI’s activity had subsided. There are currently no grassroots initiatives promoting microfinance in Sweden.

### **Microfinance in the United Kingdom**

The UK has a long history of cooperative movements and credit unions, but like in Norway and Sweden microfinance initiatives on a larger scale only emerged towards the end of the 1990s. Small MFIs, such as the Norwich Full Circle Fund, existed as far back as the late 1980s, but these were small and scattered. It was the election of Tony Blair and New Labour in 1997 that propelled microfinance into the national spotlight. One of Blair’s chief promises was to address the growing class divisions and income inequalities that had emerged in the UK under the Conservative rule over the last decades. One of his first tasks was to create the Social Exclusion Unit to deal with these issues. With the 1998 launch of SEU’s ambitious National Strategy for Neighbourhood Renewal, so-called Community Development Financial Institutions (CDFIs) became part and parcel of the government’s effort to address community deprivation poverty (Social Exclusion Unit, 1998). CDFIs encompassed microfinance institutions, credit unions, and community loan funds dedicated to improving access to finance among the financially excluded.

Over the next decade the government launched a host of measures in order to support the emerging CDFI sector, such as the Phoenix Development Fund, Regional Development Agencies, the Social Exclusion Task Force, and the Office of the Third Sector. Unlike Norway and Sweden, the government took a more passive role in terms of providing financial assistance. Institutions such as the Social Exclusion Task Force worked on policy development, while funds such as the Phoenix Fund, provided wholesale capital for on-lending, that is, for CDFIs to provide further to their own clients. Around these measures therefore, a new sector of CDFIs emerged, rather than the divided development that occurred in the two other countries. Towards the end of the decade, however, some of the earlier enthusiasm had subsided. Policymakers had turned their attention elsewhere, and after the Phoenix Fund closed down in 2005, maintaining funding had become a challenge for many CDFIs, as the degree of self-sustainability amongst them was generally low.

Around the 2010 general election the situation had once again turned around. First, the financial crisis had led to the launch of a series of new measures supporting entrepreneurs and small business owners in a tight credit market. Second, the election of the Conservative-Liberal Coalition government headed by David Cameron brought in a renewed focus on entrepreneurship and business. With this focus came several new programs, such as the Regional Growth Fund, Startup Loans and the New Enterprise Allowance. In the years since the election, these new funds have led to renewed growth for the sector. These funds are complemented by the extension of the PROGRESS programme to UK CDFIs (“First Progress Microfinance agreement with internet lender Ezbob and the EIF,” 2014). At the same time the sector itself is becoming more and more mature with rising levels of sustainability and professionalism. Today the CDFI sector is alive and well in the UK with over £250 million worth of outstanding loans and lending to nearly 15,000 businesses (CDFA, 2014a).

## **2.4 Summary and conclusion**

This chapter I presented the historical backdrop for microfinance. First, the post-war era saw the proliferation of subsidised credit to promote human and economic development, and the problematic aspects of this approach. Subsequently, I looked at the emergence and spread of microfinance as a hybrid tool to provide credit to the financially excluded. While not without controversies, the success of this model caused it to spread to other developing countries and eventually to developed countries as well. I showed how microfinance was adopted as a

measure to address the lack of functioning financial markets in the former Soviet countries, and how it has emerged as a measure – first as a grassroots movement, later driven by the European Union – among Western European countries to address social and financial exclusion.

Finally I provided a short summary of the development of microfinance in Norway, Sweden, and the United Kingdom was provided. Looking at the three cases at a whole some tendencies emerges: After a promising start, the Norwegian development split and eventually stalled towards the end of the 2000s. In Sweden, there is also a split, but whereas the grassroots initiatives have struggled, the government initiative has continued to thrive. Finally, in the UK there is no such split, and despite signs of slowing down towards the end of the 2000s, microfinance has nevertheless thrived and continues to do so. In all three cases microfinance emerged around the same time, but there are considerable difference in performance. Is it possible to explain this variation? As I return and elaborate more thoroughly on the three cases in Chapter six the argument is that this is indeed possible.

# 3 Literature Review

Now that we have seen historical developments of microfinance, let us turn to what the literature say on its actual impact. Does microfinance actually work, or is it the appeal of a market-based approach to development assistance that has attracted support from donors and governments across the world? This chapter outlines the literature on microfinance impact. Next, I discuss the issue of microfinance sustainability, before I say a few words on microfinance and public policy. Finally I discuss some of the deficiencies and methodological challenges that the current literature suffers from.

## 3.1 Does microfinance work?

### Impact in developing countries

Is microfinance effective at addressing poverty and exclusion in developing countries? The tendency in the literature points weakly towards positive impacts. On the one hand, an early study of the impact of Grameen Bank in Bangladesh by Hossain in 1988 shows that on average, Grameen members had 43% higher income than that of target non-participants in villages without any presence from the Grameen Bank, and 28% higher than non-participants in villages with presence from the Grameen Bank (Goldberg, 2005, p. 6). Studying Bangladesh between 1991/92 and 2011/12, Khandker and Samand (2013) finds that microfinance works particularly well on reducing extreme poverty, and that microfinance intervention may account for as much as 9 percent of the total poverty reduction in Bangladesh over the last decade.

One the other hand, a study quoted by Schrenier and Sharma (1999, p. 69) found that on average microfinance interventions tend to stabilise rather than increase income, and preserve, rather than create jobs. Another study conducted on microfinance clients in Hyderabad, India, showed some effect of microfinance on business income in the top end, but no effect in terms of health, education, and women's empowerment (Duflo, Banerjee, Glennerster, & Kinnan, 2013). A literature review conducted by Duvendack et. al. (2011) concludes that from the few strong studies that exist, no discernable effect on well-being and women empowerment is found.



One problem is that studies emphasise different aspects of microfinance. In their review of the literature between 1989 and 1998 Schreiner and Sharma survey the results of twenty studies on microfinance interventions. Acknowledging the many dimensions that microfinance addresses, they classify the results using indicators of human capital, physical capital, social capital, income and environment. Results are scored as positive, mixed, or negative. Their summary, which is reproduced below shows how results differ across the various indicators.

Table 3.1: Microfinance and impact on welfare (taken directly from Schreiner & Sharma 1999, p. 88)

**Table 1: Microfinance and Impact on Welfare, Empirical Evidence**

Authors <sup>1</sup>	Capital			Income	Environment
	Human... <sup>2</sup>	Physical... <sup>3</sup>	Social... <sup>4</sup>		
Berger (1989)			±	±	
Diagne (1998)	± <sup>5</sup>			± <sup>6</sup>	
Khandker (1998)			±		
McNelly & Dunford (1998)	± <sup>7</sup>			+	
Lund (1995)			+ <sup>8</sup>		
Morduch (1998)			- <sup>9</sup>		
Mosley & Hulme (1998)				+ <sup>10</sup>	
Nguyen (1998)			± <sup>11</sup>		
Osmani (1998)			±		
Pallen (1997)					+
Pitt & Khandker (1996 & 1997)			+ <sup>12</sup>		
Schrieder (1996)	±			+	
Schrieder & Pfaff (1997)	±	+	±		
Schrieder & Heidhues (1993)		± <sup>13</sup>		+	
Schuler, Hashemi, & Riley (1997)			+ <sup>14</sup>		
Srinivas & Pallen (1998)			+ <sup>15</sup>		+
Zaman (1998)			±		
Zeller (1993)	+	+		+	
Zeller, Diagne & Mataya (1997)		± <sup>16</sup>		+	
Zeller <i>et al.</i> (1998)					+

Notes: + indicates positive welfare effect, ± indicates an equivocal result, and - indicates a negative result.

The impact of Business Development Services (BDS) such as training in accounting, marketing, and other parts of the business, has also been the focus of scholars. One study from Bolivia cited in Sievers and Vandenberg (2007, p. 1350) found that people who received BDS performed better with their business than those who did not. Moreover, McKernan (2002) found that non-credit aspects of participation in microfinance programs increased enterprise profits between 84% and 173% after controlling for the effect of access to capital. This finding is particularly interesting, considering the importance of business development services in the Western context.

## Impact in developed countries

Comprehensive quantitative impact studies of microfinance interventions, including the effects of BDS in developed countries, are rare. An explanation might be that the small scale of European microfinance interventions likely makes such studies more difficult. One of the few such studies from the United Kingdom showed a fairly strong impact of microfinance business lending on reducing inner city poverty (Lenton & Mosley, 2012). Most studies, however, use “softer” indicators of success and rely on surveys and questionnaires of clients. One such study of ADIE in France from 2011 measures microfinance impact on income and quality of life, and finds a positive impact of the intervention (Aldeghi & Olm, 2011). Another early study on the clients of ACCION in the United States showed that microfinance increased income and profits, as well as providing qualitative benefits such as pride, self-realisation, and community participation (Himes, 1998).

In the absence of academic studies, program evaluations and annual reports from the MFIs themselves can give an impression of the impact of microfinance in Europe. Here impact is typically measured in client satisfaction and jobs created or safeguarded. For example, a 2010 evaluation of the CDFI sector found that the impact of the outstanding loan portfolio on the local level was 1,705 new businesses created and 1,372 safeguarded; 3,635 jobs created and 3,618 safeguarded; £560 million of new turnover generated, and £788 million safeguarded (GHK Consulting Ltd, 2010, p. 79). Another study by the French MFI ADIE attempted to calculate the opportunity cost of welfare and self-employment. This study found that the cost of becoming self-employed would amount to €4,000, whereas the cost of unemployment benefits would amount to €18,600, not including lost tax revenue and national insurance contribution (Evers et al., 2007, p. 30).

## **3.2 Microfinance sustainability**

One could argue that almost any policy will work as long as enough money is being spent on it. Part of the attractiveness of microfinance, however, lies in its potential to be a cost effective measure to reduce poverty and social exclusion. A key debate within the microfinance community is the role of subsidies and sustainability. Many donor agencies, such as the Consultative Group to Assist the Poor (CGAP), have made the argument that financial and operational self-sustainability should be the goal of all microfinance interventions. They call this a “win-win” situation (Morduch, 2000, p. 617).

The “win-win” argument is based on the premise that sustainability is achieved through either sufficiently high interest rates, or with sufficient scale. Donors argue that the poor are not sensitive to high or low interest rates. By subsidising low interest rates governments and donor agencies are merely creating incentives to uphold inefficient practices. Furthermore, scale leads to better access for the poor, savings mobilisation, and more efficient services, while governments and development agencies save money and avoid the risk cronyism Sustainability creates a positive outcome for everyone, thus achieving greater impact in terms of poverty reduction.

Others argue that although sustainability on its own is a good thing, it is often either unfeasible or ignores social– or other non-economic considerations. Targeted subsidies help to provide credit to the poorest segment of the population, which is and important end in itself even if not sustainable. Whereas large non-governmental organisations such as BRAC can cross-subsidise less profitable programs, demands for sustainability might force smaller MFIs to slash programs on education and business training in order to balance their budgets. Moreover, the push for sustainability can cause MFIs to “graduate” away from their original clients towards the less poor (Johnson, 1998, p. 801). Morduch (2000, p. 624) argues instead that “pricing” social benefits into the budget and reward system of the MFI leads to a more nuanced focus on sustainability.

What do the numbers say? In one study from 2003, only 66 out of 124 MFIs surveyed were sustainable. For MFIs serving the low-end of the market the number was just 18 out of the 49 surveyed (Armendáriz de Aghion & Morduch, 2005, p. 232). While sustainability has improved since then many MFIs still rely on subsidies. For example, Grameen Bank, which calls itself subsidy-free still receives loans that might have an interest rate of one percent and a maturity of twenty years (Armendáriz de Aghion & Morduch, 2005, p. 236).

The situation for MFIs operating in developed countries is even more pronounced: In 2005, programs in the US supported by ACCION International managed to reach a level of self-sufficiency ranging from 32-80% (Burrus, 2006, p. 20). In Europe 40% of all MFIs rely on subsidies to cover at least 75% of their operational costs (Evers et al., 2007, p. 23). A UK evaluation conducted by GHK in 2010 showed that the median CDFI in 2006/07 was 30% operationally sustainable, while the corresponding figure for 2007/08 was 39% (GHK Consulting Ltd, 2010, p. iv). These tendencies are reinforced by the fact that European MFIs and banks are reluctant to charge the kinds of interest rates required for sustainability, either

because of anti-usury laws that sets a cap on interest rates, or because of reputational concerns (European Commission, 2007, p. 20). Moreover, arrears are typically higher than those in developing countries. For example, average ninety-day arrears rate for UK CDFIs were around 20% for the period 2002-2009, compared to 3% for developing countries (Lenton & Mosley, 2012, p. 13)

The situation is nevertheless slowly improving. In Eastern Europe operational sustainability has recently been achieved in several countries (see Bendig, Unterberg, & Sarpong, 2012) The UK situation has also recently improved somewhat: the 2013 industry overview reported 31% of CDFIs attaining operational self-sustainability, with a further 21% covering 90% of costs (CDFA, 2014b, p. 14). Unfortunately the diversity of the sector and lack of good data makes it difficult to paint an accurate picture of the issue of sustainability. This leads me directly to the next point on methodological considerations.

### **3.3 Microfinance and public policy**

Even more lacking than studies on performance and sustainability are studies that engage in the intersection between public policy and microfinance. Some studies look at microfinance from a perspective of government business promotion. In their study of IN's microfinance initiative in Norway Ellingsen and Lotherington attempt to create ideal types for how the initiative is managed by the authorities. Moreover, they identify a conflict between authorities and the grassroots based on different perception of management (Lotherington & Ellingsen, 2002). Other studies look at the legal and regulatory framework governing microfinance in Europe (see e.g. Basel Committee on Bankin Supervision, 2010; Thomson Reuters Foundation, 2011).

Given the origins in development economics, however, little emphasis is placed on institutional and political factors as supposed to economic factors. I have only been able to find one single paper that explicitly deals with the relationship between microfinance and public policy. This paper focuses on the political process leading up to the European Union's adoption of microfinance as a policy measure (see Unterberg, 2008). This is unfortunate, as the intersection between public policy and microfinance is of particular importance in Europe. As subsidies generally come from the state, the issue of impact and sustainability is of great interest among policymakers.

### **3.4 Some methodological considerations**

A problem with assessing microfinance performance is the lack of good quality data. A 2011 comprehensive literature review of over two thousand articles on microfinance argues that much of the existing literature suffers from weak research designs. After screening out these they are left with 58 studies, of which only two are randomised controlled trials (Duvendack et al., 2011, pp. 2–3).

This is necessarily the cause of bad science: all microfinance interventions look different, face different hurdles, and apply to different circumstances, and measuring impact is therefore complicated. This creates a heterogeneous body of literature as studies use differing methodologies and look at different aspects of implementation, with some focusing on the gender aspect, others on the social aspect, and yet others on the income aspect (Goldberg, 2005, p. 46). A microfinance intervention might be considered a success in terms of social outreach, but a failure in terms of poverty reduction, and vice versa. Morduch (2000, p. 624) has argued that so-called social transfer prices could potentially have a large impact on how one measure the success of microfinance interventions. In practice, however, this approach is limited by methodological challenges with regards to the operationalisation of social benefits. Reports often simply conclude that “microfinance works” based on measures such as client satisfaction in surveys.

Moreover, Schrieder and Sharma (1999, p. 82) argue that these problems are compounded by issues of bias as most studies focus on successful MFIs rather than those who have failed. Some MFIs even resist the use of impact assessment because they think they do not “fit” their particular situation or fail to take into considerations social impacts and will therefore judge them negatively. Pritchett (2003) even suggests that MFIs have incentives to avoid impact studies, as a negative result may threaten their funding. In practice, MFIs are also usually understaffed and underfunded, which make them reluctant to engage in expensive impact assessments (Evans, 2011, p. 6).

Another reason for the difficulty of engaging in serious impact studies in developed countries is the many counterfactuals that must be asked. What would the alternative been for the poor? Often studies, such as the above mentioned ADIE study rests on dichotomies of dubious nature, like “what is the opportunity cost of using microfinance versus being on welfare?”

This is especially the case in developed countries, where the alternative to microfinance is not simply poverty, but some kind of alternative competing policy.

### **3.5 Summary and conclusion**

Summing up, we see that there are moderately strong indications that microfinance is a useful tool for poverty alleviation and financial inclusion. While Duvendack et. al.'s meta-study finds no conclusive evidence, other meta-studies, such as the one by Srieder and Sharma, finds a more positive tendency. The positive tendency increases when measuring additional indicators such as social value, and Morduch argues that this approach captures a more nuanced picture of microfinance performance.

Furthermore, when it comes to sustainability the overall picture is that microfinance initiatives by and large still struggle with dependence on subsidies. This is especially the case for MFIs who engage in business development services, as well as those targeting the poorest segment of the market. This is the case in developing as well as developed countries. While there are tendencies of improvement, it is likely that certain MFIs will never become operationally self-sustainable.

Finally, the field is plagued by the lack of thorough research. The few rigorous studies often fail to find a clear effect of microfinance whereas studies that get “down and dirty” tend to find a positive impact of microfinance, but struggles with low external validity and potential biases. The academic literature on microfinance and public policy is nearly non-existent. This is problematic as states remain the chief financier of microfinance initiatives in Europe. The next chapter on theoretical aspects will attempt to address this gap.

## 4 Theory

This chapter outlines the theoretical aspects of microfinance. Although they are not directly relevant for my analysis, I have nevertheless chosen to briefly present the core concepts of microfinance for the reader to gain an understanding of what microfinance actually *is*. After presenting the core theoretical elements, I proceed to discuss their relevance in developed countries. I argue that the highly developed market economies in developed countries makes the theoretical underpinnings of microfinance less relevant. Instead I present microfinance in the context of the social economy and social entrepreneurship, and argue that this is a more useful conceptualisation of microfinance in a developed context. Finally, I make the case that public policy is the key aspect to study in order to explain the success of microfinance initiatives in developed countries, and proceed to present two theories of public policy that will provide an analytical framework for understanding the relationship between microfinance and policy.

### 4.1 How does microfinance work?

Conventional economic theory states that because of the law of diminishing marginal returns to factors of production, developing countries should be an attractive target for investment. Returns to capital should be higher relative to that of a capital-abundant country, and the poor in those developing countries should therefore be able to pay higher interest rates, which in turn increases profit for banks (Armendáriz de Aghion & Morduch, 2005, p. 5)

This is, however not the case. As shown by the figure below there is a strong relationship between economic development and the depth of credit markets. Put simply, the reason we do not see more bank lending in developing countries is risk. After the loan is given the lender has no way of knowing for certain whether that money is going to be repaid or not: while the borrower might say he will invest the money in his farm, he might be spending it instead on the stock market. This is a problem of asymmetric information (Armendáriz de Aghion & Morduch, 2005, p. 7). Only the borrower knows in truth whether he is a trustworthy person or not; the lender can only infer from the information the borrower gives him or the one that he can observe from his actions.

The lender will therefore have to trust the borrower blindly, or device some kind of agreement that creates incentives for repayment. Thus, rather than being purely governed by the price mechanism, i.e. supply and demand, finance is also influenced by agreements (contracts) between asymmetrically informed partners. In finance, this asymmetry of information gives rise to what is often termed the “principal–agent problem.” This problem arises when two contracting parties have different interests: the lender (principal), on the one hand, wishes to receive back his money in due time with the interest agreed upon. The borrower (agent) on the other hand, might prefer not to repay the loan at all. The task is then for the principal to get the agent to act in the principal's interest (Martimort, 2008). This task involves two primary challenges, namely those of adverse selection and moral hazard.

### **Adverse selection, moral hazard, and transaction costs**

Adverse selection arises because agents have incentives to misrepresent information about whether they are risky or not (Morduch, 1999, p. 1570). In short, a bank or lender cannot ensure that the borrower will make a *credible commitment* to repay the loan. In the case of finance the borrower will have incentives to withhold information that might affect the lender's assessment of his creditworthiness negatively, such as past borrowing history, appetite for risk, and planned use for the loan. For example, investment into crops and fertilizer is generally less risky than investment in risky stocks. A borrower will therefore have an incentive to convince a bank that he will buy fertilizer, even if the plan is to gamble on the stock market. In technical terms: risky borrowers do not fully internalise the costs associated with lending, which instead are borne by the bank, and therefore risky borrowers can outbid safe borrowers competing for the same loans (Ray, 1998, p. 580). The bank must therefore make sure there are screening mechanisms that can reveal potentially withheld information of the borrower. If those mechanisms can reveal a risky borrower the bank will demand a higher interest rate to compensate for the added risk, or refuse to give the loan outright.

Moral hazard arises after the loan has been given. It occurs because when the loan is given the bank takes on all of the risk: the borrower has all the money and the bank has none! Even if a contract specifies the terms agreed upon for the repayment of the loan there is no guarantee that the borrower will actually uphold such a contract. As the bank will have to physically give up possession of the money being lent out, there is a chance that when the time for



repayment comes the borrower might not be willing or able to honour his obligation (Armendáriz de Aghion & Morduch, 2005, p. 7). Perhaps he lost all the money on the stock market, or decided to move to another city. The solution to moral hazard is therefore to demand some form of collateral: the opportunity cost of losing a prized possession such as a house or car creates sufficient incentives for the borrower to uphold the contract and repay his debt.

Adverse selection, moral hazard and the principle-agent problem all affect what is called the transaction costs of financial activity. Dahlman (1979, p. 148) groups these into three categories: search and information costs refer to the costs associated with finding safe borrowers; bargaining and decision costs refer to the costs of settling the terms of the loan; enforcement and policing costs refer to costs associated with making sure contracting parties uphold their end of the deal. Combined, these can account for a large amount of the costs associated with contracting: one study estimated that transaction costs accounted over half of total costs in the American economy in 1970 (Wallis & North, 1986, p. 120). Transaction costs are more manageable when there are few actors involved, but as scale increases the number of borrowers becomes harder to administrate, as each contract requires the bank to gather the necessary information to assess the risk profile of the customer, negotiate a contract that both parties can accept, and ensure that those contracts are enforced. This necessarily increases costs, which must be then offset by higher interest rates and fees.

### **Financial exclusion and the informal market**

Banks in developing countries usually lack the kind of information gathering capabilities necessary to assess the riskiness of the poor. These clients usually live in inaccessible rural villages, have no credit history, and if they had there are no centralised records for the bank to consult. Moreover, banks have difficulty reducing the moral hazard. There are two reasons for this: first, the poor usually lack access to collateral, which creates incentives to repay the loan and prevents the borrower from defaulting; and second, the enforcement capacity of the state is weak and underdeveloped (Ferrand, 2013, p. 463). Moreover, financial literacy – the ability to understand basic information about financial products and services – is low, so borrowers do not fully understand the kind of agreement they are entering (Staschen & Nelson, 2013, pp. 76–7).

The result is that the poor are excluded from conventional sources of finance. Data from the World Bank shows that worldwide 2.5 billion people and 75% of the world's poor do not have a bank account (The World Bank, 2012). Moreover, financial exclusion and economic growth correlate with one another. The lower the gross national income per capita, the less likely a person is to have an account at a formal financial institution (Ferrand, 2013, p. 461).

In the absence of conventional banks financial markets are therefore left to informal actors. Informal actors encompass family, relatives, moneylenders and loan sharks (Todaro & Smith, 2006, p. 745). One study showed that in Indonesia, over 70 percent of the population uses some form of informal finance (Armendáriz de Aghion & Morduch, 2005, p. 57). Because informal actors have a local presence they are often better situated to judge risk than an urban bank. It also allows them to accept alternative forms of collateral, such as harvests and labour, which would be impractical for a conventional bank (Ray, 1998, p. 573). Finally, they are to a greater extent able to enforce agreements or renegotiate terms if borrowers have trouble repaying the loans. For example, if the lender is a relative kinship ties can be effectively used to create incentives for borrowers to repay.

The drawback of informal actors, however, is that they tend to charge usurious rates of interest, where the result is that the poor become trapped in cycles of perpetual debt. One early survey of moneylenders from the Punjab region in India showed annual interest rates ranging between 134 and 159 percent (Singh, 1983, p. 252). Another study from Ghana, Malawi, Nigeria, and Tanzania found informal market interest rates at least 50% percent above formal market rates (Steel, Aryeetey, Hettige, & Nissanke, 1997, p. 823).

### **Microfinance innovations**

The innovations engendered in microfinance combine the information-gathering capabilities of informal lenders with the organisational strength and stability of a regular bank, thereby making finance accessible to millions of previously excluded poor. According to Morduch (1999, p. 1579), the most important of these innovations are first: group lending; second: dynamic incentives; third: regular repayment schedules; and fourth: collateral substitutes. While each of these 'innovations' has a long history prior to the advent of microfinance, the application is novel. The promise of microfinance is that by applying these principles the problems of adverse selection, moral hazard, and prohibitive transaction costs are mitigated.

The group lending is by far the most studied mechanism of microfinance, and the one touted as its most important. Its logic builds on that of the ROSCA:<sup>4</sup> groups of four to seven people come together to apply for a loan. If the loan is repaid a new loan is given, and so on. If some of the members of the group fail to repay the group will come together with the MFI and work out some form of new repayment plan. If that does not help, the group as a whole is barred from making any new loans. The group allows members to pool together resources and thereby increase the size of loan; but more importantly, the social pressures associated by joint liability creates powerful incentives for the individuals to uphold their responsibility and repay the loan (Ray, 1998, p. 752). Since most poor lack collateral, joint liability addresses the challenge of moral hazard. Furthermore, the group has an important screening function: because individuals coming together to form a group prefer to associate themselves with other trustworthy people, some of the costs associated with information gathering are borne by the borrowers rather than the MFI. This mechanism, called positive assortative matching, addresses the risk of adverse selection (Ray, 1998, p. 580)

In addition to group lending, microfinance takes advantage of dynamic incentives. This means that if a group succeeds in repaying a loan in the first period, the size of the loan increases in the next period, and so on. This method is a cornerstone of the Grameen model, where an initial “test loan” is given to assess the viability of the group before regular lending starts. This practice is also widespread in Western adoption of microfinance (Wiggen, 2005, p. 71). Dynamic incentives address the problem of moral hazard: successful repayment increases the loan over time. Borrowers will only gain access to the larger sums if they demonstrate diligence and loyalty; defaulting from one loan with the intention of getting a new loan elsewhere forces the borrower to start from scratch.

Next, regular repayment schedules mean that unlike conventional business loans, where the principal and interest is repaid in full at the end of the period, repayments start almost immediately after the loan is disbursed. The advantages of this are several: first, undisciplined borrowers are quickly revealed to the group and loan officers; second, because some money must be repaid even before the investment bears fruit, it means that the household must have some additional income, which acts as quasi-collateral (Rogaly, 1996, p. 104).

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<sup>4</sup> See Chapter 2.1

Finally, there is the case of collateral substitutes. In most cases the poor cannot provide the necessary collateral. Collateral substitutes include, for example, mandatory savings, where borrowers are forced to set aside a small sum every week for an “emergency fund” in case of default. Other forms include items that might not have value to the bank, but which have great value to the borrower (Armendáriz de Aghion & Morduch, 2005, p. 135). Interestingly this mimics some of the practices typically carried out by the informal lender, and illustrates the potential of microfinance to draw on the strengths of both formal and informal finance.

## **4.2 And how does it work in developed countries?**

It should come as no surprise that while financial exclusion exists everywhere, the circumstances under which European MFIs operate are considerably different from those in developing countries. In developed states the issues of moral hazard, adverse selection and transaction cost have to a large extent been solved. Adverse selection is mitigated through the widespread adoption of information and communication technology, which allows banks to access records of credit history and use mathematical models to assess potential borrowers. These countries also have well-developed judicial and regulatory institutions, which ensure that enforcement costs are kept down: a defaulting borrower cannot simply move to another part of the country and be in the clear. In other words, search and information costs as well as enforcement costs are low, which allows conventional finance to reach a greater portion of the population.

We have nevertheless seen in Chapter 2 that even in Europe almost 10% of the population faces financial exclusion. These are often low-skilled people with weak attachment to the labour market. Moreover, European countries are characterised by formal and highly developed capitalist economies. Under these circumstances merely supplying cheap capital is typically not enough for a potential microentrepreneur to survive and thrive. Common for microfinance initiatives in the West is therefore that they not only engage in lending, but also put heavy emphasis on ‘microcredit plus,’ i.e. various forms of business support and training services, such as marketing, accounting practices, and other activities (Evers et al., 2007, p. 10).

### **Social exclusion, social economy, and microfinance**

In the Western context financial exclusion is often considered a facet of the broader concept of social exclusion. Gonzales defines social exclusion as the alienation from economic, political, and cultural institutions (Gonzales, 2007, p. 122). A similar definition provided by Rogaly and Fischer is a “process which brings about a lack of citizenship, whether economic, political, or social” (Rogaly et al., 1999, p. 3). They argue these phenomena have complex links that tie them together with one another, and where one often feed into the other. Perhaps the most typical form of social exclusion is unemployment. While poverty does not mean being social excluded, it increases the chances of such an outcome. Studies from Italy show being financially excluded correlated with being socially excluded as well (European Commission, 2008, p. 48).

Ever since the Beveridge Report was released in 1942, there has been a firm understanding in Europe of social issues as being under the purview of the state. A traditional conceptualisation of social democracy considers it as a compromise between labour and capital, where the state cushions negative consequences of competition, such as unemployment. In his book on the variations of capitalist welfare states, Gøsta Esping-Andersen coins the term “decommodification” as a measure of the degree to which welfare systems can allow citizens to “freely, and without potential loss of job, income, or general welfare, opt out of work when they themselves consider it necessary” (Esping-Andersen, 1990, p. 23). In other words, how easy it is to not work without suffering negative consequences. In states with a high degree of decommodification it is easy for people to step out of the labour market without consequence, while in states with a low degree of decommodification this would have adverse effects. Connecting this concept to social exclusion we can say that low levels of decommodification increase chances of social exclusion.

Today the welfare state is the chief “decommodifying” force in Europe. Historically, however, there has been a range of non-state actors working to alleviate these societal ailments, including, charities, voluntary organisations, and so on. But other actors do not fit into this category. While these actors’ goals are ultimately of a social nature most of them in fact work within the boundaries of the market. This can be referred to as the social economy.<sup>5</sup> The range of social economy actors is large, from cooperatives and credit unions to firms employing ex-convicts to renovate apartments. They nevertheless elude the traditional binary categorisation of either state or market: while they are not operating on a voluntary basis, they

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<sup>5</sup> Alternatively the third sector, which is the most common term for the concept in the United Kingdom

are not profit maximising either. These actors can be said to be operating within a “social economy.” According to Noya and Clarence (2007, p. 10) the idea of the social economy seeks to “capture both the social element as well as the economic element, inherent in those organisations which inhabit the space between the market and the state.”

Furthermore, in many European countries the welfare state is under increasing pressures. Alongside what many considers a decline of the welfare state in many developed countries over the last few decades, the concept of the social economy has gained increased prominence (Ash, Cameron, & Hudson, 2002, pp. 5–6). Conning and Morduch (Conning & Morduch, 2011, p. 409) argue that social investments makes business sense too: while orthodox proponents of the free market argue that firms should only care about maximising shareholder value they argue that if markets are imperfect, mixing business and philanthropy can make sense. Microfinance can be understood as an example of an actor social economy (Noya & Clarence, 2007, p. 26). It certainly operates in the social economy space: target groups, as we have seen, are usually excluded from mainstream sources of finance, dependent on welfare, and are on the fringes of society. Moreover, microfinance initiatives are usually non-profit, only attempting to cover costs and investments into capacity.

Advocates of microfinance have often been grassroots activists attempting to create positive change in people’s lives. These activists are called social entrepreneurs. A social entrepreneur specialises in solving social problem using approaches from the business world. Thus the social entrepreneur fills the gaps that exist between the state and the market. Success is measured by the impact the business has on the society, rather than profits. (DAMVAD, 2012, p. 10). As argued by Tan et. al. (2005, p. 353) social entrepreneurs promise an altruistic form of capitalism that does not evaluate all human activities in business terms. In their review of the concept of social entrepreneurship, Peredo and McLean (2006, p. 63) present a table illustrating the whole range of activities that can be defined within its scope. The opacity of the text refers to the importance of the social or commercial goals for the enterprises belonging in that category: bold text means that the goals are very important, whereas transparent text means that the goals are not important at all

Table 4.1 : Social entrepreneurship. Taken directly from Peredo & McLean (2006)

<i>Place of Social Goals</i>	<i>Role of Commercial Exchange</i>	<i>Example</i>
<b>Enterprise goals are exclusively social</b>	No commercial exchange	NGOs
Enterprise goals are exclusively social	Some commercial exchange, any profits directly to social benefit ('integrated') or in support of enterprise ('complementary')	<i>Grameen Bank ('integrated'); Bangladesh Rural Advancement Committee printing press, cold storage, garment factory ('complementary'), Newman's Own</i>
Enterprise goals are chiefly social, but not exclusively	Commercial exchange; profits in part to benefit entrepreneur and/or supporters	<i>Missouri Home Care, Ciudad Salud</i>
Social goals are prominent among other goals of the enterprise	Commercial exchange; profit-making to entrepreneur & others is strong objective	<i>Ben &amp; Jerry's</i>
Social goals are among the goals of the enterprise, but subordinate to others	<b>Commercial exchange; profit-making to entrepreneur &amp; others is prominent or prime objective</b>	<i>'Cause-branding'; social-objectivities undertaken by corporations such as banks</i>

### **'Social' and 'Entrepreneurial' microfinance**

How is microfinance as a social economic actor relevant to our discussion? Within this context, although the challenge to European microfinance initiatives is fundamentally the same, the context is different, and the social economy dimension gives a more appropriate understanding of the function of a European MFI.

Peredo and McLean's table presents two dimensions of social enterprise. On the one hand there is the place of social goals. On the other hand is the role of commercial exchange. We can think of these to as being opposites on a continuum. The social economy perspective and the types of activities that fall within its scope are also important to understand the different nuances of microfinance. Roughly, microfinance can be divided into two main categories that correspond to the above typology: *I) Microfinance initiatives that emphasise the social aspect, and II) microfinance initiatives that emphasise the entrepreneurial aspect.*

The first "social category" deals more with microfinance as a tool for personal empowerment, integration and employment, and to give people meaning in their lives. It can also focus on the supply of cash to poor families. The second "entrepreneurial category" deals more with promoting business creation, often within growth-industries. It also focuses on financing SMEs under market imperfections, in face of capital constraints. Of course, this is no real dichotomy; there is no clear-cut division between the two ideals. The strength of microfinance is precisely that it always embodies a mix between both social and entrepreneurial goals.

Nevertheless, this distinction serves as a simply analytical tool to broadly classify the activities of a microfinance initiative.

Below is a visualisation of this distinction, based on a model created by the European Microfinance Network. First, microfinance as a whole is divided into two subcategories. Moreover the social category in turn can be divided into personal and business loans. A segment of microfinance initiatives specialise in providing personal microfinance loans in order to compete with loan sharks and doorstep lenders. This category nevertheless only represents limited initiatives in select countries, and I will therefore exclude this category from the analysis.

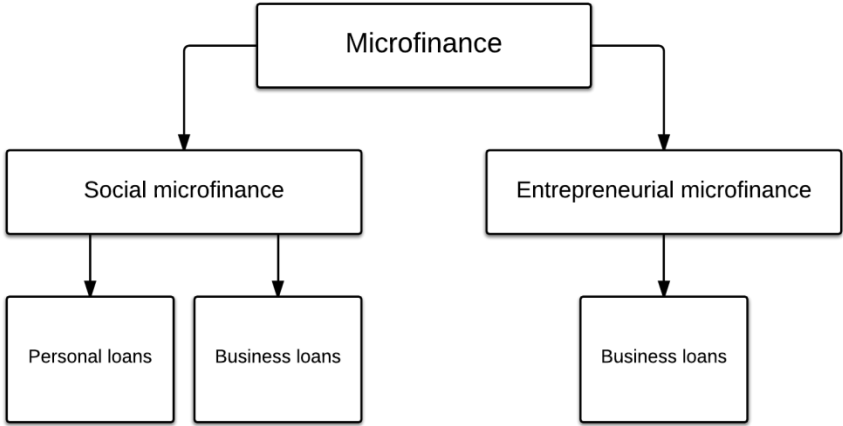


Figure 5.1: Types of microfinance. Based on model in (Bendig et al., 2012, p. 16)

### 4.3 Public policy and microfinance

Now that we have a good overview of the theoretical aspects of microfinance and its role within the social economy, let us turn to the theoretical elements that will guide the analysis of the political role of microfinance. While studies of microfinance usually focus on the development economics aspect of microfinance performance I have chosen to approach the issue of microfinance from a public policy perspective. We have already mentioned how some of the theoretical concepts are not very useful. Moreover, there are practical barriers as well. For example, joint liability has little impact as long as financial laws prohibit clients for taking responsibility over other people’s loans. The development perspective only explains “half” of the picture. My thesis will try to explain the second half.



Sustainability or profitability, or even effectiveness, are not strictly necessary for microfinance initiatives to survive. I argue that the most important determinant of microfinance success is financial and political support from policymakers. We have already seen how microfinance initiatives are dependent upon funding from governments. Therefore, policy processes have been important in enabling microfinance initiatives to emerge. Policy windows such as elections therefore become important catalysts as policy makers open up to new and innovative ideas like microfinance. Policy support is also necessary to sustain microfinance initiatives. An unsustainable, or even inefficient microfinance initiative can be sustained as long as it fits policymakers' definition of the problem is to be treated and what a good solution should look like.

Focusing on a few selected concepts within policy theory I will try to explain why some microfinance initiatives have succeeded while others have not, and everything in between. The thesis therefore addresses a gap that exists in current literature. Investigations of microfinance in Western countries use either economic theory or are a-theoretical; the study of microfinance and EU policy formation was cited as one exception to this tendency. While the material is rich in descriptions of the various initiatives, there are few attempts at contextualising these findings into a framework where microfinance performance is contingent on the political processes that involved in competition for scarce public resources. Below I will now present the two core explanatory variables of my argument.

### **4.3.1 The policy window**

How do policies emerge? In his influential work on the workings of U.S. politics, Kingdon proposes three streams that together determine the successful adoption of a policy. First, the problem stream deals with the various issues that present themselves to policymakers. Problems emerge through systematic indicators, focusing events, or feedback from current policies. Second, the policy stream deals with the alternatives that present themselves to policymakers as solutions to those problems. Policy proposals constantly float around, but whether they are given serious attention depends on several things, such as feasibility, national mood, and fit with dominant values. Third, the political stream deals with politicians and their willingness to implement those solutions. Government or legislative turnovers, national mood, or coalition makeups are all examples of elements within the political stream. (Kingdon, 2014, pp. 19–20).

The three streams are largely independent of each other, but when they meet and couple, policy changes are likely to occur. This occurs when so-called policy windows open up. Policy windows open up because of the appearance of pressing problems or changes in the political stream (Kingdon, 2014, p. 20). When these policy windows are open, the decision agenda of governments becomes more malleable to the influence of external forces seeking to influence policymaking. Think only of the 9/11 terrorist attacks and its lasting impact on the conduct of U.S. domestic and foreign policy, where consequences include the invasion of Afghanistan and the creation of the entirely new Department of Homeland Security. Moreover, policy windows can be predictable or unpredictable. Kingdon uses the example of the collapse of the Penn State Railroad: in the wake of the collapse a number of policy measures came up, many not directly related to the case at hand, proposals about subsidies, deregulation, nationalisation, loan guarantees, roadbed rehabilitations, and so on (Kingdon, 2014, pp. 171–174).

Open policy windows are periods of opportunity. They allow actors outside of the government to access and influence the agenda. These actors subsequently use this influence to push their pet proposal as a solution to the policy issues that have emerged. Usually proposed policy solutions are tied explicitly to the problem at hand, but sometimes this connection might be vague. There is no automaticity in what kind of solutions a specific policy window calls for: it is often a chaotic and uncontrolled process, where a number of solutions enter and attempt to compete for attention from policy makers.

#### **4.3.2 Problems and problem definitions**

Policy problems and the definition of these are contested. According to Rochefort and Cobb (1993 p.57) policymaking has often been understood from a “rationality perspective” where social problems present themselves to public officials, who in turn assess the problem on the basis of all available knowledge and subsequently act accordingly through legislation until the problem is solved. This perspective, however, does not correspond to empirical evidence. In the words of Dery (1984) (quoted in Rochefort & Cobb, 1993, p. 55) “problems do not exist ‘out there’; they are no objective entities in their own.” What ought to be considered a policy problem, how to understand that problem, and what a solution to that problem should look like, all depend on the perceptions and interests of actors involved.

Rocheftort and Cobb list five dimensions of problems that shape problem definitions. These are as follows: first, the cause of the problem; second, the nature of the problem, including aspects such as severity, incidence, and novelty; third, characteristics of the problem population; fourth, ends-means orientation of the problem definer; and fifth, the nature of the solution (Rocheftort & Cobb, 1993, p. 62). These dimensions are accompanied by various options for the policy response. For example, the characteristics of the problem population might be defined by whether the group is considered worthy or unworthy. Similarly the cause of a problem might be attributed to personal or impersonal causes. The table below summarises Rocheftort and Cobb’s anatomy of problem description.

Table 5.2: Anatomy of Problem Description, taken from Rocheftort and Cobb (1993, p. 62)

<i>An anatomy of Problem Description</i>	
<i>Dimension of Problem</i>	<i>Options</i>
<i>Problem Causation</i>	Personal – impersonal Intended – accidental Blame allocated – blame avoided Simple – complex
<i>Nature of the problem</i>	
Severity	Degrees of severity
Incidence	Growing, stable or declining: by class, population, cohort, age etc.
Novelty	Unprecedented – familiar
Proximity	Personally relevant – a general social concern
Crisis	Crisis – noncrisis Emergency - nonemergency
<i>Characteristics of the Problem Population</i>	Worthy – unworthy Deserving – undeserving Familiar – strange Sympathetic – threatening
<i>Ends – Means orientation of Problem Definer</i>	Instrumental – expressive
<i>Nature of the solution</i>	Available – nonexistent Acceptable – objectionable Affordable – unaffordable

### 4.4 Summary and conclusion

In this chapter I outlined the main theoretical mechanisms underpinning microfinance, such as the problems of moral hazard and adverse selection, and transaction costs. Through mechanisms such as group loans, stepped lending, and joint collateral microfinance is able to resolve some of these problems, thereby reducing transaction costs. I nevertheless argued that these mechanisms were less relevant in a European context, as I) the economic and legal

system already solves some of the problems, and II) the highly formal and competitive market economy makes self-employment more difficult.

Moreover, European economies are characterised by welfare states, which allow people to step out of the labour market without suffering the same penalties as elsewhere. There is nevertheless financial and social exclusion in developed countries. I argue that microfinance therefore must be understood in the context of the social economy. The social economy and the actors within it attempt to create social value as opposed to purely economic value. Using market mechanisms they identify and try to fill the cracks and holes between the market and the state. Microfinance can therefore be conceptualised as an approach within the social economy.

Finally I argue that there is little attention to the policy aspect within the literature on microfinance, despite this being perhaps the most important determinant of microfinance performance in developed countries. Subsequently I present theoretical perspectives on problem definition, social construction of target groups, as well as the policy formation process. In the next chapter I will use these perspectives to build a framework for analysing microfinance in Norway, Sweden, and the UK.

# 5 Research Design

In this chapter I spell out how I will use the theoretical perspectives to analyse the three cases. I present simple model attempting to explain the relationship between policy windows, problem definitions, and political support for microfinance. I then proceed to discuss the methodical aspects of my design. I discuss the nature of the research, the rationale behind the selection of case, as well as how data has been collected analysed. Throughout the methodical section I will discuss some of the strengths and weaknesses of the design, and how they can be addressed.

## 5.1 Building a theoretical framework

How do the theoretical concepts discussed in Chapter 4 relate to the introduction and performance of microfinance initiatives? We have seen how microfinance has been adopted in various developed countries, with various degrees of success. With the increasing focus on microfinance in the future, a relevant question to ask is what factors can explain the emergence of microfinance and the differences in success, also in developed countries. Here I revisit the research question:

*Which factors can explain the difference in political support of microfinance initiatives across developed countries in general, and between Norway, Sweden, and the UK in particular?*

Using this research question as a point of departure I focus on two aspects of the process. First, using the policy window aspect of Kingdon's three streams theory, I look at the emergence of microfinance initiatives in the three countries and how political support influenced this process. Microfinance do not represent a reflexive policy option, something that is automatically there to respond to a specific problem; Rather, the hypothesis is that microfinance has been able to take advantage of the policy windows to present itself as a solution for policymakers.

Second, I look at how the problem definition of microfinance has affected political support, and why political support has been secured. Microfinance cuts across many policy areas, and this means that how policymakers defines it will influence the policy process. Using a

simplified version of Rochefort and Cobb’s approach I focus on three aspects of problem definition: the problem itself; the target group, and the solution at hand. I collectively refer to these three aspects the problem elements. Moreover, I try to identify the various microfinance initiatives according to the ‘social’ and ‘entrepreneurial’ distinction. Finally I also look at the emergence of the concept of the social economy/third sector and how that affects how the actors define microfinance.

Below I sketch out a simple model of the relationship between the policy variables and the support for microfinance. The ambition of the model is not to provide an exhaustive explanation of the three cases based on the dimensions presented in the table; rather the hope is that these dimensions can help us better understand the mechanisms that underpin the public support needed for the introduction and survival of microfinance in Western countries.

### Analytical model

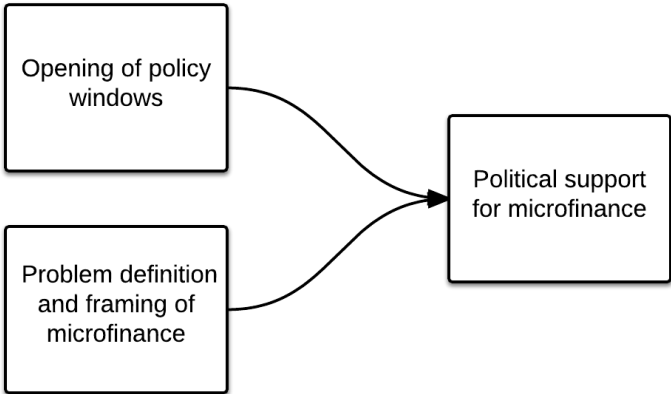


Figure 5.1: Analytical model

### 5.1.1 Spelling out the arguments

#### Opening of policy windows

As the model shows, I argue that the opening of policy windows influences the chances of microfinance receiving political support, which in turn influences its performance. As discussed in Chapter 4 policy windows open when pressing problems emerge or there are changes in the political stream, such as elections. Because it’s a new and relatively unknown

approach, microfinance is not widely known among politicians, and under normal circumstances receives little attention from policy makers. I argue that policy windows opens up politicians to new and innovative ideas, as well as allowing policy entrepreneurs and advocates outside of government to successfully influence the policy agenda. Elections, for example, bring in politicians eager to fulfil voter promises and create quick results. Crises put pressure on politicians and force them to consider alternative ideas. Conversely, when there is no policy windows open, the introduction of microfinance is a much slower process.

### **Problem definition and framing of microfinance**

Next, I argue that how target groups are defined and how microfinance is framed as a solution to a specific problem also influences political support for microfinance. Microfinance is often advocated as an approach that joins goals that are of both social and economic character, and is used to target several policy issues, such as social exclusion, entrepreneurship, or regional development. I argue that if microfinance initiatives fit into policy makers' definitions of problems, target groups, or solutions, they are more likely to receive political support. I also argue that while the many-faceted approach of microfinance makes it a flexible policy tool, this can lead to mismatches between different goals and competing definitions, and therefore a source of conflict that reduces political support for microfinance.

This also implies that changes over time in problem definitions can give rise to such mismatches. For example, a new government or organisational developments within the bureaucracy might bring in new definitions of the problems, target groups, and solutions that favour different approaches. This might take away political support for microfinance.

Furthermore, I argue that microfinance initiatives targeting groups perceived in a more positive light, such as entrepreneurs and small business owners, are more likely to receive support than those targeting relatively weaker groups, such as women and immigrants. Policymakers prefer giving out benefits to popular and powerful groups, whereas marginal and weak groups tend to slip under the radar. These groups and their needs is considered less important and worthy of official attention than those of numerous and powerful groups.

## **5.2 Research design**

## **A comparative case study**

This research project seeks to uncover and understand some of the political factors that influence the performance of microfinance initiatives in developed countries. The thesis takes the form of a qualitative case study. According to Gerring, case studies are useful in situations where the research goals are generating rather than testing hypotheses, where the goal is insight into causal mechanisms rather than the magnitude of causal effects, and where data availability is concentrated rather than dispersed (Gerring, 2007, p. 38). Gerring (2007, p. 40) also states that case studies may be useful when a subject is encountered for the first time or is being considered in a fundamentally new way.

Case studies are sometimes criticised for providing limited grounds for generalisation, but we have already seen in Chapter 3 that little attention has been given to microfinance within the field of political science in the existing literature. Given the novelty of the approach I therefore argue that this thesis fits Gerring's description well: I am investigating a subject in a new way; I'm not interested in testing hypotheses; the data is concentrated and not readily available; and the data gives little room for testing for causal effects.

The design of this study can be described as lying somewhere between what Levy (2008, p. 5) calls a theory-guided case study, and a hypothesis-generating study. While the approach has been to apply concepts from public policy theory as a theoretical lens in order to "make sense" of an under-theorised field, the thesis goes beyond what Levy calls theory-guided case studies in that it attempts to say something about the relationship between microfinance and public policy in general, rather than just explaining the three cases. Although the main focus has been to explain and understand the outcome in the three cases, these explanations are in turn part of a broader goal to understand microfinance implementation in other developed countries.

The thesis studies three countries, Norway, Sweden, and the United Kingdom. Why compare? The first and foremost argument for comparing is control (Sartori, 1991, p. 244). By systematically collecting the same information across carefully selected units using theoretical guidance we strengthen our causal inferences (King, Keohane, & Verba, 1994, p. 45). In only studying one case, for example Norway, one risks misattributing causal relationships where there are none. Control allows generalisations such as "entrepreneurially oriented microfinance is more likely to receive government support than socially oriented



microfinance” to be tested under different circumstances. If this holds only for Norway, this limits the value of this generalisation to explain microfinance in other countries. Another reason is that a comparative approach simply yields more data of how microfinance works in different countries: whereas Norway has had two institutions engaging in microfinance, Sweden has had at least four and the UK well over forty.

Lijphart (1975, p. 164) explicitly defines the comparative method as hypothesis-testing, rather than hypothesis-generating or theory guided. This is too ambitious for my own research: First, balance of the data collected from the cases makes testing difficult. For practical reasons I have not been able to obtain equivalent data from all three countries. Moreover, the lack of well-defined control variables makes it difficult to rule out competing explanations. Nevertheless, the research attempts a form of dialogue between the testing, generating, and explaining: The three countries have been studied based on the theoretical framework. Where particular relationships or causal mechanisms have been found in a particular country, these have subsequently been compared to the two others in order to test whether these holds for all three cases.

### **Case selection**

The cases studied are Norway, Sweden, and the UK. George and Bennet (2005, p. 69) argue that cases should not simply be chosen because they are interesting or because they are rich in data. It is nevertheless important to note that I have not selected these cases randomly, but rather on their various outcomes on microfinance performance. According to Geddes (1990), selection on the dependent variable in comparative studies is problematic because it can potentially lead to biased conclusions. In order to mitigate this threat I have chosen cases based on several criteria's. First, both cases with positive and negative outcomes on the dependent variable have been chosen: microfinance has had the least public support in Norway, the most in the UK, with Sweden somewhere in between. This approach ensures variation among the cases and to some extent addresses the risk of misattribution. It should nevertheless be noted that as the research process has progressed it has become clear that such a dichotomous classification of the dependent variable is overly simplistic.

Another way of viewing case selection is according to a most-similar most-different type of design (see Frensdreis, 1983; Levy, 2008). Although these designs have been regarded as opposing ideals, Frensdreis (1983, p. 269) nevertheless argues that both are informed by the

same logic, attempting “to identify variables related to the dependent phenomenon through covariation and eliminate (or control) other factors through the lack of covariation.” Similarly, Levy argues that maximising variation across independent and/or dependent variables stimulate the imagination and are useful for studies at a very early stage of exploratory research (Levy, 2008, p. 8).

Using Norway as the baseline case the following rationale has informed my own selection: I have chosen the United Kingdom as a contrast case is because it has had a more successful implementation of microfinance than Norway. Furthermore, drawing on Esping-Andersen’s classification, Norway, Sweden, and the UK represents different forms of welfare capitalist systems. These systems might differ in their view on self-employment, the social economy, and entrepreneurship, all aspects influence microfinance. Sweden is selected because appears to have had a more successful implementation of microfinance compared with Norway and because similarly to Norway it is typically classified as a Nordic type of welfare state. This way I hope to address the problem of selection on the dependent variable, while at the same time maximising variation on background variables such as welfare state type.

### **Data material and collection**

Data have been collected mainly from three sources. First, I have analysed government primary sources such as white papers, press releases, parliamentary committee publications, and parliamentary hearings. Second, I have analysed a range of secondary sources, mostly reports and evaluations, but also academic sources and news articles. Some of these are evaluations of individual MFIs, others deal with government funding programs, and yet others are annual reports and sectorial overviews at either the national or European level. Third, I have conducted five interviews with key informants as well as personal email correspondence with various sources.

The coverage of the three cases is not balanced, in the sense that sources correspond with one another across the three counties. This is a result of several factors. In cases such as Norway, it has been much easier to obtain interview and historical data about individual microfinance initiatives. In the UK, which has a much larger sector than either Norway or Sweden, reports, public documents, and evaluations relating explicitly to microfinance have been much easier to obtain. While this lack of balance can be a source of bias, I nevertheless argue that the lack

of well established procedures on the subject, compared with the relative explorative nature of the thesis, that this approach gives sufficient coverage.

Only Norwegian actors have been interviewed in person. This choice is based on practical considerations, as establishing contact in the other countries is more difficult. Although this can potentially bias my findings, I have prioritised getting a more detailed insight into one particular country over a less detailed insight into all three countries. The findings from Norway have subsequently informed the data gathering in Sweden and the UK.

Five interviews were conducted throughout the summer of 2014 to gain in-depth information from key informants that have been involved in various aspects of Norwegian microfinance initiatives: with Cultura Bank, Microfinance Norway, Innovation Norway, the Norwegian Labour and Welfare Administration, as well as a grassroots actor involved in the early efforts on introducing microfinance in Norway. The interviews therefore cover a range of actors that have been involved in microfinance, also ensuring a good breadth of data. They have been conducted in a semi-structured fashion (see Bryman, 2004, p. 321) where an interview guide have been prepared for each interview, based on my assumptions and the information needed. This has given me the opportunity to adjust the interview process when the questions have been irrelevant, and to follow up interesting leads. Where interviews have not been possible I have relied on email exchanges instead. I have communicated with one grassroots actor in Norway, two grassroots actors in Sweden, and one bank in Sweden in this manner.

Interviews entail the risk of various biases, such as reporting bias or confirmation bias. For example, one interviewee had mixed up the order of events of a particular political process. Moreover, several of the actors had strong opinions of the events that had unfolded. For example, one informant went to the extent stating that the authorities had more or less sabotaged the microfinance pilot in question through unrealistic demands for documentation because they did not believe the results the pilot had achieved. Several of the actors also had a professional and personal stake in the portrayal of the events. As a researcher in such situations it is important to take these biases into consideration as they can threaten the internal validity of the causal inferences (see Adcock & Collier, 2001, p. 529). These issues have been solved in several ways; first by crosschecking with various documents; second by cross-checking information with actors “on the other side of the table;” third, by contacting additional informants. These strategies have helped to address the biases.

To ensure confidentiality the informants have been anonymised. Rather than names, I will therefore refer to the actor or institution that the informant represents. To ensure the reliability of the process interviews have been recorded. In the case of the Norwegian grassroots informant the interview was conducted via phone, which made recording difficult. This interview has instead been transcribed to text. Quotes from informants are therefore followed by an abbreviation and time signature, for example (Interview MFI, 24:00), which marks where in the audio recording the quote is found. Permission to undertake the interviews have been obtained from the Norwegian Social Science Data Services (NSD). Below is a table listing the various sources I have consulted.

Table 5.1: list of sources consulted

<b>Type</b>	<b>Source</b>	<b>Abbreviation in-text</b>
Interviews	Microfinance Norway Norwegian Labour and Welfare Administration Cultura Bank Innovation Norway “Grassroots” informant in Norway	MFI NLWA CB IN GN
Email	Swedish Bank involved in pilot Project manager in Swedish pilot “Grassroots” informant in Sweden	SB PM GS
Written documents	Primary sources: government publications, hearings Secondary sources: newspaper articles, reports, evaluations,	Not applicable Not applicable

**Method of analysis**

The research uses the data collected to analyse the three cases over time. I have focused on important milestones, such as the establishment or demise of a microfinance initiative, and traced the political process leading up to these events. Moreover I have attempted to analyse written and oral statements by politicians and other actors. While some indicators, such as government documents explicitly promoting microfinance, are easily identifiable, others are not. For example, identifying a policy window or a particular problem definition inevitably involves some form of interpretation of events or actors’ statements. In the cases where there has been uncertainty, I have therefore attempted to look for and provide additional pieces of evidence in order to strengthen my arguments.

A problem of studying historical processes over time is the risk of post-hoc rationalisations. If my argument is that policy windows are important enablers of microfinance initiatives there is

a risk that when a microfinance initiative is observed, I will falsely conclude that a policy window was present. This is a form of confirmation bias, where the smallest sign of a policy window will be taken as sufficient evidence. The solution to this is to look at instances where a policy window would be exogenous to the process of introducing microfinance. Elections or external shocks are good examples of this, and we will later see that in most cases, the problem of post-hoc rationalisation can be addressed. In some cases, however, such as when it comes to the introduction of microfinance as a policy in Sweden, the evidence is less clear. I have simply not been able to obtain detailed knowledge of the process. This is something that I am aware of.

### **5.3 Summary and conclusion**

In this chapter I presented the theoretical framework that will be the basis for the analysis. First I revisited the research question and my rationale for studying the subject. Next, a model illustrating the relationship between policy windows, problem definition, and microfinance was presented and discussed. Finally I presented an overview of the research design. Here I discussed the choices informing the design including case selection, as well as the data collection methods. Strengths, potential weaknesses, and how my study places itself in the broader context were all discussed. We will now turn to the analysis of the three cases.

# 6 Empirical Analysis

Let us review the core elements of my framework. The premise underlying my approach is that microfinance initiatives cannot emerge and become successful on a larger scale independent of state support. Drawing on the two theories presented in Chapter 4, support for microfinance is in turn dependent upon the following:

- A) The opening of policy windows;
- B) The problem definition and framing of microfinance.

This chapter will attempt to explain how the variables chosen have affected the political support for microfinance initiatives. Each of the two main independent variables will be discussed in a separate section, and each section will discuss the two underlying factors.

## 6.1 Political support for microfinance

From our discussion of microfinance sustainability in Chapter 3, we know that in Western economies microfinance initiatives are largely unable to sustain themselves solely based on their economic activity. Not only is the target group poor and therefore unable to pay fees and interest, they also tend to suffer from low levels of financial literacy, which among other things increases delinquency rates. While the advantage of microfinance lies precisely in using innovative mechanisms such as group loans and stepped lending to address these issues, is not enough to mitigate the higher transaction costs from lending to the poor. An underlying premise is therefore that attention and support from policy makers is a key variable responsible for microfinance success.

The sustainability premise is confirmed by several of my interviews. According to the informant at Microfinance Norway subsidies in one form or another were absolutely necessary. Given their focus on immigrants, and the services that MFN delivers, some form of subsidy was absolutely necessary. Even though the ambition was to become at least financially self-sustainable, the informant said that operational self-sustainability, which includes business development services and transaction costs, was not possible (Interview MFN 10:30).

The interview with MFN's partner bank Cultura reveals the same tendency. The bank's informant pointed out that although Cultura is a so-called social bank, meaning it is willing to provide funding and take risks where conventional banks will not, their microfinance portfolio was showing consistently poorer performance than other areas of their business. While 75% of each micro loan was covered by an EIF guarantee, and despite a handling subsidy of €200 per loan (Interview CB 35:00) the losses, which at times exceeded 10%, was beyond what the bank could afford (Interview CB 18:40, 23:00). For a small bank such as Cultura, even a mere five percent loss was described as unbearable in the longer run without greatly increasing interest rates (Interview CB 23:00).

These findings echo findings from both Sweden and the UK. One organiser of a Swedish microfinance pilot observed that despite considerable interest in the products and services of the pilot, clients lacked knowledge on a wide range of areas from accounting to basic language training. The costs of providing basic training, let alone business development services far outmatched the level that the MFI could afford (Email, SP). Aspire, a UK CDFI reported that whereas they initially expected to cover all of their expenses through lending, the actual number was only ten percent (Forster, Lederman, Mayshak, & Mercer, 2006, p. 1)! Moreover, the MFI Street UK had to reduce its initial geographical scope from national to regional when faced with unexpectedly large costs associated with travelling between areas of operation (Copisarow, 2004, p. 8).

Why were Cultura's losses so high? Let us recall the theoretical discussion on adverse selection and transaction costs. Remember that the target segment of microfinance has often already been rejected by conventional banks. This means it is more likely that the bank will adversely select "bad" borrowers that are more likely to default or be delayed in their repayment. If the bank or MFI subsequently needs to spend a large amount of time providing free training, meeting face to face with clients, reporting of portfolio performance, or ensuring clients repay on time, sustainability becomes a serious problem. In fact towards the end of the 2000s MFN experienced organisational difficulties that made the client follow up difficult. The bank informant explained that in the absence of MFN they simply did not have the capacity to provide the necessary follow up, which in turn increased delinquency rates (Interview CB 9:30). Moreover, strict EIF reporting standards combined with the informal character that is associated with projects financed by microfinance loans contributed to

increase the transaction costs on the part of the bank (Interview CB 7:45, 11:35). All of these factors contributed to raising the transaction costs beyond sustainability.<sup>6</sup>

Having established that microfinance is dependent upon government sources, let us now turn to the policy variables. Which issues that receives government attention, let alone government resources, is not a straightforward question. The following discussion will attempt to provide an answer.

### **6.1.1 The policy window variable**

The opening up of policy windows is crucial for the establishing microfinance initiatives. While microfinance initiatives existed in all three countries prior to political involvement, these were scattered and on a small scale. The introduction of the initiatives on a larger systematic scale occurred only as a direct result of government support. In all three cases we can trace this support back to catalytic events, policy windows that paved the way for microfinance. Microfinance is in and by itself no obvious answer to a certain policy problem, such as poverty; it is rather the successful coupling of microfinance to these issues that have been the key for its introduction. The following discussion will map out the role of the policy window in each of the three cases.

#### **The Norwegian experience**

The introduction of a publicly supported microfinance initiative in Norway can be traced back to a policy window opened in the wake of the 1997 general election and government reshuffle. The turnovers brought in a new leadership eager to prove their ability to implement policy. The new government also came into power with an intention to address the neglect of women's issues in regional policy that had existed since the early 1990s. This coupling of the problem stream and the political stream opened up a policy window. This led to policy entrepreneurs advocating microfinance being able to seize the opportunities and couple microfinance as an alternative to various policy problems.

In October 1996 long-time Prime Minister Gro Harlem Brundtland decided to relinquish leadership of the Labour Party. Thorbjørn Jagland was chosen to replace her and form a new government of his own. Eager to prove himself, Jagland took office launching his flagship

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<sup>6</sup> In this case we can think of business development services as a kind of bargaining and decision cost.



policy, called the 'Norwegian House' (Statsministerens kontor, 2006). Jagland was concerned with adapting to new times, to technology, and globalisation (Norderval, 2014), and in his inaugural speech Jagland emphasised the importance of a "broad dialogue about how the country should be run" advocating the creation of committees across a range of policy areas, "...composed of persons of high competence recruited from across the spectrum of society". The election is a clear indicator of a change in the political stream.

We saw in Chapter 2 that Norwegian microfinance initiatives had existed ever since 1992, albeit on a smaller scale. There was actually government interest early on in the approach: in the wake of the Lofoten pilot an interdepartmental committee had been working on the prospects of using microfinance in Norway. The outcome of this process was "Kvinnebanken Norgesnett," or the Women's Bank, a private non-profit created in 1996 to act as an umbrella organisation for the small, scattered groups across the country (Landbruksdepartementet, 1996). Jagland later said that "the network associated with the Women's Bank are one of the grassroots initiatives from below that I emphasise in the construction of the Norwegian House" (Width, 2010, p. 129). While the Women's Bank was a grass roots initiative where the government only played an advisory role and provided limited funding, it nevertheless represents the first attempt of consolidation of grass roots knowledge of microfinance built up across the country since the early 1990s.

What was the fuzz about? The early pilots and the Women's Bank were all attempts to address the situation of women living in rural districts. According to Pettersen et. al (2000, p. 21) women's focus had entered regional policy in the mid-1980s but during the years 1993-97 there had been a gradual reduction on funds and efforts on the matter. By the time the new government took place this criticism had become vocal. Women's issues were therefore in the forefront of the problems stream.

These changes in the political and problem streams caused a policy window to open. When the Ministry of Local Government and Regional Development (MLGRD) in April 1997 published the white paper on regional policy there was a therefore renewed women's focus, and microfinance was an important aspect of this. The inclusion of microfinance, however, was not a part of the government's original proposition. According to a key informant, up until a week before the publication the white paper completely lacked any measures on women's issues in regional policy (Interview GN). When this was pointed out, the Ministry realised the potential embarrassment for the government. In a stroke of fate, however, one of

the people involved in the process with the white paper had also been closely involved in the work with the Women's Bank. This person therefore suggested microfinance as a possible measure to include (Interview GN) and, in the span of days a completely new measure had been included in the Ministry's portfolio of measures.

The almost accidental process illustrates the importance of policy entrepreneurs, and their ability to rapidly couple issues to issues on the government agenda: despite having no knowledge about microfinance, the need of the new Ministry to prove itself as well as avoiding a potential embarrassing situation made the coupling successful. This policy proved to be the entry point from which microfinance transformed from a purely grass roots initiative supported by government into an official policy tool.

Let us move forward in time. Although it is too early to conclude, change in 2013 can also possibly be defined as another policy window opening up. Towards the end of the 2000s microfinance in Norway had come to a halt. In 2008 Innovation Norway (formerly NIRDF) chose to discontinue microfinance as a part of their portfolio. At the same time MFN was struggling with lack of funding and organisational troubles. Over the last few years, MFN had been financed in large part by NAV's so-called "poverty money," as well as a support scheme for social entrepreneurs.<sup>7</sup>

Parallel with this development there has been a growing awareness of social entrepreneurship in Norway. Ferd, a private investment fund has been a key actor, arranging annual conferences bringing together actors from state, private, and voluntary sector. In 2012 the consultancy firm DAMVAD undertook an extensive study of social entrepreneurship in Norway, the first of its kind (DAMVAD, 2012). In 2013, the Nordic Council initiated a study on social entrepreneurship led by the Norwegian Ministry of Labour and Social Affairs (Arbeids- og sosialdepartementet, 2014c).

Moreover, In 2013 the Centre-Left coalition was defeated by a new coalition consisting of the Conservatives and the Progress party, supported by the Liberals. The government quickly signaled a positive attitude towards the third sector and social entrepreneurship. Indeed, Robert Eriksson from the Progress Party – a populist party traditionally opposed to high government spending – was appointed Minister of Labour and Social Inclusion. Eriksson has on several occasions voiced his support for social entrepreneurship (see e.g. Arbeids- og

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<sup>7</sup> According to several of my informants, this scheme was lobbied by the social entrepreneurs themselves

sosialdepartementet, 2014a; Haugan, 2014), and in spring 2014 invited social economy actors to a dialogue meeting with the government concerning funding social entrepreneurship (Arbeids- og sosialdepartementet, 2014b). The informant at MFN explained that over the last year the number of inquiries by government agencies has risen dramatically, as the new leadership looks for input new ways to (Interview MFN 46:38). Financially the new government has strengthened this support scheme considerably and plans to further strengthen it in the future (Arbeids- og sosialdepartementet, 2014a).

We see that the last few years' developments indicate that social entrepreneurship is emerging as a serious policy alternative within the policy stream. Moreover, the election of the new government has brought about a change in the political stream. While it is too soon to determine the outcome of the current processes, there are signs that a current policy window might open. According to Kingdon, however, policy windows also require a change in the problem stream. Unlike in 1997, there is currently no clear problem that microfinance can attach to. The new government has emphasised social entrepreneurship as an alternative to costly public welfare. While this evokes the problem of welfare state sustainability that is currently affecting many European states, it is probably less relevant in Norway.

### **The UK experience**

Like in Norway, the introduction of microfinance can be traced back to a policy window opened in the wake of the 1997 election. 'New' Labour entered government with a clear ambition of addressing the growing gap between the rich and the poor in the UK. The government also intended to do this using new and innovative ideas about the third sector and the social economy, and by reaching out to actors across the spectrum of society. Thus, the policy window created allowed policy entrepreneurs promoting finance to impact the policy agenda, leading to the introduction of microfinance.

When Tony Blair was elected in 1997 his promise was to end the growing class divisions in Britain, to "bring Britain back together." Many of the "old Labour" policies of government intervention, however, had long been discredited and by many considered the reason for the party's long streak of poor elections (Kendall, 2000, pp. 14–16). When 'New' Labour was elected it was therefore promising a new approach, unlike both the Conservatives and 'old' Labour. For example, the election manifesto stated that "New Labour will be wise spenders, not big spenders. We will work in partnership with the private sector to achieve our goals"

(The Labour Party, 1997). Blair promised to strengthen regional economic opportunities through the creation of Regional Development Agencies, and to tackle unemployment through “New partnerships between government and business, fully involving local authorities and the voluntary sector, [in order to] attack long-term joblessness” (The Labour Party, 1997).

Preceding the election were also developments in the policy stream. Most notably, a 1996 report by the independent Commission on the Future of the Voluntary Sector spelled out many of the proposals and ideas that would find their way to the New Labour manifesto. The report called for the authorities to recognise, formalise, and strengthen the role of voluntary and community organisations, calling for a “concordat” to be written between the third sector and the government (Joseph Rowntree Foundation, 2006). The influence of the report is clear: in 1998 the so-called “Compact” between New Labour and the third sector was presented, echoing the 1996 report, and established goals concerning independence of the sector, aspects of funding, and the terms of cooperation between the state and the sector (see Zimmeck, Rochester, & Rushbrooke, 2011, pp. 138–155 for original compact). The election victory therefore enabled the coupling of the political and policy streams.

One of the first acts undertaken by the new government in 1997 was to set up the so-called Social Exclusion Unit (SEU). The same year as the Compact was signed SEU presented *Bringing Britain Together: a National Strategy for Neighbourhood Renewal*. The report was the flagship of the Labour’s efforts, promising to close the gap between the poorest neighbourhoods and the rest of the country through “investing in people... involving communities... making a long term commitment” along with a host of other goals (Social Exclusion Unit, 1998).

The NSNR shows the government’s intention cooperate with the third sector. It consisted of eighteen Policy Action Teams (PATs) covering a range of issues, from housing, to crime, to financial inclusion. Rather than simply civil servants, the PATs involved a range of actors from across the spectrum of society, such as private business, the voluntary sector, and government. Suddenly advocates and policy entrepreneurs of all kinds were able directly influence the agenda. Indeed, “PAT 3 – Business” included champions of community finance Ed Mayo of the New Economics Foundations and Richard Street of The Prince’s Youth Business Trust, one of the early microfinance initiatives (Social Exclusion Unit, 2001, p.

253). Indeed, it was PAT 3 that eventually recommended the implementation of a government policy in microfinance.

The NSNR introduced two policies supporting microfinance: first, the £98 million Phoenix Fund providing capital to MFIs; and second, the Community Interest Tax Relief (CITR), a tax exemption especially targeting CDFIs and recognising their social utilities along purely financial ones. Along with other institutions providing financial services to poor communities such as credit unions, MFIs were branded as Community Interest Financial Institutions (CDFIs).

I argue that the 1997 election shows all the ingredients for a policy window to open up. First, the UK faced a problem of growing class divisions and community deprivation. Second, the election represented a change in the political stream with a new government open to new approaches. Third, developments in the policy stream meant that third sector alternatives were moving to the forefront of the agenda. Combined with institutional structures encouraging external involvement, such as the PATs, this provided the ideal opportunity for coupling of microfinance with Labour's policy agenda.

Like Norway, the UK provides a second example of how policy windows have facilitated political support for microfinance initiatives. By the late 2000s, the CDFI sector was stagnating under an increasingly unstable funding situation and little growth in loan numbers (CDFFA, 2014b see also figure 5 below). Then two significant events turned things around. First was international financial crisis that was affecting economies across the world, including Britain. The crisis led to a substantial increase in demand for CDFI loans, as main street banks tightened lending policies for SMEs and individuals (CDFFA, 2009, p. 2). Moreover, the adverse effects of the financial crisis, especially with respect to SMEs and employment, prompted the government to launch the Enterprise Finance Guarantee, providing guarantees up to 75% of loans to small businesses, including CDFIs to stabilise the funding situation (CDFFA, n.d.). This not only helped CDFIs survive themselves, it also helped them serve their new clients.

The second event was again a government turnover. In 2010 Labour was replaced in by a Conservative-Liberal Democrat coalition government led by Prime Minister David Cameron. Cameron sought to shake things up: the Conservative election manifesto was a marked departure from that of Labour, emphasising deficit reduction, tax cuts, and other 'blue'

policies. The emphasis was on small business creation and financing, and education and skills; not to “bring Britain together, but rather “so the next generation can succeed in the global race” (Conservative Party, 2010, p. 5, n.d.). Considering the “social” profile of the efforts to foster the third sector under Blair the turnover did not bode well for CDFI industry. Cameron opened his tenure by shaking up initiatives that had been central in fostering the CDFI industry. The Regional Development Agencies were replaced with the new Local Enterprise Partnerships (LEPs). Moreover, the Office of the Third Sector as well as SEU’s successor, the Social Exclusion Task Force was swallowed by the new Office of the Civil Society (Helm & Asthana, 2010).

What the Conservatives took with one hand, they nevertheless gave back with the other. First, the Enterprise Finance Guarantee was reformed and improved to specifically aid CDFIs (CDFFA, n.d.). Second, the £3.2 billion Regional Growth Fund was created, intended to promote private sector in areas most at risk of public sector cuts and create sustainable jobs (Government, 2012). Third the New Enterprise Allowance scheme (NEA) and the Start-up Loan Scheme (SUL) was launched, designed to help unemployed wanting to start their own enterprise (Daily Mail Reporter, 2010).<sup>8</sup> And fourth, the government launched the so-called Big Society Bank, the world’s first wholesale bank explicitly devoted to social investment and funding the third sector. Interestingly, Big Society Bank was chaired by Ronald Cohen, former chair of the Social Investment Task Force and one of the chief advocates of CDFIs (CDFFA, 2012). From 2011 and onwards the CDFI sector has seen substantial growth, from around 1000-1500 to over 9000 loans. 82% of the new business loans made were made through the NEA and SUL programmes (CDFFA, 2014b, p. 20). Below are two figures detailing the growth in loans by number and value.

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<sup>8</sup> The NEA was interestingly a reintroduction of the Enterprise Allowance Scheme first introduced by Thatcher in 1981

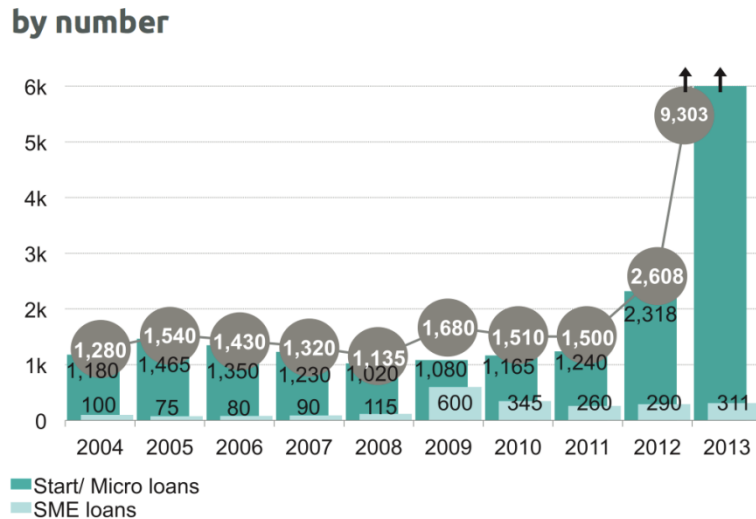


Figure 6.1: CDFI business loan growth by number. Taken directly from (CDFA 2014 p. 19)

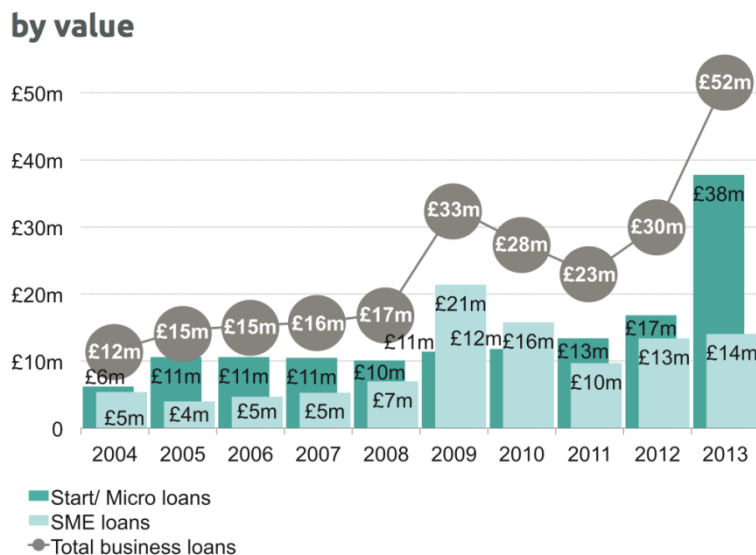


Figure 6.2: CDFI business loan growth by value. Taken directly from (CDFA 2014 p. 19)

The figure shows the spike in loan numbers and value that came in the wake of the financial crisis and the introduction of the EFG in 2009. This effect, however, seems short-lived. Next there is a rapid growth occurring after 2011, with the introduction of the NEA and SUL programs.

Let me sum up the second example. First, the election marks a change in the political stream. The election in turn caused a change in the policy stream, with a renewed focus on business policy and SMEs. Cameron also embraced the Big Society Bank, which had floated around in the policy stream of several years. Moreover, the financial crisis brought a change in the problems stream. The immediate effects of attempts of mitigating the crisis is seen in Figure 5

and 6 above, but the crisis also affected the rhetoric of the Cameron government that took office in 2010. This resulted in a series of new policies that directly or indirectly benefited the CDFI industry. The link between policies and CDFIs is less explicit than in 1997: the NEA, SUL, and other measures were general in nature, rather than policies directly targeting CDFIs. Nor is the role played by policy entrepreneurs as clear, with the possible exception of Big Society Bank. Nevertheless, it seems clear that the policy window helped reinvigorate political support for microfinance in the UK.

### **The Swedish experience**

The contribution of policy windows for the introduction of microfinance in Sweden is less clear. Swedish microfinance initiatives were not introduced on the background of a general election or government turnover, but rather on the back of a series of developments that occurred throughout the 1990s. I identify changes in the problem stream as well as the policy stream, but I am not able to identify changes in the political stream, nor the role played by policy entrepreneurs.

The developments leading up to the introduction of microfinance started in the early 1990s. In 1990 Sweden experienced a considerable economic downturn. Excessive government deficits forced incumbent right-wing government led by Carl Bildt to slashing public expenditures and scaling back on measures fostering regional development. This in turn exacerbated an already existing pattern of rural depopulation and deindustrialisation that was occurring across Europe at the same time. The result was a policy vacuum emerging throughout the 1990s (NUTEK, 2001, pp. 17–18).

The recession and depopulation paved the way for Swedish EU membership. Membership in the Union in turn opened up access to the European structural funds. The structural fund and its programs are part of EU's regional policy intended to narrow the regional disparities in Europe (European Commission, n.d.). programs would eventually become models on which the new Swedish regional policy was based (Regeringen, 2001, p. 78). The structural funds would also play an important role in the establishment of grass roots microfinance initiatives, through programs such as EQUAL.

Towards the late 1990s the pendulum swung back: starting 1998 the newly reelected social democrat government led by Göran Persson launched a series of policy propositions on



regional policy starting with the “Regional Growth – for work and welfare.” The proposition highlighted the difficulty of securing financing for SMEs, and among the measures included was easing the process of establishing and running small enterprises as well as increasing the supply of capital to young entrepreneurs (Regeringen, 1998, p. 89). Finally, in a proposition from 2001 the first explicit policy initiative on microfinance was passed when government proposed a system of “micro loans” should be created, administrated by ALMI (Regeringen, 2001, p. 173).

Although it seems clear that these events have contributed to the introduction of microfinance, it is probably too bold to claim there was a policy window present like in the other cases. According to Kingdon, policy windows only stay open for shorter periods of time (Kingdon, 2014, p. 169). While it could be claimed that the magnitude of the economic and political transition that were undertaken kept the a window open for longer, the introduction of the micro loan should rather be seen as the culmination of a more drawn out process, where several problems emerges on the agenda over time. The economic crisis and vacuum on regional policy represents concrete changes in the problem stream. These were problems that spurred EU membership, along with several policy initiatives dealing with regional and economic policy. With respect to the policy stream there are also indicators: during the years leading up to the introduction of the micro loan, several parliamentary proposals, most of them from the Liberal People’s Party, proposed the creation of a Swedish microfinance initiative run by ALMI (see e.g. Riksdagen, 1998, 1999). While policy windows or favourable changes in the political stream are not necessary to implement new policies, their absence seems to slow down the process.

The strengthening of ALMI’s mini loan represents a more clear-cut example of a policy window strengthening political support for microfinance. In 2009 the ceiling of the loan was raised from SEK 100,000 to SEK 250,000, the requirement of collateral removed, and the loan rebranded into a “micro loan.” This was preceded by a change in the political stream: in 2006 Perssons Social Democrat government was replaced by a right wing coalition led by Fredrik Reinfeldt from the party Alliance for Sweden. The new government’s platform included among other measures cutting red tape and easing the financial situation for SMEs.

In late 2007 a committee of enquiry was set down tasked with evaluating existing financial support measures on behalf of the new government (Näringsdepartementet, 2007). Among the recommendations presented in the resulting report was improving the terms of the mini loan

through increasing the ceiling and removing the need for collateral (Företagsfinansieringsutredningen, 2008, p. 67). Simultaneously two other reports, one by the Ministry for Agriculture and the Swedish Agency for Economic and Regional Growth (SAERG) argued the same (Landsbygdsdepartementet, 2008, p. 15; NUTEK, 2007, p. 56). This shows that microfinance was also present in the policy stream.

Finally, the 2009 Financial Crisis that hit the world between 2007 and 2009 represents a change in the problem stream. In the wake of the crisis ALMI saw a large increase in applications for the mini loan as credit conditions tightened. New loans made increased by 88%, while the total capital lent out increased by 42%, much of it presenting demand for the mini loan (Finansdepartementet, 2013, p. 639).

It is clear that a policy window preceded the strengthening of the microfinance initiative. First, Reinfeld's new government came into power with a strong emphasis on SMEs and entrepreneurship. Second, the series of proposals advocating strengthening the microfinance initiative shows the support amongst policymakers. Third, the financial crisis contributed to opening a policy window that expedited these proposals to the forefront of the decision agenda. Although I have not been able to identify any influence by policy entrepreneurs, the joining of the three streams nevertheless provided sufficient to ensure political support for microfinance.

### **Summary of the policy window variable**

Let me sum up the policy variable. I argue that the empirical analysis supports the assumption about the importance of policy windows for political support of microfinance initiatives. According to Kingdon the policy window opens during changes in the problem and political streams. The joining of the three streams increases the chance of a policy proposal being successful. Let me therefore summarise the three streams in the three countries.

First, microfinance is more likely to emerge because of changes in the problems stream. In Norway, the problem was women's entrepreneurship and depopulation of rural areas. In addition a more acute problem was the lack of women's measures in the new government's regional policy. In the UK, the problem was the growing disparities and community deprivation. Later on, the problem was the effects of the financial crisis. In Sweden, the problem was the 1990s economic crisis and its effect on rural development. Later on, the

problem was the effects of the global financial crisis. The crisis saw demand for microfinance increase in both Sweden and the UK. Incidentally, the financial crisis coincided with the *demise* of microfinance in Norway, possibly due to the lower impact of the crisis on the economy relative to the other two countries. The problems, some sudden and others more prolonged, shaped the attention of policymakers and encouraged microfinance as a possible “fix.”

Second, microfinance is more likely to emerge in the wake of changes in the political stream, most notably because of government turnovers. A government turnover preceded the introduction of microfinance in Norway in 1998. It also preceded the renewed strengthening of social entrepreneurship, although it is too early to say whether this will affect microfinance. A turnover preceded the introduction of microfinance in the UK in 1998, as well as the renewed growth in 2011-2012. And, a turnover preceded the strengthening of ALMI's loan in Sweden in 2009. There was also an election preceding the introduction of the original mini loan in Sweden in 2001, although I cannot conclude that this played a key facilitating role. I argue that this pattern was not a coincidence: the turnovers brought in new leadership interested in new approaches and eager to implement policies.

Third, microfinance is more likely to emerge in the wake of changes in the policy stream, although the tendency is less clear. In Norway, there were tendencies of women's and regional issues moving to the forefront of the policy stream preceding the 1998 introduction. Similarly we see the issue of social entrepreneurship emerging around 2011. In the UK, the concept of the third sector emerged in the policy stream prior to the 1998 introduction. In Sweden, microfinance had floated around in proposals prior to the introduction in 2001. Moreover, strengthening the loan had been suggested in several reports prior to the 2009 decision. While systematic impact of changes in the policy stream is less clear, we nevertheless see several examples of how pre-existing policies have entered the decision agenda of governments prior to the introduction of microfinance initiatives.

I identify four policy windows that have catalysed political support for microfinance. The fact that these windows appear and behave in a similar fashion across all three indicates that policy windows indeed have been important.

1. Preceding the introduction of microfinance in Norway in 1998

2. Preceding the introduction of microfinance in the UK in 1998
3. Preceding the strengthening of microfinance in Sweden in 2009
4. Preceding the strengthening of microfinance in the UK ca. 2010

The current process surrounding social entrepreneurship that is ongoing in Norway could possibly be identified as another policy window, although it is too early to conclude. Finally, there are signs of a policy window preceding the introduction of microfinance in Sweden in 2001, but I have not found enough evidence to conclude. Now I move to the next variable where I attempt to delve deeper into the problems stream and the various problem definitions that influence political support for microfinance.

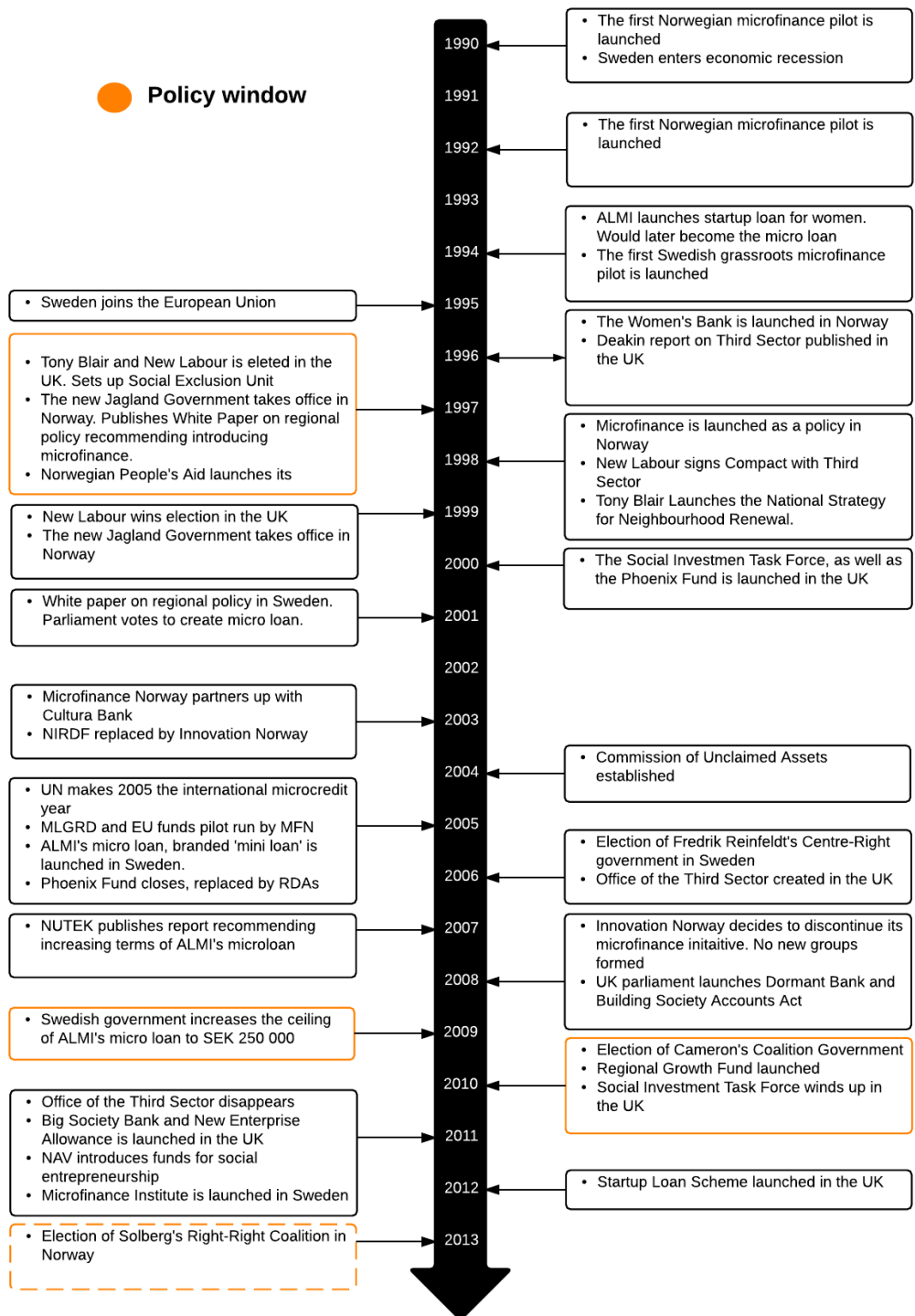


Figure 6.3: Time line over developments in the three countries 1990-2013

## 6.1.2 The problem definition variable

We see how policy windows are important for setting the stage for coupling of microfinance and the government agenda. If policy window variable explains *how*, the problem definition variable therefore tries to explain *why*, and perhaps just as important, *why not*. Policies are responses to problems that presents themselves to policymakers (Rocheffort & Cobb, 1993, p. 56). We saw in chapter 4 that specification of a problem is not straightforward.<sup>9</sup> The various ways problems, target groups, and solutions are defined affect the political support for these problems, groups, and solutions.

I identify five problem definitions that have all been central to the developments in the three countries. These are poverty and community deprivation; gender and ethnic issues; regional policy; access to capital for SMEs and entrepreneurs, and welfare state alternative. If we combine these with the social and entrepreneurial distinction, the first three belongs to the social category, while the latter two belong to the entrepreneurial category. The last one, welfare state alternative, is perhaps best considered a hybrid.

I find that social forms of microfinance tend to be given less support than entrepreneurial. In both Norway and Sweden social approaches to microfinance have struggled with low funding and low interest. In the case of Norway, this approach eventually led to tensions that affected political support, as policymakers over time gravitated towards a more entrepreneurial approach while the microfinance initiative did not. In Sweden, there was no similar explicit connection between microfinance and the social problem definition

While the UK do not have the same strong distinction between social and entrepreneurial microfinance as in Norway and Sweden, we can also here see the tendency of moving from social towards more entrepreneurial microfinance in the UK. The negative impact of social microfinance is nevertheless mitigated by the problem definition of microfinance-as-welfare-alternative, which creates scope for more social approaches as well.

### The Norwegian Experience

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<sup>9</sup> See section 4.3.2 Table 3: An anatomy of problem description

Following the “schism” that has existed between microfinance initiatives in Norway<sup>10</sup> I have separated the discussion according between the grass roots and the official microfinance initiatives. I begin by discussing the official microfinance initiative. My finding argument is that a change in IN’s definition of the problem from one of gender equality into one of entrepreneurship contributed to the demise of its microfinance initiative. At the same time the rationales, structures, and procedures of the microfinance initiative remained firmly embedded in the same definition of the problem as one of gender. Thus microfinance was no longer seen as a proper solution and therefore cut.

The 1997 white paper on regional policy provided the entry point for microfinance. We have seen how the election of Jagland in 1997 caused renewed interest in regional- and gender policy. Like Sweden, Norway had experienced the deindustrialisation and subsequent depopulation of rural districts that occurred throughout the 1980s and 1990s. In the 1997 white paper, the government promised to introduce targeted measures to maintain settlement patterns and ensure employment and welfare in rural areas experiencing population decline (Kommunal- og arbeidsdepartementet, 1997, sec. 1.5). Women’s issues were also given an important role in the white paper. The white paper based its rationale on a 1996 report criticising the declining priority of women’s measures in regional policy. Moreover, it was argued that prioritising women was crucial in order to correct the skewed gender balance in the districts. Making women stay would in turn make young families stay, which in turn help the government reach its goals of maintaining settlement patterns (Kommunal- og arbeidsdepartementet, 1997, sec. 7.1).

Microfinance was introduced as a part of a new collection of programs called “Women in Focus” organised under NIRDF. After a phase of initial excitement the process nevertheless slowed down. According to one informant NIRDF lacked both competence and interest in the matter, but nevertheless decided to exclude the Women’s Bank, the main source of knowledge and best practices on microfinance that had been built up by the 1990s pilots (Interview GN). Indeed, Pettersen et. al. reports considerable confusion and disagreement inside NIRDF of what women’s issues in fact entailed. Some even argued that it broke with the principle of equality of treatment embedded in NIRDF and was therefore inappropriate (Pettersen et al., 2000, pp. 60–61). We therefore early on see the tensions between the social focus of the microfinance initiative and the priorities of NIRDF.

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<sup>10</sup> See chapter two

While the early troubles delayed implementation for a year, the next couple of years saw the program running relatively smoothly. Politically, there was broad support: in a 2003 comment from the Standing Committee of Business and Industry on the creation of NIRDFs successor IN, representatives from all parties but the Progress Party supported sustaining and strengthening “Women in Focus” (Næringskomiteen, 2003, p. 4). Moreover, in 2008 when the government presented its White Paper on entrepreneurship among women, microfinance figured prominently, as a measure to be continued and strengthened (Nærings- og Handelsdepartementet, 2008, p. 26).<sup>11</sup>

Within IN there was nonetheless growing dissatisfaction with the initiative. According to IN’s informant the cost of monitoring the microfinance groups outweighed the benefits: without any coordination the network groups fell apart, and considerable resources had to be used on monitoring and follow-up. Attempts of improving organisation produced only temporary results (Interview IN 09:35). A 2008 National Auditor evaluation also revealed dissatisfaction with the niche-programs, such as those targeting women and youth. According to IN staff, these programs were sub-optimal and cumbersome to administrate, and some argued they should be removed (Riksrevisjonen, 2008, p. 55).

Simultaneously to these developments the informant stated that IN slowly changed their priorities this change occurred as a gradual change in NIRDF’s priorities, from quantity of businesses created, to quality. In the words of the informant, “we now have a very strong focus on growth and survival, especially growth. This is IN’s new strategy” (Interview IN 19:20). While its predecessor NIRDF was tasked a range of policy goals including maintaining employment, patterns of settlement as well as protecting industries in rural districts, Innovation Norway, as the name implies, was to promote an increasing focus on innovation, modernisation, and competitiveness among Norwegian businesses (see Landbruksdepartementet, 1999, p. 15; Nærings- og Handelsdepartementet, 2003, p. 6).

The shift was probably also influenced by the increasing criticism that IN faced in the media and academia. Already in 2004 a report criticised IN for launching small and short-term women’s measures attempting to solve problems that were structural or long-term in scope, calling these rent-seeking (Teigen, 2003, p. 7). The above mentioned National Auditor evaluation moreover argued that most of IN’s funds were spent on non-innovative projects,

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<sup>11</sup> According to informants, the inclusion was primarily caused by considerable lobbying efforts by key activists from the microfinance community



that programs were confusing and complicated; and that the international focus was weak (Riksrevisjonen, 2008, pp. 8–12). Combined with the sentiments that existed internally in IN, this likely sped up the transformation of priorities, away from targeted measures towards more universalistic ones, and from “social” to more “entrepreneurial” measures.

In 2008 IN decided to discontinue microfinance as a measure. In doing this, they ignored a 2008 evaluation by Rambøll (see Rambøll Management Consulting, 2008) advocating the continuation of the initiative, as well as the recommendations in the government white paper on women’s entrepreneurship. A short-lived replacement, so-called Gründer groups, was introduced as a replacement serving the same target group, but without the loan capital. A 2010 evaluation of IN illustrates the culmination of this process, recommending that IN’s women’s efforts be reassigned from a primary consideration, that is, a priority that deserve its own discrete program, to a so-called “cross-cutting secondary consideration” meaning that women’s issues should instead permeate as a priority throughout other IN programs.

I argue that the change in priorities affected microfinance negatively. The demise of the initiative can certainly be partially explained by its mixed performance. But part of the reason can be found in IN’s reorientation of focus. The problems that microfinance originally was supposed to fix were more “social” in nature, such as unemployment, gender equality, and maintaining rural settlement. By the end of the decade the problems were considerably more “entrepreneurial,” focusing on measures such as innovation, growth, and internationalisation. Moreover, the external criticisms faced by IN likely contributed to this development. At the same time microfinance initiative stayed firmly anchored in “Grameen-style” definition of microfinance as a tool targeting women, and revolving around the group as a social arena for borrowing, networking, and sharing experiences. With respect to the three aspects of problem definition, we see that the problem definition change, the definition of the target group and solution stayed the same. The resulting conflict had a negative impact of political support for microfinance.<sup>12</sup>

Let us now turn to the grass roots microfinance initiative. The story of Microfinance Norway illustrates another aspect of how problem definition shaped political support towards microfinance. The story of MFN is one of lack of official interest and a constant struggle of

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<sup>12</sup> It is important to recall that I do not refer to political support strictly as support for politicians. We saw above that politicians were supportive of microfinance, but that this did not matter much as bureaucracy was against. See discussion in chapter five.

attracting funds. I argue that the approach to welfare provision advocated by MFN competed with that of the government, where the former has promoted self-employment and microfinance, whereas the latter has preferred either labour or existing welfare provisions. Over the last few years, however, we see signs of change. With the emergence of social entrepreneurship as a concept and the new Solberg government there is a reconceptualisation of the problem as one of welfare state sustainability.

As described in Chapter 2, MFN, or Network Credit Norway as it used to be called, grew out of the microfinance project conducted by the Norwegian People's Aid. For MFN, the emphasis on the "social" aspect of microfinance over the "entrepreneurial" was even more pronounced. The target consisted primarily of immigrants, often women with a weak attachment to the labour market, and as opposed to creating innovative businesses with growth potential, the goal of MFN's clients was rather to secure some form of self-employment, empowerment, and to get the clients off welfare.

When NIRDF launched its microfinance initiative in 1998, MFN applied for money. According to the informant at MFN, they were immediately met with resistance within NIRDF, who wanted to prioritise groups in the districts. The informant claims that there was a belief that immigrants, the main target group of MFN, were unsuited for starting their own business (Interview MFN 5:00). Funding was eventually granted after a supportive coordinator at the local NIRDF office in Oslo overruled the central administration (Interview GN).

The money from NIRDF was nevertheless only a one off sum. The lack of stability has been the single biggest impediment for operating the microfinance initiative and over the course of the 2000s MFN went through a host of sources of finances, from the Trondheim municipal government and Hordaland county council to the Ministry of Foreign Affairs, Ministry of Local Government and Regional Development (MLGRD), and even private donors (Interview MFN 01:20-09:10). Common for all of them was that funds were granted on a one-off or short-term basis.

Moreover, funds granted sometimes also had strict requirements attached. In 2005 MFN won a bid for a pilot contract on integration of third-country nationals within the EU, personally initiated by minister Erna Solberg and jointly financed by the Ministry of Local Government and Regional Development (MLGRD) and the EU (Kommunal- og arbeidsdepartementet,

2005). According to MFN the pilot was successful and managed to deliver considerable results given the limited funding. These results nevertheless did not satisfy the Ministry, which according to the informant demanded research of a scale and scope that MFN was in no position to deliver (Interview MFN 12:00).

Three sources of funds have proved somewhat stable. First, the guarantee facility extended to Cultura and MFN by the European Investment Fund, providing a guarantee of 75% of eventual losses;<sup>13</sup> Second, the so-called “poverty money,” provided by NAV starting 2009 to support voluntary organisations working for the poor and socially excluded. While technically is not a voluntary organisation, the authorities decided to extend the scheme on the ground of the unique service MFN provided; and third the money supporting social entrepreneurship, also offered by NAV since 2011.

The picture painted is first and foremost one of official disinterest. When funding has been granted it seems to have been patchy and based on personal involvement from politicians and administrators. This tendency may explain why the MLGRD switched from supportive to hostile towards MFN when Erna Solberg left after the election defeat of 2006. The disinterest in MFN in particular may reflect a general disinterest in entrepreneurship as a means for employment amongst immigrants, as opposed to traditional programs of work training for the regular labour market. We have already seen how IN’s focus gradually changed. A 2008 evaluation of two business development centres for immigrants illustrate this: Out of 122 course participants 22 applied for capital, either from IN, banks, or the city, and only one person was approved. Immigrants told stories of having to attend numerous courses only to be rejected when the question of accessing capital came up (Enehaug, Gamperiene, & Osman, 2009, p. 122). It seems that immigrants do not fit into the government’s definition of potential entrepreneurs; for this population the solution is either conventional labour or welfare.

Over the course of the last few years there are signs of a new definition of the problem emerging. The rise of the concept of social entrepreneurship brings with it the idea of the limits to the traditional welfare state. Social entrepreneurship implies that the social goals can be met through market or hybrid approaches, thus challenging the hegemony of the welfare state in Norway. The new understanding therefore has the potential to cause a renewed interest in microfinance as a policy tool.

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<sup>13</sup> Technically this was a guarantee agreement rather than actual funds, but the effect –increased capital for lending – was the same.

The election of the Solberg government in 2013 accelerated this process. This is not a coincidence: We already know that the new Prime Minister Solberg is favourably disposed towards social entrepreneurship. Moreover, both the Conservatives and the Progress Party have traditionally been more sympathetic to non-state means of delivering welfare. In the words of the new Minister of Labour Robert Eriksson:

The current welfare state must be overhauled to be sustainable in the future... we must allow voluntary and charitable organisations as well as private social entrepreneurs in our welfare production. We must move from a welfare state to a welfare society. (*Haugan, 2014*)

Under this new problem conceptualisation “social” microfinance fits into public policy as the solution to a different problem: The problem is not necessarily low levels of entrepreneurship, or financial or social exclusion. Rather, it is a bloated and unsustainable welfare system. Under this definition, microfinance becomes a solution to a different problem: not to market failure, but to government failure.

Perhaps this is one reason why MFN’s approach to microfinance has been ignored under previous governments? As the informant interviewed at NAV pointed out, social entrepreneurship challenges the principle of universality deeply embedded in the Nordic model. According to this informant one of the strengths of the Nordic model is that it relies less on means-testing and offers a reliable base safety net, rather than pushing unemployed into self-help strategies such as self-employment (Interview NAV, not recorded). The issue of microfinance in the context of social entrepreneurship raises ideological debates about the tension between the welfare state and employment and the role of microfinance.

## **The UK experience**

The United Kingdom does not exhibit the same “schism” as we see in Norway, and I will therefore discuss it as one case. My main finding is that the UK case has been dominated by the definition of microfinance as means to address poverty and community deprivation. Hand in hand with this definition is also the idea of microfinance as an alternative – or “solution” – to public welfare. This definition has not only contributed to broad political support, it allows flexibility in the various forms of microfinance. We therefore see a larger range of implementations in the UK compared to for example Norway, where microfinance was explicitly tied to women as the target group.

In The UK, microfinance was implemented in the context of addressing poverty and deprivation in local communities. This problem definition is reflected in the acronym for MFIs in the UK: Community Development Financial Institutions. In the preamble of the National Strategy for Neighbourhood Renewal (NSNR) it reads that the strategy was created in order to “develop integrated and sustainable approaches to the problems of the worst housing estates, including, crime, drugs, unemployment, community breakdown, and bad schools etc.” (Social Exclusion Unit, 1998, p. 1). In the same document, Tony Blair states that “Our goal is simple: it is to bridge the gap between the poorest neighbourhoods and the rest of Britain” (Social Exclusion Unit, 1998, p. 3).

While women and minorities were given extra priority, microfinance were not restricted to these groups (Social Exclusion Unit, 2001, p. 49). Indeed, only a few CDFIs, such as the Norwich Full Circle Fund run by WEETU were exclusively targeting women. Moreover, the mainstreaming of microfinance has apparently not led to a disadvantage to women or ethnic minorities: although updated aggregate data does not exist, figures from the loans made under the Phoenix Fund between 2001 and 2005 show that out of 900 business loans issued, 40% were made to women, and 30% were made to ethnic minorities (GHK Consulting Ltd, 2004, p. 55). More recent data from the London CDFI East London Small Business Centre (2012, p. 5) showed that 46% of loans agreed on went to women. ScotCash, another CDFI operating in Scotland, reported that in 2013 72% of their clients were women (Scotcash, 2013, p. 11).

The British development must also be seen in conjunction to the emergence of the concept of the social economy, or the “third sector” as it is referred to in the UK. Over the course of the 1990s the third sector started to galvanise as a term. By the end of the 1980s The Labour Party was attempting to distance itself from what Kendall (2000, p. 15) describes as the “old dogma” of state-centrism. When Tony Blair assumed leadership of the party in 1994, this process only accelerated as Blair sought ways to embrace a more market-friendly approach while at the same time appealing to traditional Leftist values. When he entered power, Blair therefore wholeheartedly embraced the “Third way” as a means to distance “New” labour from the failed ways of the past, while at the same time rejecting the Tory dichotomy of state and the market. When New Labour was elected in 1997, the idea of the third sector was therefore heavily embedded in Blair’s rhetoric. As he states in the election manifesto:

*In each area of policy a new and distinctive approach has been mapped out, one that differs from the old left and the Conservative right. This is why new Labour is new. (The Labour Party, 1997).*

It was also described in the discussion on the policy window variable how the government reached out to actors from both the private and the third sector.

One consequence of this approach to microfinance is that whereas the Norwegian and Swedish sector can be divided into grassroots- and official initiatives, the UK sector has no such distinction. While the government provides funding, initiatives are all run by private CDFIs.

The poverty/welfare-alternative definition of microfinance ensured sustained political support throughout the 2000s. A number of initiatives were launched, such as the Regional Development Agencies, the Phoenix Fund, the Social Investment Task Force, the Office of the Third Sector, and the Commission for Unclaimed Assets. Between 2000 and 2008 the government invested around £55 million into CDFIs (HM Treasury, 2008, p. 90). Of course, the CDFI sector was not immune to the ebb and flow of the policy cycle: for example, the Phoenix Fund closed down in 2005, with funding responsibility being delegated to the RDAs. But on the whole funding arrangements remained stable over time and gave the sector the predictability it needed to grow.

The Coalition win in the 2010 election led to a move away from the poverty definition towards a greater focus on the entrepreneurial aspect of microfinance. We have seen earlier that the election saw many of the old measures created under Labour replaced by new measures more explicitly focused on businesses. There are signs that the increasing focus on competition affecting social microfinance negatively. For example, in 2013 the Norwich-based Women's Employment, Enterprise Training Unity, one of the oldest MFIs in the UK, and one of the few exclusively targeting women using group loans, were forced to close in the face of funding cuts (Woods, 2013). These tendencies are also a product of the increased focus on sustainability that occurred towards the second half of the decade.

This shift from a socially oriented towards a more entrepreneurial focus should nevertheless not be overestimated. Already before the election the Social Investment Task Force noted that

in the current run-up to the 2010 General Election, there have been a number of policy statements by the main political parties demonstrating a remarkable degree of consensus that the social investment approach is needed to complement grant making and public sector spending if we are to address social issues effectively. (Social Investment Task Force, 2010, p. 8)

Although new programs, such as the Startup Loan program is closer to conventional support schemes targeting entrepreneurs in general, other programs have maintained the focus on the

poor and unemployed. The New Enterprise Allowance programme, for example, targets those already on benefits, encouraging self-employment as a way to get off benefits.

A perfect example of the consensus is the Big Society Bank. Big Society Bank was the culmination of a process that started with the 2004 Commission on Unclaimed Assets. The background for the commission was how to best make use of “lost money” locked up in old dormant bank accounts no longer in use. In 2007 the Commission recommended the creation of the so-called Social Investment Bank (The Commission on Unclaimed Assets, 2007, p. 2), and in 2008 a unified Parliament passed the act enabling the creation of the bank.

As it turned out, the SIB fit right into Cameron’s ideology. With the election victory the bank was renamed Big Society Bank and incorporated in the new government’s flagship policy of Big Society. Big Society was the Conservative response to “Big Government,” focusing on using the state to “help stimulate social action, helping social enterprises to deliver public services,” as “the size, scope, and role of the government in the UK has reached a point where it is now inhibiting, not advancing, the progressive aims of reducing poverty, fighting inequality, and increasing general well-being” (Conservative Party, 2010, p. 37).

The UK case shows relatively clearly how the problem definition variable influences the likelihood of political support for microfinance. When New Labour introduced the NSNR in 1998 microfinance was seen as a solution to poverty and community deprivation. The election of the Coalition government in 2010 saw this definition of the problem shifted in favour of a stronger focus of the entrepreneurial potential of CDFIs. Unlike Norway, however, this shift in problem definition created a positive impact on support for microfinance. The reason for this is that both Labour and the Conservatives also considered microfinance in particular and the third sector in general as solutions to a different problem, namely the problem of welfare state sustainability. This problem definition ran parallel to the other two “images” of poverty and entrepreneurship, and is the main reason we see a consensus among politicians of the importance of CDFIs. This consensus has helped safeguard funding over time.

### **The Swedish Experience**

The Swedish case is discussed in a similar manner as the Norwegian one, first focusing on the government microfinance initiative before turning to the grassroots initiatives. My main finding is that in contrast to IN’s initiative, ALMI’s initiative was anchored in an

“entrepreneurial” approach from its introduction. Although its roots can be traced to the government’s attempt to address the problem of gender imbalance in business and regional policy, microfinance was rather the solution to a problem affecting all entrepreneurs and SMEs, namely the lack of capital. While recognising the importance of vulnerable groups, such as women and immigrants, the definition of microfinance was not explicitly tied to serving these groups. ALMI’s microfinance alternative has therefore been able to maintain relevance, ensuring continued political support.

As in Norway, the roots of microfinance in Sweden can be traced back to the problem of equality and entrepreneurship among women living in rural areas. In 1993, a white paper on regional development the government was published, arguing that women were underrepresented among entrepreneurs. In order to correct the imbalance, the white paper among other things proposed a so-called ‘micro grant’ of maximum SEK 20,000, tailored explicitly towards “soft investments” and the smaller capital needs of women living rural districts (Regeringen, 1994, p. 105). Moreover, the government decided to establish regional “Women’s Resource Centres,” tasked with providing business support services for women entrepreneurs.

In 2001 a joint ALMI-SAERG report recommended the expansion of the women’s loan into a micro loan with universal applicability (Riksdagen, 2002, p. 22). This recommendation were embraced by the government and subsequently incorporated in the already mentioned 2001 white paper on regional policy. The premise of original woman’s business loan was that this group often struggled to gain access to finance. Their lower capital needs and the type of business started by this group made them undesirable or unprofitable for conventional banks. In the white paper, however, the government stated that while the “difficulties with securing small loans have previously been considered mainly a problem for women, immigrants, and youth... the demand from ALMI and other actors have been deemed high across the spectrum of entrepreneurs and small business owners” (Regeringen, 2001, p. 175). The old target groups would remain prioritised, but the new loan would be open to everyone.

Comparing the 1993 white paper to the 2001 white paper shows a broadening definition of the target groups of microfinance. The new micro loan was based on the idea that although women might be at a particularly disadvantaged position, the problem was not about female entrepreneurship and lack of access to capital in particular, but rather about challenges for entrepreneurs in general. In a 2008 report from the Swedish National Auditor quoted ALMI



employees stating that they first and foremost evaluated the merit of the business, with questions of “equity” as a secondary criterion (Riksrevisionen, 2007, p. 32). In another study, an ALMI employee stated that minorities should not be the subject of special treatment, and that every loan application should be judged on its own merit (Högberg & Svensson, 2005, p. 33). This stands in contrast to Norway, where IN as well as the grassroots actors defined microfinance as more or less an explicitly women’s measure, but where tensions emerged over time as IN moved towards a more “entrepreneurial” approach.<sup>14</sup>

This transformation nevertheless did not necessarily hurt the gendered measure that the original business loan was intended to address. Numbers from ALMI shows that out of the SEK 206 million lent out through microfinance initiative in 2013, 76 million were given to women. Similarly 88 million were given to immigrants (ALMI, 2013, p. 15). These numbers have been consistent over the last few years, and shows that women and especially immigrants are in fact overrepresented relative to their share among the greater population of entrepreneurs. It is therefore clear that ALMI has managed expand coverage while maintaining its outreach towards women and immigrants as prioritised groups.

It can even be argued that the transformation instead helped safeguard the women’s focus. A 2008 report from the Swedish National Auditor criticised many of the existing programs explicitly targeting women and immigrants. While the Auditor noted that while these programs “have been valuable for those participating in them... they nevertheless had only marginally utility for the entrepreneurial activities of the targeted groups as a whole.” Moreover, the report noted that, “the supported businesses and projects risk becoming dependent on the earmarked money. When the money stops, the project stops” (Riksrevisionen, 2007, pp. 8–9). The report concluded that a better way to ensure that the goals towards these groups were effective, efforts should be taken in order to increase their participation within the state’s ordinary programs. The Auditor’s conclusion echoes the statements given on women’s measures by IN as well as several Norwegian evaluations (see e.g. Econ Pöyry, 2010; Teigen, 2003).

Let us now turn to grassroots microfinance initiatives. Whereas ALMIs microfinance initiative today is well-established and well-used, the grassroots organisations have struggled to survive. Like MFN in Norway, the grassroots microfinance initiatives have adopted the

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<sup>14</sup> As exemplified by the statements given to the Norwegian National Auditor.

socially oriented strand of microfinance, and likewise, they have also struggled with attracting funds as well as with low interest from the authorities.

The earliest example of Swedish microfinance is from the project “Nätverksbanken i Dalarna,” which ran between 1994 and 1998. The focus was women living in rural regions, financed by a combination of local- and EU funds, and modelled on the Norwegian Lofoten initiative (“Nätverksbanken i Dalarna,” 2014). The bulk of the initiatives, however, came about considerably later. In 2004 a “Swedish Platform for Microcredit” was started by various grassroots organisations, inspired by the United Nation’s decision to make 2005 the international microcredit year (“Nyhetsbrev Nr 04 - mars 2005,” 2005). That year a Swedish microfinance model was developed as a part of an EU financed pilot project on alternative financing solutions for social economy businesses (Herlitz, 2006, p. 33).

Since 2005, several pilots have been tested across Sweden. The initiatives emerging during this second “wave” have explicitly focused on immigrants as the target group, often those outside the ordinary labour market. For example, Mikrofinansinstitutet, an MFI born out of experience with the PITEM pilots and the first of its kind in Sweden, explicitly targeted unemployed immigrants: 85% of participants were to be born outside of Sweden, while 80% were to be women (Arbetsmarknadsdepartementet, 2012, p. 126).

We can also see the same signs of official disinterest as in Norway. In the words of one informant:

The public support for grassroots microfinance initiatives is in principle zero... There is no problem in attracting politicians enthusiastic about the idea, but when it comes to actually supplying capital for lending there is no interest. (Email GS)

A key actor in the PITEM I pilot lamented that one of the main problems of introducing microfinance to Sweden was that the Swedish government showed no interest in microfinance (Högberg & Svensson, 2005, p. 37). A report from PITEM I’s successor PITEM II argued that civil servants within the Swedish Public Employment Service<sup>15</sup> were unfamiliar with the project and its intention. They supposedly showed little sympathy for the microfinance approach, and preferred to simply ignore in favour of traditional measures used towards unemployed immigrants. The report claimed that in order to achieve any traction with the authorities, the project was crucially dependent on sympathetic individuals “within the

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<sup>15</sup> The Swedish equivalent of the Norwegian Labour and Welfare Administration

system” (BalticFem, 2008, p. 15). Finally, a 2004 project not focusing explicitly on microfinance but rather on social entrepreneurship, reported that public officials were critical to the project, arguing they did not live up to public standards. The officials called for “real voluntary work,” rather than social economy actors competing with already well-working public services (Eriksson, 2004, p. 12).

Moreover, the success rates of the various initiatives have been low: a 2011 review of the different microfinance initiatives in Sweden shows that out of four surveyed pilots none managed to meet original expectations (Altafi, Wennberg, & Borelius, 2011, pp. 28–31). It must, however, be noted that although the lack of support has been crippling, the difficulties must also be traced to the nature of the pilots themselves. According to the project manager of one pilot the main reason for failure was because the participants often lacked basic knowledge of Swedish, as well as knowledge of basic accounting and legal issues. These ultimately became larger barriers to starting a business than lack of access to capital. The amount of training needed to address the shortcomings was simply insurmountable compared to the pilot’s limited access to funding (Email GS). In another pilot the microfinance aspect was eventually discarded altogether, as the handling bank simply moved its microloan customers into its regular portfolio (Email RS).

Today, no grassroots microfinance initiative exists in Sweden. While the social bank Ekobanken advertises microfinance as a part of their portfolio, their micro loan actually requires collateral and is therefore not a “true” micro loan. Mikrofinansinstitutet, is also supposedly providing micro loans, although it shows no signs of activity, and several attempts to contact the MFI have proved unsuccessful.

Although the Swedish grassroots initiatives do not fit that well within the theoretical framework, let us nevertheless draw out some tendencies. The grassroots initiatives are clear examples of “social” microfinance. Like in Norway we see that there is little public interest in these initiatives. While the government also recognises the problem of immigrants with a weak attachment to the labour market, it appears that the authorities believe solutions such as microfinance are not appropriate for the target group. It should be noted the empirical material to some extent confirms this. Finally, the definition of microfinance as a welfare alternative has not gained traction in Sweden like in Norway (and as we will see, the UK). While there is certainly a growing understanding of the social economy (see e.g. Palmås, 2008), microfinance has so far not been implied in this debate.

## **The impact of decentralisation**

There is also a tendency to tie the target groups of microfinance to geographically delimited spaces, such as women in rural districts, or people living in deprived communities. This definition of the target groups has opened up for decentralisation of the responsibility for funding. As the funding process is removed from central control, microfinance becomes more sensitive to changes in the local economy and priorities of local administrators. This has in turn has affected the microfinance initiatives negatively

Let me give a few examples. In 2003, a new public reform, called “Ansvarsreformen” was enacted in Norway, decentralising power from the central government to county councils and municipalities. For IN this meant that decision making powers and control over the microfinance funds was given to county councils, which then collaborated with the local IN offices around the country on how to spend those funds (Rambøll Management Consulting, 2008, p. 38). The idea was that the reform would have a democratising effect: according to one of the informants, the policy makers thought that by bringing decision-making power closer to those with local knowledge closer to the ground (Interview GN).

The reform, however, ultimately had a negative effect on the microfinance initiative. First, it led to the removal of the earmarking of funds for microfinance. According to the informant at IN this is what hurt the microfinance initiative the most (Interview IN 12:50). Moreover, in 2005 IN removed the designated head office coordinator of microfinance, as the local offices took over responsibility for coordinating the local microfinance groups. A 2008 report argued that after funding responsibility was delegated to local offices, fewer new network groups were created. Low levels of both knowledge of and interest among the local IN offices, combined with competition from other programmes, led to microfinance being given less priority (Rambøll Management Consulting, 2008, p. 52)

During the mid-2000s, the UK CDFI sector experienced a similar decentralisation process as the one in Norway. When the Phoenix Fund closed down in 2005, responsibility for funding CDFIs devolved to the Regional Development Agencies. Unlike the Phoenix Fund, however, RDAs were not centrally coordinated, but instead free to pursue their own agendas. This led to the adoption of a variety of strategies supporting CDFIs, where some RDAs showed a strong commitment to supporting CDFIs, while others showed little interest.

A 2010 evaluation of the CDFI sector shows that although the RDAs were positive to CDFIs, the level of funding provided was nevertheless much lower than in the Phoenix era (GHK Consulting Ltd, 2010, p. 15). RDAs were also in general more concerned with sustainability than the Phoenix Fund. In NEFs 2006 survey of the CDFI sector, several of the practitioners called on the government to lift the emphasis on geographical deprivation and instead incorporate CDFIs into broader policies for social inclusion (New Economics Foundation, 2006, p. 28).

The UK case shows that through decentralisation responsibility is fragmented, and funding becomes conditional on the knowledge and priorities of lower-level administrators. Moreover, note the two conflicting tendencies shaping CDFIs: on the one hand there is the demand for sustainability, which among other things requires scale and focus on the national level. On the other hand there is decentralisation and focus on the most deprived communities, which leads to a focus on the local level. This dichotomy between what government expects of microfinance initiatives and how it enables those initiatives to fulfil them seems to be typical of the microfinance initiatives in Norway and the UK.

Finally, the Swedish case does not reveal the same patterns of decentralisation that have occurred in Norway and the UK. ALMI is not bound by any geographical limitations with respect to where the loans should be given, and one could make the argument that precisely this lack of geographical scope has precluded the possibilities for decentralisation of the initiative. The grassroots initiatives, on the other hand, were usually dependent upon local funds for their operations. One pilot complained that these local funds came with strict requirements concerning their use, thus preventing microfinance initiatives to reach out to other markets (Herlitz, 2006, p. 38).

## **The impact of EU**

A second tendency concerns the role played by the European Union. We have seen in Chapter 2 how the EU has been a major advocate of microfinance lending. In Norway and Sweden in particular, but also in the UK as well, the EU has also been one of the few sources of funding for more social types of microfinance. In Norway, the EU was involved in projects focusing on various social issues such as developing a microcredit models to combat urban and rural deprivation, integration of third country nationals, as well as the mentioned EIF guarantee to MFN and Cultura (see European Commission, 2006, p. 41; Sekkesæter, 2002, p. 6) In Sweden

a review of the various grassroots initiatives reveals that four out of six (excluding ALMI) initiatives were financed in part by EU funds (Altafi et al., 2011, pp. 28–31). The Full Circle Fund, one of the few ‘Grameen-style’ MFIs in the UK also received funds from the EU (*Examination of Witnesses (Questions 381 - 395)*, 2000, para. 383).

One explanation for why the EU appears to be more willing than domestic governments to fund socially oriented microfinance initiatives might be because the EU to a greater extent is shielded from public opinion. The debate that occurred in Norway in 2008 surrounding IN’s supposedly poor use of public funds illustrates the potential backlash in public opinion when funding “riskier” projects with a social rather than a more innovative profile. We have already seen tendencies of policy makers being more reluctant to try new and experimental treatment policies such as microfinance in order to address the problems facing target groups such as immigrants. EU on the other hand suffers no such consequences, and can therefore afford to fund these politically riskier projects targeted at weaker and less popular groups. The Equal programme, under which many of the grassroots initiatives were funded, explicitly targeted immigrants, women, and inclusive entrepreneurship. This highlights EU’s historical role as a normative power promoting social cohesion throughout Europe.

### **Five common definitions**

I now present a table summarising the five main problem definitions that I have identified in the analysis. We see that regional policy and gender ethnicity have influenced the microfinance initiatives in Norway. Access to capital for SMEs and entrepreneurs has underpinned initiatives in Sweden and the UK. Microfinance as a welfare state alternative has been influential in the UK, and we see that this is an emerging understanding of microfinance in Norway. Finally, poverty and community deprivation have been an important rationale for supporting microfinance in the UK.

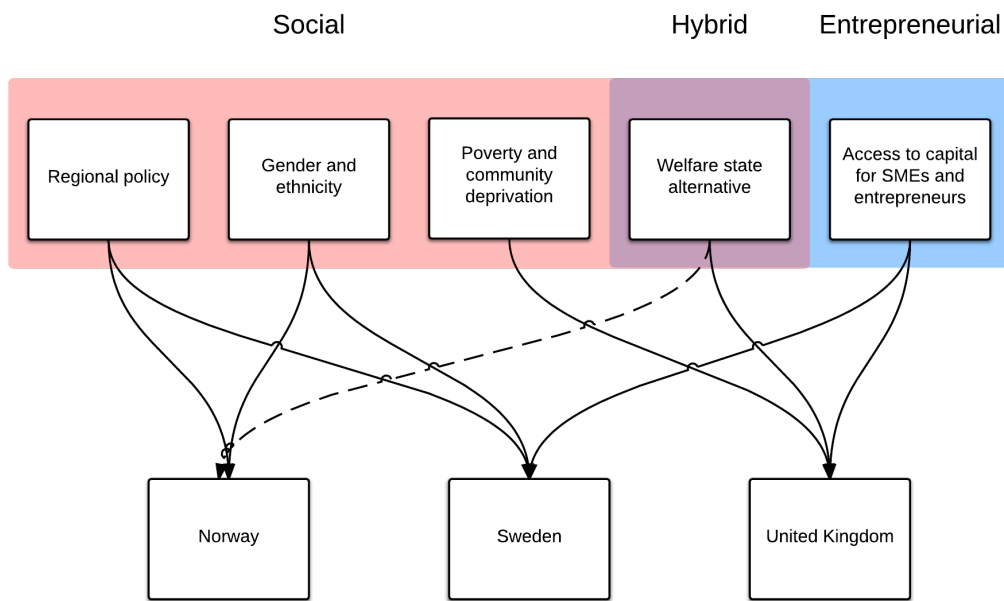


Figure 6.4: Overview over dominant problem definitions

### Summary of the problem definition argument:

Let me now summarise the main findings from the problem definition argument. The roots of the arguments concerning problem definition can be traced back to the two-sided nature of microfinance. Microfinance purports to be the solution to several problems, ranging from gender discrimination to unemployment to costly public welfare. Whether microfinance is successful is therefore dependent on how it is defined, and how that definition fits into public policy.

First, we see that in Norway and Sweden, microfinance can roughly be divided into social and entrepreneurial initiatives, where the social type has been a grassroots type of microfinance, and the entrepreneurial type have been state run. Governments seem to be more interested in funding entrepreneurial forms of microfinance over social, and we see in both Norway and Sweden that grassroots initiatives were largely ignored by the authorities. One reason for this tendency is that the entrepreneurial initiatives have a more positive image attached to it. The Norwegian case illustrated how both public and academic criticisms of IN's funding priorities put pressures on IN to gravitate towards more useful and deserving target groups. It is harder for policymakers to justify spending public funds on so-called "rent seeking" activities rather than growth oriented and innovative businesses.

Second, the analysis shows that the definitions of the problem and target groups shape what solutions are considered appropriate. For example, in Norway and Sweden the problem was defined as one of gender representation and regional policy, whereas in the UK it was defined as one of poverty and community deprivation. I argue that subsequent changes in these definitions influence the likelihood of political support for microfinance. Rigid definitions of microfinance, combined with changing government priorities can lead to mismatch between microfinance governments' definition of appropriate solutions. IN's definition of microfinance as a measure explicitly targeting women meant that when IN shifted towards a greater focus on innovation and growth, microfinance was no longer an appropriate measure. This tension eventually led to the demise of the initiative. This stands in contrast to Sweden, where a change in ALMI's focus from women to all entrepreneurs was followed by a change in the terms of the loan. This ensured the continued growth of the measure,

Third, the definition of microfinance as a welfare alternative increases the likelihood of political support of microfinance. This definition was part of the rationale when Blair introduced the NSNR in 1998 and has underpinned the development of the CDFI sector. The argument, in turn, has two implications. First, it explains why there is no "schism" in the UK sector as the non-state approach was part of the very reason for the sector's creation. Not only does this lead to a greater range of MFIs, it also meant that there have been no "pet" microfinance initiatives for the government to promote at the expense of other initiatives. Second, it, explains why the change in problem definition in the UK did not influence political support. Although UK too saw a change in problem definition, from a more social focus under Blair into a more entrepreneurial under Cameron, there was consensus on the idea of microfinance as an alternative to the state, which ensured continued support.

Whereas microfinance-as-welfare-alternative has been part and parcel of the UK story from its beginning, we are only recently seeing signs of this definition emerging in Norway and Sweden. The development seems to move somewhat faster in Norway, and MFN have since 2011 received funding earmarked for social entrepreneurship. While terms such as social entrepreneurship and the third sector are still a novelty, recent developments, including the election of the Solberg government may see this definition strengthened in the future. This will not only increase the likelihood of political support for microfinance, it might also lead to a renewed focus on social microfinance.



In the last part of the analysis I looked at aspects influencing political support for microfinance, although not a part of my framework. It is clear that processes of decentralisation tend to weaken political support for microfinance initiatives. As responsibility is delegated to lower levels of government, microfinance are faced with actors lacking knowledge or interest of microfinance, which is then forced to compete with other, sometimes more familiar measures.

I have also found that the EU often steps in and finance microfinance initiatives that have a more social focus. Several of the Norwegian and Swedish grassroots initiatives have been enabled by EU funds. The following sections explore the problem definition of microfinance and target groups to show how it affects the outcome of the various microfinance initiatives undertaken in the three countries. A possible explanation is that the EU is to a greater extent shielded from criticism and the public opinion, allowing it to support “riskier” social microfinance initiatives.

It must be noted that I have used Rochefort and Cobb only in the most descriptive sense. Rather than focusing on “who’s defining,” I have primarily asked “how is it defined?” There are certainly interesting points to be made of the problem definer. For example, it seems like Conservative parties are more willing to embrace the microfinance-as-welfare-substitute, rather than microfinance as gender policy. This would be in their interest as it fits into their ideological perceptions of the state and the role of welfare. Moreover, it seems that leftist parties are more likely to define microfinance as a regional or gender policy measure, as it fits with their traditional commitment towards these groups. The problem, however, is that there are no clear-cut tendencies to draw upon. Entrepreneurial microfinance has also been introduced by leftist governments in Sweden, and social microfinance have been encouraged by right-wing governments in Norway, exemplified by the so-called Erna money.

Of course, a consequence of my more descriptive use of problem definition is that the concept and its impact is admittedly somewhat elusive. I nevertheless argue that it has proved useful as a framework to understand support, or lack of support from policymakers.

# 7 Overall Conclusions

Why does microfinance emerge in developed countries such as Norway? This was the question I asked myself when I chose the topic for my thesis. From this question followed a journey through a new and unfamiliar field. A journey that runs from economic theories of how microfinance corrects market imperfections in developing countries, to stories of Norwegian women coming together to create work for themselves, to theories of how politics is formed.

Microfinance is a subject of large contrasts, not only as in contrasts between the rich and the poor world, but also in the way a researcher approaches the topic. One day I have been reading about the lack of randomised controlled trials or the influence of policy entrepreneurs on agenda-setting. Some weeks later I would find myself at group meetings listening to immigrants discuss their one-man import business over tea in a ubiquitous office building in the suburbs of Oslo.

It is this field I have tried to “make sense of.” As the research progressed it became clear to me that political, rather than economical explanations are the most important to understand why microfinance succeeded or not. This led me to my research question of which factors that affect political support for microfinance. Taking a public policy approach, and doing a comparative study of Norway, Sweden, and the United Kingdom, I have tried to answer this question. Below are my main findings.

The analysis of the policy window variable reveals that policy windows are important determinants of political support of microfinance. If a policy window is present, microfinance initiatives are more likely to receive political support. Four distinct policy windows have been instrumental in the introduction of microfinance initiatives in the three countries. The policy windows, opened by turnovers or the emergence of pressing policy problems allowed microfinance to couple with the governments’ decision agendas.

In Norway, the policy window opened through a combination of a new government and a problem of rural depopulation and gender imbalance in regional policy. This enabled advocates to promote microfinance as a solution to this problem. In the UK policy windows have emerged both during the 1997 and 2010 general elections. In the first case, microfinance rode on the back of New Labour’s effort to combat poverty and community deprivation. In

2010 microfinance coupled with the new government's attempt to address the effects of the financial crisis combined with its renewed focus on business and entrepreneurship. In Sweden, a policy window preceded the transformation of the existing mini loan into a fully-fledged microloan. The new government's effort to strengthen measures for small business and entrepreneurship, combined with the financial crisis restricting access to credit, created the perfect conditions for improving ALMI's loan.

The analysis of the problem definition variable reveals that the definitions of the various problems and target groups that microfinance is supposed to address influences political support for microfinance. Five problem images have shaped political support for microfinance in the three cases. In Norway microfinance was introduced on the background of gender and regional policy. In addition a potentially new problem definition is emerging, and this might lead to more political support for microfinance. In Sweden too gender and regional policy were important problems driving the introduction of microfinance. In addition the lack of capital to SMEs and entrepreneurs has also been an important problem definition ensuring support for microfinance. In the UK microfinance was introduced in the context of growing poverty and community deprivation as well as the emerging third sector as an alternative to the welfare state. In 2010, the poverty definition was replaced with one emphasising the business aspect, renewing the support for the sector.

Moreover, whereas the early microfinance initiatives were centered around the social variants of microfinance, over time policymakers have tended to favour the more entrepreneurial forms of microfinance. In the case of Norway, this shift in policymakers' preferences led to a mismatch with the initiative. In the case of Sweden this mismatch was mitigated by transforming the definition and structure of the microfinance initiative to accommodate the new definition. Finally, in the case of the UK the shift in preferences towards entrepreneurial microfinance after the 2010 election represented less of a problem, as the Coalition government also supported the definition of microfinance as a welfare alternative.

## **7.1 Implications**

Where is microfinance in Europe headed? With the EU committing considerable resources, and an increasing number of MFIs approaching sustainability, there are certainly signs that

microfinance is here to stay. Self-employment strategies will likely become more important in the future, and microfinance might be a key source of capital for those starting on their own.

There are many more explanations of why microfinance receives public support or not, let alone of why some are successful while other are not. Nevertheless, despite all of its flaws my study represents one of the first attempts to study microfinance through the lens political science, using a public policy approach. Considering its dependence upon the public sector, there is little awareness of how microfinance behaves in relation to the state. I therefore hope my study can fill a gap and represent a contribution to a broader conceptualisation of the microfinance plays in developed countries today. If it can inspire someone to write on the topic, and perhaps even improve on the approach presented here, the thesis has fulfilled its purpose.

Moreover, the thesis reveals how important the way microfinance is understood is for both the practitioners themselves and for policymakers. I have showed how microfinance initiatives sometimes fail just because of misunderstandings between the involved actors of what microfinance is supposed to achieve. For example, a recurring theme in all three cases is that governments have tended to define microfinance as more of an economic measure, while target groups or MFIs promoting microfinance have tended to view it as more of a social measure. Microfinance is no panacea, but it would probably work better if everyone involved had a little better understanding of the other part.

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