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Taking Trade-offs Seriously: Examining the Contextually Contingent Relationship Between Social Outreach Intensity and Financial Sustainability in Global Microfinance

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Abstract. A key insight from research on hybrid organizing is that the joint pursuit of competing goals exposes an enterprise to potentially problematic tensions and trade-offs. Yet while studies have examined the former, the actual trade-offs that these organizations face—and how these might vary among enterprises and contexts—has been largely overlooked. Focusing on social enterprise, we address these gaps by (1) developing a framework that can be used to predict the compatibility of social outreach and financial sustainability for different types of enterprises and (2) arguing that the acuteness of trade-offs will vary based on the cultural roots of the issue an enterprise addresses, the market conditions where it operates, and the quality of its management. We test our arguments by studying 2,037 microfinance organizations in 115 nations between 1995 and 2013. Results support our predictions. Social–financial trade-offs are amplified when a social issue is intertwined with deep-seated cultural problems, such as discrimination, and when an enterprise operates in a weak institutional environment. Intensive social outreach becomes sustainable, however, when cultural barriers to outreach are low, market-supporting institutions are strong, and an enterprise is professionally managed. Our study thus shows that social–financial trade-offs are contingent and that the promise of sustainable social outreach varies widely across contexts.

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Introduction

Social enterprises are hybrid organizations that use commercial operations to address social issues, such as poverty, inequality, and environmental degradation (Santos et al. 2015). Examples include businesses that create and sell socially or ecologically beneficial products (Pacheco et al. 2014), work integration social enterprises that employ marginalized people and help them to reenter the workforce (Tracey et al. 2011), and microfinance organizations that provide financial services to the poor (Mair et al. 2012). While the specific integration of social and financial aims varies across these examples, in each case the two are mutually constitutive, and neither can be removed without fundamentally changing the enterprise's model.

Much of the excitement about social enterprise owes to the idea that these organizations have the potential to provide meaningful and self-sustaining solutions to long-standing social problems (Dacin et al. 2011, Smith et al. 2013). While there is some debate about the desirability of engaging in intensive social outreach (i.e., targeting high-need beneficiaries and areas of great social need) versus seeking financial returns that enable growth and broader impact, a social enterprise will ideally be able to achieve both (Santos et al. 2015, Smith and Tracey 2016). Intensive outreach has little value if an enterprise cannot sustain itself, and the utility of scaling up to serve more people is debatable if doing so comes at the expense of creating beneficiary value (Morduch 2000). As such, Battilana et al. (2012) have argued that social enterprises should aspire to the "hybrid ideal," where intensive social outreach simultaneously generates revenue that is sufficient to sustain and grow the organization.

While it is appealing, most agree that the hybrid ideal is difficult to achieve in practice, as there are often trade-offs between an enterprise's social and financial aims. For many organizations, costs and revenues vary with the intensity of their social mission pursuit, such that offering more extensive support to beneficiaries or targeting high-need groups causes financial strain (Santos et al. 2015). In turn, this is associated with problematic intergroup tensions, as different stakeholders pressure the organization to prioritize either social

outreach or commercial gain (Battilana and Dorado 2010, Pache and Santos 2013). As a result, many social enterprises have difficulty sustaining a strong social mission focus, let alone generating surplus (Battilana and Lee 2014).

Given these challenges, the literature has endeavored to understand how social enterprises can productively integrate their dual aims. Studies to date have focused on the existence of tension between social and financial goals (Besharov and Smith 2014), how this is perceived by an enterprise's leaders (Hahn et al. 2014), and how it manifests in organizational structure (Raisch et al. 2009). In turn, this has served as a foundation for examining the processes that enterprises use to integrate their goals and defuse conflicts between groups who support one or the other. Yet the more fundamental relationship between social outreach intensity and fiscal sustainability has been largely ignored. Studies have offered examples of particular trade-offs, but there has been little systematic or sustained attention. We believe that this is problematic. It is important for an enterprise to manage tensions that arise from its dual aims, but doing so is unlikely to affect the underlying relationship between the two. Resolution attempts may or may not yield financially viable outcomes (Tracey et al. 2011), and sustainability may only be possible with less intensive outreach (Smith et al. 2013). Trade-offs may also vary among enterprises and contexts. Understanding these contingencies is important for identifying contexts where social enterprise has the potential to be effective and sustainable versus those where it has less promise as a social outreach tool.

In this paper, we begin to address these gaps by developing an approach that theorizes (1) the underlying compatibility of intensive social outreach and financial sustainability and (2) the contextual contingency of trade-offs between the two. Our approach thus speaks to the level of social outreach that an enterprise can sustain in practice and to the contextual conditions under which social–financial trade-offs might be attenuated to the point that achieving the hybrid ideal becomes a practical possibility.

To this end, we draw on examples offered by extant studies to develop a simple, integrative framework comprising mechanisms that link social outreach to fiscal sustainability, and we argue that this can be used to predict social–financial trade-offs in specific social enterprise contexts. We further argue that the nature and acuteness of trade-offs is contingent and that contextual factors may work through the mechanisms we highlight to affect the trade-offs that they produce. In particular, we draw attention to three broadly relevant factors that studies from outside of the social enterprise literature have suggested may affect an organization's social outreach and commercial operations. These include (1) the cultural roots of a given social issue, (2) the market environment that an enterprise operates within, and (3) the quality of its management. Indeed, research on discrimination has shown that there is a general pattern where social issues unduly affect the members of certain cultural groups (Tilly 1998). To the extent that this creates adverse intergroup relationships, enterprises that address such issues may run into frictions that make it more difficult to serve high-need beneficiaries. Trade-offs may be reduced, though, when market-supporting institutions (Mair et al. 2012) and professional management (Hwang and Powell 2009) help to offset the efficiency losses and increased risk that can accompany intensive outreach.

We develop and test our arguments in a study of global microfinance. Microfinance organizations (MFOs) are social enterprises that make loans to financially excluded people as a way to address poverty and generate revenue. We chose microfinance as our context for three reasons. First, MFOs are globally prevalent and operate in nations with varying levels of discrimination and market development. This allows us to test our arguments with the type of large-scale, quantitative analysis that scholars have called for, but it is not feasible with other types of social enterprise (Battilana et al. 2017). Second, most agree that an MFO's social outreach intensity is reflected in the poverty level of its clients, and the literature offers clear guidance on how this can be measured (Cull et al. 2007). Third, there have been mixed findings about the relationship between social outreach and fiscal sustainability in microfinance (Reichert 2018). As one of the world's most prominent forms of social enterprise, it is important to understand this relationship, how it varies across contexts, and how trade-offs can be reduced so that these organizations can sustain their operations and expand their outreach without abandoning high-need beneficiaries.

An analysis of 2,037 MFOs in 115 nations between 1995 and 2013 reveals a negative relationship between social outreach intensity and financial sustainability. As expected, trade-offs are accentuated in nations with high discrimination but ease, and even reverse, when an MFO is professionally managed or operates in a nation with strong market-supporting institutions. Our results thus suggest that the hybrid ideal is indeed a practical possibility for MFOs in some contexts but that the challenge of sustaining intensive social outreach becomes daunting in the harshest institutional environments. Our approach and findings have implications for research on social enterprise, organization theory, and microfinance.

Theory and Hypotheses

To date, social enterprise research has focused on understanding how tensions are resolved when an

organization's stakeholders disagree about the legitimacy of prioritizing social versus financial aims. While this work focuses on sociocognitive motives and processes, there is a general assumption that tensions arise because of trade-offs between the pursuit of social welfare and fiscal sustainability, such that allocating more attention and resources to one negatively affects the other (Battilana and Lee 2014, Smith and Tracey 2016). To this end, studies often cite examples of specific trade-offs as a way to motivate their focus on internal organizational tensions. While the precise nature of these trade-offs has not received much consideration, this work collectively suggests a number of mechanisms through which the intensity of an enterprise's social mission pursuit might affect its sustainability. We integrate these mechanisms to create a simple framework that can be used to predict the baseline relationship between social outreach intensity and fiscal sustainability in specific social enterprise contexts.

In many cases, there are direct costs associated with engaging in more intensive social outreach. This is particularly evident among social enterprises that produce and sell socially beneficial products. For instance, specialized equipment is required to generate ecologically beneficial energy, and the cost of technologies, such as wind turbines, correlates positively with their efficiency and effectiveness (Pacheco et al. 2014). Marquis and Park (2014) have also observed that some social enterprises choose to pay more for production inputs if it is socially beneficial to do so. For enterprises that follow a "one-for-one" model, costs are also greater when sales are tied to larger charitable donations (Marquis and Park 2014).

For other social enterprises, costs may increase when support or training programs are required to effectively serve high-need beneficiaries. For instance, MFOs address poverty by lending to financially excluded people, but poorer clients may not be able to manage or repay their loans unless the MFO helps them attain basic numeracy and literacy skills (Mair et al. 2012, Morduch 1999). Enterprises that employ marginalized people as a way to help them integrate into the workforce also tend to offer programs that teach job-search and life skills. However, the level of support that is required is greater when beneficiaries have addiction problems, are homeless, or suffer mental illness (Smith et al. 2013, Tracey et al. 2011). As Santos et al. (2015, p. 47) note, "The additional activities required to generate impact [in such situations] do not contribute to generating revenues, and thus have a negative impact on profits."

In addition, increased social outreach can hamper operational efficiency, effectively creating situations where greater resource inputs are required to achieve similar commercial outputs. For instance, high-need beneficiaries are often less reliable than traditional employees and need more time and support to execute tasks (Smith et al. 2013). As well as creating a direct productivity drag, the time spent with these beneficiaries may divert staff attention from pursuing other efficiency improvements (Battilana et al. 2015, Tracey et al. 2011). A commitment to creating value for such beneficiaries may also make an enterprise reticent to trim its workforce when competition increases or the economy slows down (Cooney 2012). When beneficiaries are customers, a focus on high-need individuals may also increase transaction costs. For instance, retailers that sell needed products and services to people at the "base of the pyramid" often extend credit to make their offerings accessible (Armendariz and Morduch 2010, Bratton 1986, Hammond and Prahalad 2004). It is time-consuming to assess the repayment risk posed by very poor clients, however, as they are less likely than wealthier people to have credit ratings or collateral.

In some instances, however, a social enterprise's costs may decrease when social mission pursuits motivate external parties to donate time, expertise, or other resources. For instance, Tracey et al. (2011) found that volunteers contributed valuable expertise that enabled Aspire, a British work integration social enterprise, to develop and implement a novel business model. Yet this support eroded as Aspire's social mission waned over time. An enterprise may also benefit when its social outreach attracts volunteer labor (Chell 2007, Mancino and Thomas 2005) or catalyzes outside support for its marketing efforts (Sine and Lee 2009, Weber et al. 2008). Operating costs may also be reduced through financial or in-kind donations, such as those that Goodwill stores in the United States and Bulky Bob's Furniture World in the United Kingdom rely on for their sales inventory (Battilana et al. 2015, Brennan and Ackers 2004).

In addition, high levels of social outreach may have legitimacy and marketing benefits that contribute to an enterprise's revenue generation efforts (Moizer and Tracey 2010). Indeed, studies have shown that demand exists for socially beneficial products, such as wind energy and green building (Pacheco et al. 2014), as well as for products offered by firms that follow variants of a one-for-one model, such as TOMS shoes, which donates a pair of shoes for each one sold, and the Aravind Eye Clinic, where clients pay more for eye surgeries as a way to subsidize ocular care for the poor (Mair and Martí 2006). Smith et al. (2013, p. 425) have also argued that focusing on high-need beneficiaries can help work integration social enterprises "by serving as a marketing tool with clients in a particularly competitive industry."

Still, there are a number of ways in which intensive social outreach might undermine revenue generation. There are often concerns that offerings produced by high-need beneficiaries are of lower quality than those produced by more typical employees. For instance,

Bell (2011) found that Every Language, a social enterprise where marginalized immigrants provide translation services, had sales difficulties because clients were skeptical that work was up to "business standards." Smith et al. (2013) similarly reported that the limited technical skills of high-need beneficiaries, such as girls rescued from sex trafficking, resulted in lower-quality work and unhappy clients at Digital Divide Data, a social enterprise in Cambodia that uses marginalized people to provide remote information technology services.

Additional challenges may arise when an organization's customers are also its beneficiaries. In such cases, those with the greatest need also tend to be those with the least ability to pay. Serving such beneficiaries often means that a social enterprise must offer very low-priced products and services (Mair and Martí 2006, Santos et al. 2015), potentially affecting profit margins and sales volumes. An absence of reliable information can also make it risky for an organization to extend the credit that is often required to make offerings accessible to high-need beneficiaries. In turn, repayment delays and defaults negatively affect an organization's revenues. Studies have suggested that this applies to microfinance organizations (Cull et al. 2007, Yaron 1994) and other such enterprises that offer products and services to the poor (Bratton 1986, Hammond and Prahalad 2004).

As shown in Table 1, the above mechanisms can be integrated into a simple and comprehensive, if not exhaustive, framework that suggests a number of mechanisms through which outreach intensity may affect financial sustainability. While not all mechanisms are equally relevant to all enterprises (and some may not apply at all), the framework is useful for thinking through the likely social–financial trade-offs faced by specific types of social enterprises. In turn, this can be used to predict the relationship between the intensity

Table 1. Potential Mechanisms That Link Social Outreach Intensity and Financial Sustainability

Operating revenues		Operating costs	
Mechanisms	Examples in the literature	Mechanisms	Examples in the literature
		Trade-offs	
Quality concerns Customers may be concerned about the quality of products or services produced using the labor of higher-need beneficiaries	WISEs[a] (Bell 2011, Pache and Santos 2013, Smith et al. 2007, Tracey et al. 2011)	Direct costs of outreach Costs incurred through donations linked to sales or specialized equipment purchases	One-for-one donation models (Marquis and Park 2014) Socially beneficial product sales (Wilson and Post 2013)
Ability to pay Poorer customers/beneficiaries have limited financial means; may affect margins and revenues	MFOs[b] (Battilana and Dorado 2010, Hermes et al. 2011, Mersland and Strøm 2009) BOP enterprises[c] (Mair and Martí 2006, Santos et al. 2015)	Beneficiary training/support Higher-need beneficiaries may require additional support and/or training to reach desired outcomes	WISEs (Battilana et al. 2015, Santos et al. 2015, Smith et al. 2013, Tracey et al. 2011) MFOs (Battilana and Dorado 2010)
Repayment risk Poorer customers/beneficiaries more likely lack credit information; they may also lack skills to manage and repay debt	MFOs (Battilana and Dorado 2010, Cull et al. 2007, Karlan and Valdivia 2011) BOP enterprises (Anderson and Billou 2007, Bratton 1986, Hammond and Prahalad 2004)	Operating efficiency Higher-need employees/beneficiaries may not be as productive as others Transaction costs may be higher when dealing with poorer customers/beneficiaries	WISEs (Battilana et al. 2015, Santos et al. 2015, Smith et al. 2013, Tracey et al. 2011) MFOs (Hermes et al. 2011, Mair et al. 2012, Zeller and Meyer 2002, Zhao and Wry 2016)
		Symbiosis	
Marketing/legitimacy benefits Greater social outreach intensity may increase the appeal of an enterprise's offerings to nonbeneficiary customers	WISEs (Besharov and Smith 2014, Smith et al. 2013) One-for-one donation models (Mair and Martí 2006, Marquis and Park 2014) Socially beneficial product sales (Cobb et al. 2016, Pacheco et al. 2014, Wilson and Post 2013)	Reduced resource costs Greater social outreach intensity may help an enterprise to attract volunteer labor as well as resource donations or subsidies	WISEs (Battilana et al. 2015, Brennan and Ackers 2004, Tracey et al. 2011) Socially beneficial product sales (Chell 2007, Mancino and Thomas 2005)

[a]Work integration social enterprises. [b]Microfinance organizations. [c]Enterprises that focus on serving "bottom-of-the-pyramid" customers.

of an enterprise's social mission pursuit and its financial sustainability.

Social Outreach Intensity and Financial Sustainability in Microfinance

We apply our framework to predict the baseline relationship between the social outreach intensity and financial sustainability of microfinance organizations (Battilana and Dorado 2010, Mair et al. 2012, Zhao and Wry 2016). MFOs operate on the premise that making loans to financially excluded people is an effective and potentially profitable anti-poverty intervention. These organizations raise capital from commercial lenders, governments, and charities, and they use this to finance loans to people who lack access to the formal banking system (Cobb et al. 2016). Borrowers benefit by using funds to absorb financial shocks, start and grow small businesses, finance household purchases, and otherwise avoid exploitative local lenders. In turn, loans are repaid with interest, and this allows an MFO to repay its own funders and generate revenue to support its ongoing operations. Each loan is approved and monitored by a loan officer who serves as the point of contact between the borrower and the MFO (Canales and Greenberg 2016).

It is widely agreed among both scholars and practitioners that the intensity of an MFO's social outreach is reflected in the poverty level of its clients: the very poor have a strong need for microfinance and arguably derive the most benefit from financial inclusion (Cull et al. 2007). Indeed, while the overall effects of microfinance are debated (Karlan and Zinman 2010), economists have argued that poverty reduction benefits should be much greater when an MFO focuses on the very poor (e.g., Morduch 2000). Ideally, an MFO will also generate revenues that are sufficient to sustain and grow its operations, but there is mixed evidence about the feasibility of achieving this while focusing on high-need beneficiaries. While most agree that shifting away from very poor clients reflects mission drift (i.e., a reduced social mission focus), studies have variously found that doing so bolsters financial sustainability (Hermes et al. 2011), has no effect (Cull et al. 2007), or leads to negative financial outcomes (Husain and Pistelli 2016).

Despite these mixed findings, applying our framework to microfinance leads us to predict an overall negative relationship between social outreach intensity and financial sustainability. Per Table 1, MFOs that focus on poorer borrowers may face trade-offs related to ability to pay, repayment risk, beneficiary support programs, and operating efficiency. We delve into each mechanism and argue that repayment risk and operating efficiency are particularly germane to understanding social–financial trade-offs in microfinance. We also note that MFOs are unlikely to benefit from the types of social–financial symbiosis discussed in our framework. As such, we expect that a well-specified analysis will reveal that increased social outreach leads to lower financial sustainability and that this relationship is mediated by repayment risk and operating efficiency.

With regard to "ability to pay," studies suggest a relatively straightforward relationship whereby the amount that a person can afford to borrow is inversely related to his or her poverty level. The corollary is that an MFO's average loan size is thought to reflect its social outreach intensity (Cull et al. 2007). This may have pecuniary implications, as the cost to make and monitor a loan is similar regardless of the amount being borrowed, but there is less per-loan revenue when lending small sums. As such, some have argued that an MFO's revenue will decrease as an inverse function of its poverty focus (Conning 1999). Others have disputed this conclusion, however, noting that differences in yield can be offset through higher interest rates and longer repayment windows (Armendariz and Morduch 2010).

In comparison, there is more evidence to suggest that an MFO's poverty focus will create fiscal trade-offs through its effects on operating efficiency and repayment risk. The very poor often lack the numeracy and literacy skills required to manage and repay loans, and this makes them riskier borrowers (Yaron 1994). In some cases, this can be addressed through beneficiary training and support programs, but these are costly to operate and are thought to be financially neutral at best (Karlan and Valdivia 2011). Of greater concern is that a lack of credit history means that MFOs must assess borrower creditworthiness without the benefit of systematic, objective risk indicators. To deal with this, MFOs often rely on coarse proxies that must be gathered for each client, usually with significant time and effort. For instance, in a study of Latin American MFOs, Doering (2017) found that loan officers followed a laborious process of going door to door, interviewing neighbors, and speaking with very poor applicants many times before issuing a loan (see also Graham and Tevosyan 2015). As a result, MFOs that focus on the very poor may face higher transaction costs and have reduced operating efficiency. To the extent that loan assessments rely on subjective indicators and evaluations, serving very poor clients may also lead to increased lending risk (de Quidt et al. 2016). MFOs that target less poor clients may be able to offset such risks through collateral requirements, but the very poor rarely have suitable assets to pledge (Yunus 1999).

At the same time, there is little to suggest that MFOs benefit from the types of social–financial symbiosis detailed in Table 1. In terms of resources, a very small share of worldwide microfinance funding is

from donations or subsidized finance, and most external funders pay little heed to an MFO's poverty focus (Cobb et al. 2016). Furthermore, while there is evidence of volunteerism in microfinance, the available evidence suggests that this mostly takes place within credit unions (Labie and Périlleux 2008) and in immature national microfinance markets (Botti and Corsi 2011) rather than reflecting an MFO's social mission pursuit. Indeed, MFOs with a greater commitment to poverty reduction often have more difficulty attracting high-quality, professional board members (Labie 2001, Mersland 2009). MFOs are also unlikely to enjoy marketing or legitimacy benefits based on their poverty focus. Unlike customers that support work integration social enterprises (Smith et al. 2013) or firms that follow a one-for-one model (Marquis and Park 2014), microfinance borrowers are themselves poor and thus unlikely to favor particular MFOs based on their social mission pursuit. In comparison, wealthier clients generally require different and more expansive financial services and thus rely on traditional banks rather than MFOs.

Our collected arguments thus suggest that the overall relationship between the intensity of an MFO's social outreach and its financial sustainability is negative, and that this is largely due to reduced operating efficiency and increased lending risk. As such, we predict the following.

Hypothesis 1. *MFO social outreach intensity—as reflected in a focus on serving borrowers who are more acutely poor—is negatively associated with financial sustainability.*

Hypothesis 2. *The relationship between MFO social outreach intensity and financial sustainability is mediated through* (a) *lending risk and* (b) *operating efficiency.*

Cultural Barriers to Intensive Social Outreach

Although we predict that social outreach intensity is, on average, negatively related to MFO financial sustainability, we expect that the acuteness of this trade-off will vary across organizations and contexts. To this end, we draw attention to factors that may work through the mediating mechanism we have identified—specifically, lending risk and operating efficiency—to shape the relationship between social outreach intensity and financial sustainability in microfinance.

One factor that may affect the acuteness of social–financial trade-offs is the extent to which focusing on high-need beneficiaries makes it more likely that an enterprise will face cultural barriers as it pursues its social mission (Tracey and Phillips 2016, Zhao and Wry 2016). In most nations, societal ills unduly affect the members of specific cultural groups, such as ethnic, linguistic, and religious minorities (Tilly 1998). As Ridgeway (2001, p. 257) explains, "[Societal] beliefs affirm the significance of a given categorical distinction for social relations . . . and justify an inequality in outcomes between the categories." The result is that certain groups tend to be marginalized in ways that make their members prone to issues such as addiction, unemployment, homelessness, and poverty (Kabeer 2005, Tilly 1998). To the extent that a social enterprise's staff are more likely to hail from the majority group—an issue that we discuss directly in the microfinance context—addressing such problems may require an enterprise to cross cultural boundaries that make social outreach more difficult. With this caveat in mind, we expect that cultural barriers to outreach will be more salient when (1) an enterprise's target beneficiaries are overrepresented within particular groups, and (2) there are antagonisms between these groups and the socially dominant group that make communication, trust, and general interaction difficult.

To this end, we argue that it is useful to consider the level of discrimination in a society—that is, a general pattern in which particular categories of people are subject to prejudicial and unjust treatment (Tilly 1998, Ridgeway 2001). While certain groups are marginalized in most nations, discrimination correlates with the level of disadvantage that members experience in areas such as education, health, politics, employment, and financial inclusion (Battilana and Dorado 2010, Kabeer 2005). This pattern has been found in single-country studies that focus on nations as diverse as China (Gustafsson and Shi 2003), India (Nayak 1994), and the United States (Brubaker 2009), as well as in cross-national comparisons. For instance, Hossein (2014) showed that the level of discrimination faced by African populations in Guyana, Jamaica, and Trinidad was mirrored in the extent of their social and economic disadvantage. This applies to microfinance because, as Kabeer (2005, p. 2) notes, "The durable nature of this form of disadvantage means that members of marginal groups . . . are likely to be disproportionately represented among the poor, as well as among the chronic poor." Thus, while focusing on the very poor should increase the likelihood that most MFOs will need to interact with marginal-group members, this pattern should be particularly evident in nations where there are high levels of intergroup discrimination.

In turn, the link between discrimination and poverty may create barriers to intensive social outreach to the extent that an MFO's borrowers and loan officers hail from different cultural groups. Evidence suggests that this is frequently the case. Some MFOs make efforts to hire loan officers from the same communities where they operate or from groups that they focus on serving (Graham and Tevosyan 2015). However, to serve in this position, an individual must generally have strong numeracy and literacy skills, and many positions require a college degree (Iskenderian 2011). Based

on education differences, it is more likely that the members of dominant social groups will have such credentials and skills, and this pattern should be particularly evident in societies with high discrimination (Kabeer 2005). Thus, in many cases, it is difficult to find people from disadvantaged groups who are qualified to serve as loan officers, and this results in cultural differences between loan officers and the very poor borrowers they serve. Illustrating this in a study of MFOs in 21 European nations, Botti and Corsi (2011) found that marginal groups accounted for over 30% of all loans but only 13% of loan officers. Studies of MFOs in Latin America (Magro 2013), India (Vij and Nair 2009), and Southeast Asia (IFC Advisory Services/Access to Finance 2009) have also suggested that loan officers and clients tend to be from different cultural groups.

In addition to the standard challenges of communication and coordination among members of different cultural groups, it is noteworthy that discrimination affects the quality of intergroup relations. To wit, discrimination correlates positively with distrust, generalized antagonisms, and an aversion to interacting with members of other groups (Alesina et al. 1999, Fearon 2003). In aggregate, this makes it more difficult for people from different groups to accurately interpret intentions and trustworthiness (Baldwin and Huber 2010). It may also lead to opportunism, misunderstandings, and a tendency to interpret benign acts as confirmation of preexisting stereotypes (Miguel and Gugerty 2005). In addition, studies have found a general reluctance among the members of socially dominant groups to support initiatives that help marginalized groups while marginalized-group members tend to be skeptical of such help when offered (Fearon 2003). As such, when an enterprise serves beneficiaries that hail from groups that are discriminated against, it may encounter frictions related to building trust, rapport, and reliability.

We expect that these barriers are germane to microfinance and may lead to sharper trade-offs between social outreach intensity and fiscal sustainability by affecting an MFO's operating efficiency and repayment risk. With regard to efficiency, a lack of trust and aversion to intergroup contact will likely make it more difficult for an MFO to identify potential borrowers and increase the time required to foster client relationships (Doering 2017). This may be amplified when anticipated or actual discrimination makes borrowers reluctant to take on loans. Speaking to the challenges that such cross-group interactions can create, Magro (2013) reported that, in talking with Nicaraguan loan officers, "it was interesting to hear [them] explain the challenges of the process . . . [when encouraged] to elaborate, many stressed the different social/cultural challenges of client recruitment." Others have also remarked on the challenges that loan officers face in understanding the culture and traditions of clients that hail from different groups and the frictions that this creates in the lending process (Graham and Tevosyan 2015, Hossein 2014).

Efficient lending also requires timely assessments of creditworthiness and clear communication about loan terms (Hermes et al. 2011). The challenge posed by these assessments and interactions may be greater, however, when intergroup communication is difficult and one or both parties are predisposed to distrust the other. Reflecting this, past studies have suggested that overt or implicit biases may cause loan officers to subject minority clients to extra scrutiny (Hossein 2014, Labie et al. 2015). Cultural barriers can also make it difficult to explain loan terms and arrive at a clear understanding of the exchange relationship (Rugh and Massey 2010). The net effect is that more time and effort are likely needed to make and monitor loans. This is consistent with the general finding that transaction costs are higher in situations with uncertainty about motives and when parties do not trust each other (Fearon 2003).

With regard to repayment risk, studies have shown that discrimination and intergroup contact make it more difficult to monitor and enforce contracts (Lassen 2007). In microfinance, this might manifest as disputes between loan officers and clients, with a lack of trust heightening the likelihood of adversarial responses as opposed to empathy and adjustment (Karim 2011). In turn, this may contribute to higher default rates and a decreased propensity for borrowers to continue their relationship with an MFO upon loan repayment. Defaults may also be higher to the extent that discrimination contributes to weaker reciprocity norms (Fearon 2003). Supporting this, Karlan (2007) found that ethnic heterogeneity led to lower loan repayment rates among Peruvian MFOs. An MFO may also need to offer extra staff training or reduce the number of clients that each loan officer handles in order to address such issues, both of which are likely to result in lower efficiency. As such, we predict the following.

Hypothesis 3. *The negative relationship between MFO social outreach intensity and financial sustainability is amplified in contexts characterized by high levels of intergroup discrimination.*

The Influence of Market-Supporting Institutions

A social enterprise's ability to engage in sustainable social outreach may also be affected by the level of development in a nation's market infrastructure. Scholars from across the social sciences agree that markets rest upon bundles of institutions that comprise the "rules of the game" for economic activity in a society

(Mair et al. 2012, North 1990). While no single configuration guarantees market efficiency, key foundations include property rights, the rule of law, and regulatory regimes (Meyer et al. 2009). When these institutions are well designed and implemented, they work to reduce information asymmetries, ease corruption, formalize exchange, and stabilize local currencies, which, in turn, contributes to a business environment characterized by predictable and efficient exchanges, stable inflation, and low transaction costs (Meyer et al. 2009, North 1990). As we elaborate below, these benefits may help to offset the efficiency declines and increased repayment risks that an MFO faces when it engages in more intensive outreach efforts, potentially blunting the social–financial trade-offs that it faces.

Organizational scholars have linked the quality of market-supporting institutions to the cost and viability of different business strategies. Meyer et al. (2009) showed that entry modes are variously effective based on the institutional context where they are applied. Meyer et al. (2011) similarly found that information costs are higher and extra due diligence is required to assess business relationships in nations with weak market-supporting institutions. In such situations, firms are unable to use contracts to guarantee exchange relationships and instead must rely on informal mechanisms that are costly and time-consuming to implement and often difficult to enforce (Webb et al. 2010). Corruption and inflation are also sources of uncertainty for organizations that need to be addressed when developing strategies and making asset-allocation decisions (Cobb et al. 2016). While most of this work has focused on traditional, profit-seeking firms, recent studies have extended consideration to social enterprises based on the insight that many operate in varied institutional contexts. For instance, Mair et al. (2012) found that institutional voids in Bangladesh required BRAC (a poverty-relief NGO) to engage in market-building efforts concurrent with its revenue-generating activities. Ault (2016) also showed that poorly developed markets may contribute to mission drift, where an MFO reduces social outreach to bolster its bottom line.

We expect that the level of development in a nation's market-supporting institutions also affects the relationship between MFO social outreach intensity and fiscal sustainability. As noted, lending to high-need clients may negatively impact operating efficiency because of the time it takes to assess lending risks for clients who lack credit history or collateral. This may be allayed when institutions reduce information asymmetries, formalize exchange relationships, and increase the likelihood of loan collateral. Supporting this, there is evidence that nations with strong financial regulations are more likely to track microfinance data in their credit bureaus, thus making credit information more common for the very poor (Economist Intelligence Unit 2013). On one hand, this may make the differences between clients with varying poverty levels more stark, allowing an MFO to identify the most financially attractive clients. Yet this is unlikely to affect the relationship between social outreach intensity and fiscal sustainability. Rather, we expect that such information should ease the burden of serving the very poor because applications can be quickly assessed, and well-informed decisions can be made without resorting to the intensive processes normally required to lend to such people (Doering 2017). Further efficiencies should be gained to the extent that property rights make it more likely for poorer borrowers to possess collateral (Di Gregorio et al. 2008). Strong rule of law may also reduce the risk of lending to clients that do not have credit histories or collateral, as contracts can be used to govern the exchange relationship (Morduch 1999).

Strong market-supporting institutions may also contribute to macroeconomic stability that decreases an MFO's lending risk. Currency volatility and inflation create uncertainty, and an MFO may try to limit its exposure by charging more interest and/or requiring faster repayment (Cobb et al. 2016). This disproportionately affects the feasibility of small loans because poorer borrowers have limited ability to pay, and higher prices or tighter repayment windows effectively price them out of the market (Yaron 1994). In addition, market institutions likely support the economic activity of borrowers in ways that make defaults less likely. To wit, the very poor have limited financial means and thus lack the capacity to deal with currency devaluations and high inflation: even small fluctuations have consequences for their ability to meet financial obligations (Armendariz and Morduch 2010). In comparison, economic stability should contribute to the success prospects of microfinance-backed small businesses and decrease the likelihood that individual borrowers will face financial shocks that they are unable to absorb. Both factors should help to reduce an MFO's lending risk (Adger 2006). As such, we predict the following.

Hypothesis 4. *The negative relationship between MFO social outreach intensity and financial sustainability is mitigated when a country has stronger market-supporting institutions.*

The Influence of Professional Management

In addition to external forces, social enterprises themselves may be able to take steps that shift the relationship between their social outreach intensity and financial sustainability. Just as well-developed market institutions help to reduce costs and uncertainty by supporting formalization and transparency (Mair

et al. 2012, Meyer et al. 2009), professional management may contribute to similar efficiencies within an organization. Our argument here differs from studies that have suggested that business-minded managers pressure a social enterprise to prioritize financial interests and often spar with stakeholders who value social outreach (Battilana and Dorado 2010, Wry and York 2017). We agree that this is possible but focus instead on how rationalization and formalization may help an enterprise to offset the efficiency losses and repayment risk that come with serving high-need beneficiaries. In this way, our argument focuses on practices that may be effective for attenuating social–financial trade-offs, regardless of their utility for addressing intergroup tensions (Battilana et al. 2015).

Our argument builds on studies of professionalization in public sector organizations. This work has shown that professional managers seek to make practices measurable and transparent so as to codify knowledge and foster consistent, reliable action (Hwang and Powell 2009). Professionals also link an organization to the external environment by participating in conferences and associations that disseminate information on best practices in a given sector (Scott 2013). While formalization and rationalization may create tension within an enterprise, they are also associated with financial sustainability as they support the implementation of practices and the development of competencies designed to improve the efficiency of social mission pursuits (Hwang and Powell 2009). Applied to social enterprise, this logic aligns with Smith and Besharov's (2017) finding that professional managers helped Digital Divide Data develop processes that were relevant for integrating social and fiscal aims, rather than elevating one over the other.

In microfinance, professionalization is supported by transnational organizations such as the Gates Foundation, Microcredit Summit Campaign, and World Bank, as well as by funders such as development banks (Cobb et al. 2016). These organizations encourage MFOs to hire managers who will implement practices such as formal lending policies, technical training for loan officers, and performance evaluations, all of which help loan officers to quickly and efficiently evaluate loans by applying codified knowledge and standardized assessment tools (Armendariz and Morduch 2010). In some cases, professionalization may also entail strategies for managing relationships with different cultural groups (Epstein and Yuthas 2010).

Stronger professional management practices should improve operational efficiency and reduce lending risk for all MFOs. Yet, as with market development, we expect that benefits will be most apparent for organizations that focus on serving very poor, high-need beneficiaries. We acknowledge that formal lending policies might make some MFOs reluctant to serve clients who do not look good on paper. Yet these policies are likely useful when lending to the very poor because loans can be assessed with standardized tools rather than subjective proxies. This should help an MFO to attenuate the risk that comes with lending to such clients and contribute to higher repayment rates. Formal procedures may also contribute to efficiency gains when making loans to clients who lack credit histories and collateral as these procedures are likely to be more effective and faster to deploy than subjective vetting processes. In addition, standardization may foster consistency in how loan officers interact with clients, which Canales and Greenberg (2016) have shown leads to better relationships and reduces the likelihood of loan default: this is particularly important for borrowers who lack collateral to secure their loans. As such, we predict the following.

Hypothesis 5. *The negative relationship between MFO social outreach intensity and financial sustainability is mitigated when the MFO has stronger professional management practices.*

Data and Methods

We tested our hypotheses using data collected from the Microfinance Information Exchange (MIX), a nonprofit initiative founded by the World Bank to gather comprehensive and reliable data on the global microfinance industry. The MIX operates units in Latin America, Eastern Europe, the Middle East, sub-Saharan Africa, South Asia, and East Asia. Each unit creates a list of MFOs in its region by consulting with national microfinance associations and regional microfinance experts. The MIX then reaches out to each MFO to request data on a wide range of indicators and supplements this, when possible, with audit documents and regulator data. Reporting is voluntary, but the MIX estimates that its data cover MFOs that account for roughly 85% of all microfinance lending (see http://www.themix.org/about-mix/FAQ, accessed April 2017). These are the most comprehensive data that are currently available and have been used in many previous studies (e.g., Ault and Spicer 2014; Cobb et al. 2016; Cull et al. 2007, 2009). We merged MFO-level data from the MIX with country-level data on discrimination and market-supporting institutions to compile our final data set. Data are organized by MFO-year and include 2,037 MFOs in 115 nations between 1995 and 2013.

Variables

Dependent Variable

Our dependent variable is MFO *operational self-sufficiency* (OSS), calculated as operating revenue divided by the sum of financial expense, loan loss provision expense, and operating expenses. The variable excludes income not derived from an MFO's core

business (e.g., external funding and donations) and is widely used by both scholars and practitioners to reflect MFO financial sustainability (Armendariz and Morduch 2010). We log-transformed the variable to adjust for positive skewedness.

Independent Variables

The key predictors in our analysis are MFO social outreach intensity, discrimination in a country, the quality of a nation's market-supporting institutions, and MFO professional management. We measure social outreach intensity as an MFO's *poverty focus* (i.e., the degree to which it focuses on serving clients who are more acutely poor). Per the convention in the microfinance literature, our variable is an MFO's average loan size (ALS, logged). The measure is widely used to proxy the poverty of an MFO's clients based on the logic that the amount a person can afford to borrow varies with his or her wealth: ergo, smaller ALS reflects a focus on poorer borrowers. Our measure adjusts for inflation, is comparable across MFOs and nations, and is reverse coded so that higher values reflect greater social outreach intensity.

While most agree that ALS is a noisy proxy for borrower poverty, there is evidence to support its validity. For example, the variable correlates with self-reported (Cull et al. 2009) and objective measures (Crowther 2010) of household poverty. Others have noted that nonprofit MFOs have a stronger poverty focus than for-profit MFOs and that this is reflected in consistently lower ALS scores (Lützenkirchen et al. 2012). There is also evidence that MFOs themselves view ALS as an indicator of their poverty focus and actively communicate this to external audiences (D'Espallier et al. 2016). Still, sensitive to the measure's limitations, the MIX has begun to gather more proximate indicators, such as an MFO's self-reported "poverty focus" and "percentage of clients below the poverty line." However, data are currently only available for a very small portion of MFOs and are thus too sparse to be useful for our analysis.

Temporal variance in ALS at the MFO level may come from a variety of sources. For instance, there are indications that social outreach intensity reflects the priorities of an MFO's top management (Zhao and Wry 2016) and may thus change as organizational leaders come and go. An MFO may also lend progressively larger sums to the same clients, resulting in higher ALS scores over time if efforts are not made to recruit new clients with higher poverty levels (Armendariz and Morduch 2010). Another, more agentic, reason for ALS growth is that an MFO may decide to sacrifice its social goals for financial ones and adopt a strategy of lending to less-poor clients (Morduch 2000). However, other MFOs may reduce their ALS as a way to curry favor with subsidy providers (D'Espallier et al. 2011), and there is evidence that some MFOs redouble their social mission focus in response to public criticism associated with events such as the borrower suicides in Andhra Pradesh, India (Shylendra 2006). Reflecting these varied causes, about 54% of the observations in our data reflect MFOs increasing their ALS (decreasing poverty focus) and 29% reducing their ALS (increasing poverty focus). The magnitude of changes was similar in both directions (mean increase in poverty focus = 0.21, mean decrease in poverty focus = 0.22).

Our *discrimination* measure is based on the most recent update of the World Values Survey. For each nation, we constructed a variable based on responses to questions about whether or not a respondent would welcome the following as their neighbor: (1) people of a different race, (2) immigrants/foreign workers, (3) people of a different religion, and (4) people who speak a different language. We calculated the portion of respondents in a nation who did not want to have members of each group as their neighbors and performed exploratory factor analysis using the standardized transformation of each variable. Results suggested that the items loaded on a single factor. From this, we ran confirmatory factor analysis with maximum likelihood estimation procedures to calculate an overall discrimination score for each nation: higher values reflect stronger discrimination based on race, country of origin, religion, and language.

Following previous studies, we measure the strength of *market institutions* using the Heritage Foundation's Economic Freedom Index (e.g., Meyer et al. 2009). The index comprises data from the Economist Intelligence Unit, International Monetary Fund, and World Bank, and it scores nations on 10 market efficiency factors: property rights, corruption, government spending, fiscal freedom, business freedom, labor freedom, monetary freedom, trade freedom, investment freedom, and financial freedom. Nations are graded from 0 to 100 on each factor, and the scores are averaged to create a composite index (rescaled to 0–1). Higher scores reflect strong property rights, an effective legal system, low corruption, a favorable investment climate, and efficient regulations (Dobson and Hufbauer 2001).

We also gathered information on institutions that are specific to the microfinance sector. The variable we use, *microfinance institutions*, was created by the Economist Intelligence Unit to assess a nation's microfinance business environment. The measure reflects the quality of regulatory frameworks and practices as well as sector-specific institutions that support client protection, dispute resolution, and competition. Nations are scored on a 0–100 scale (rescaled to 0–1): higher values reflect a stronger institutional environment for microfinance operation.

Our *professional management* variable is the index developed by Cobb et al. (2016), which combines MIX

data about the quality of an MFO's financial reporting with data on its regulatory status (i.e., whether or not an MFO is regulated by a state banking authority): both measures are thought to reflect MFO management quality (Armendariz and Morduch 2010). As a check, Cobb et al. (2016) created a management quality index by surveying the same MFOs that we analyze in this paper and reported that the measure did not affect results found using the variable derived from the MIX data.[1]

Mediating Mechanisms

We test the mediating mechanisms theorized in items (a) and (b) of Hypothesis 2 by using measures of *lending risk* and *operating efficiency* suggested in the Consultative Group to Assist the Poor's consensus guidelines on microfinance financial terms (Christen et al. 2003). Lending risk is the value of loans over 30 days past due, divided by the value of an MFO's loan portfolio. The measure is more reliable than "default rate," which can be manipulated by an MFO to portray a higher quality loan portfolio. Operating efficiency is an MFO's operating cost divided by its gross loan portfolio (logged and reverse-coded).

Control Variables

All models include MFO- and country-level controls. For each nation, we control for the gross domestic product, *GDP per capita* (in thousands), as national wealth may affect demand for microfinance and thus MFO sustainability. GDP also correlates highly with rural population (0.73) and thus helps to account for extra costs that MFOs may face in serving the rural poor. Other funding that targets poverty reduction, such as Official Development Assistance (ODA), may also be relevant to microfinance. We control for this with a variable for *ODA received* (percentage of gross national income). We also control for *democracy* and *political instability* as both may affect MFO sustainability. Democracy scores are from the Polity IV Project's Political Regime Characteristics and Transitions database and range from −10 (least democratic) to 10 (most democratic). Political instability is an additive index calculated as the average magnitude of wars, adverse regime changes, and genocides based on the State Failure Problem data set. We also control for a nation's *communication infrastructure* as this may reflect the use of technologies, such as mobile banking, that can affect MFO efficiency. Our variable is mobile phone subscriptions per capita as reported by the World Bank (logged). MFO sustainability may also be affected by competition in the microfinance sector: we control for this with a variable for the *number of MFOs* per nation-year. We also gathered data on economic inequality within a nation as reflected in its Gini coefficient. We do not include this variable in our main analysis, as missing data greatly reduce our sample size, but adding it to the model does not affect our results.

We include several MFO-level controls. *MFO age* is the focal year minus an MFO's founding year. *MFO size* is number of employees (logged). We also gathered MIX data on an MFO's self-reported lending focus: our variable, *broad portfolio*, is a dummy that indicates whether an MFO serves clients across the poverty spectrum. This helps to control for the possibility that higher ALS might reflect a strategy by which revenue from larger loans is used to offset smaller loans to poorer clients rather than lower poverty focus. We also coded an MFO's *nonprofit* status. This is absorbed by MFO-fixed effects in our main analysis, but we use it in supplementary models to compare nonprofit versus for-profit MFOs. We also gathered data on an MFO's *lending method* (i.e., group versus individual lending) and whether or not it offers support programs to its beneficiaries. Data on both variables are too sparse to support meaningful analysis. Still, we use the available lending methods data in supplementary models that compare MFO subsamples.

Estimation Strategy

Our main models use generalized least squares (GLS) regression and analyze operational self-sufficiency per MFO-year. All models include MFO-level fixed effects, as this allows us to control for unobserved heterogeneity across MFOs and isolate changes in our dependent variables for individual organizations over time. A Hausman test also favored fixed effects over random effects ($\chi^2 = 17{,}720$, $p < 0.001$). We use *year* dummies in all models to address unobserved temporal effects. As reported in our supplementary analyses section, we complement these models with a matching approach that pairs and compares MFOs with a poverty focus above versus below the population median.

Results

Table 2 provides descriptive statistics and correlations for all variables. Variance inflation factor (VIF) analysis shows that there are no multicollinearity concerns (mean VIF = 2.01, maximum VIF = 3.39).

Table 3 shows the results of models in which we estimated the relationship between MFO social outreach intensity and financial sustainability as well as its various contingencies. Model 1 is the baseline with only controls included. We see that MFOs are more sustainable in nations with stronger democracy and when there are more MFOs in a nation. Model 2 adds key independent variables. Per Hypothesis 1, we find that focusing on poorer clients has a significant, negative effect on financial sustainability: on average, a standard deviation increase in poverty focus leads to

Table 2. Summary Statistics of Key Variables

	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1 *GDP per capita*	2.217	2.110	1.000																				
2 *ODA received*	2.510	4.345	−0.380	1.000																			
3 *Democracy*	4.691	5.246	0.250	−0.390	1.000																		
4 *Political instability*	1.088	1.590	−0.030	−0.280	0.370	1.000																	
5 *Communication infrastructure*	3.464	1.255	0.440	−0.430	0.150	−0.040	1.000																
6 *Number of active MFOs*	40.308	31.241	−0.060	−0.370	0.440	0.650	0.150	1.000															
7 *MFO age*	13.393	10.617	−0.010	−0.210	0.140	−0.040	0.120	0.090	1.000														
8 *MFO size*	4.494	1.610	−0.060	−0.100	0.080	0.180	0.040	0.180	0.220	1.000													
9 *Broad portfolio*	0.351	0.477	0.010	0.080	−0.020	−0.240	0.140	−0.190	0.080	−0.050	1.000												
10 *Nonprofit*	0.617	0.486	−0.100	−0.110	−0.110	−0.180	0.020	−0.090	0.140	−0.170	−0.110	1.000											
11 *Operating efficiency*	−0.236	0.208	−0.230	−0.070	−0.080	0.040	0.010	0.150	0.180	0.140	0.200	0.060	1.000										
12 *Lending risk*	0.062	0.109	0.000	−0.010	0.060	−0.010	0.040	0.010	0.030	−0.050	0.020	−0.070	−0.050	1.000									
13 *Poverty focus*	9.245	1.364	−0.380	0.050	0.000	0.300	−0.420	0.200	−0.070	0.080	−0.550	0.150	−0.210	0.000	1.000								
14 *Discrimination*	0.744	0.399	−0.510	0.010	−0.010	0.230	−0.320	0.410	0.050	0.180	−0.180	0.040	0.210	−0.030	0.410	1.000							
15 *Market institutions*	0.570	0.063	0.490	−0.070	0.250	−0.020	0.300	−0.150	−0.010	−0.010	0.100	−0.170	−0.170	0.040	−0.280	−0.560	1.000						
16 *Microfinance institutions*	0.503	0.133	−0.010	−0.160	0.580	0.320	0.000	0.380	0.140	0.040	0.090	−0.050	−0.010	0.010	−0.020	−0.160	0.290	1.000					
17 *Professional management*	0.009	0.099	−0.140	0.040	−0.050	−0.020	−0.010	0.040	0.130	0.490	0.130	−0.230	0.380	−0.070	−0.100	0.150	−0.080	−0.010	1.000				
18 *Poverty focus* × *Discrimination*	0.221	0.529	−0.150	−0.130	0.180	0.140	−0.170	0.280	0.100	0.210	−0.060	0.080	0.230	−0.010	0.130	0.420	−0.210	−0.020	0.110	1.000			
19 *Poverty focus* × *Market institutions*	−0.023	0.083	0.130	0.020	−0.060	−0.050	0.140	−0.020	−0.050	−0.150	0.020	0.040	−0.170	−0.030	−0.050	−0.180	−0.130	0.030	−0.120	−0.510	1.000		
20 *Poverty focus* × *Microfinance institutions*	−0.001	0.180	−0.020	−0.100	0.170	0.340	−0.010	0.200	−0.090	−0.040	−0.140	−0.040	−0.130	0.000	0.110	0.020	0.000	0.250	−0.100	−0.090	0.230	1.000	
21 *Poverty focus* × *Professional management*	−0.013	0.147	−0.050	0.010	−0.020	0.000	−0.030	0.030	0.120	0.230	−0.020	−0.060	0.180	0.000	−0.020	0.100	−0.100	−0.080	0.520	0.060	−0.040	−0.030	1.000

Note. Interaction variables are calculated using mean centered values.

Table 3. Models That Estimate MFO Operational Self-Sufficiency

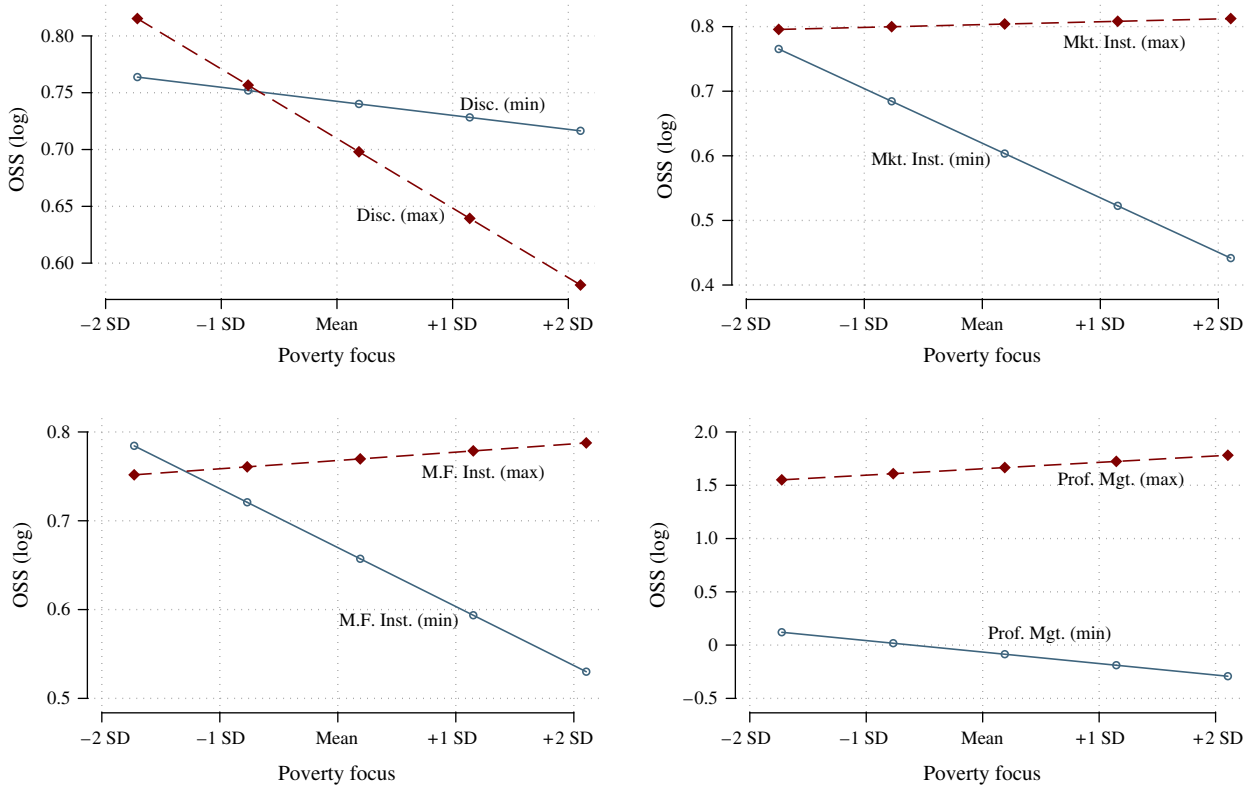
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
GDP per capita	0.001	−0.015	−0.010	−0.009	−0.016^{+}	−0.012	−0.007
	(0.010)	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)	(0.010)
ODA received	−0.002	−0.003^{+}	−0.003^{+}	−0.003	−0.003^{+}	−0.003^{+}	−0.003^{+}
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Democracy	0.004***	0.005***	0.005***	0.004***	0.005***	0.005***	0.005***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Political instability	0.007*	0.003	0.003	0.003	0.001	0.003	0.001
	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)
Communication infrastructure	−0.004	−0.012^{+}	−0.015*	−0.013*	−0.012^{+}	−0.013*	−0.016*
	(0.007)	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)
Number of active MFOs	0.000**	0.000**	0.000**	0.000**	0.000**	0.000**	0.000**
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
MFO age	0.005	0.004	0.005	0.004	0.003	0.005	0.004
	(0.008)	(0.007)	(0.007)	(0.007)	(0.007)	(0.007)	(0.007)
MFO size	0.028***	0.003	0.002	0.002	0.003	0.003	0.002
	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)
Broad portfolio	0.018*	0.003	0.002	0.002	0.003	0.003	0.002
	(0.007)	(0.007)	(0.007)	(0.007)	(0.007)	(0.007)	(0.007)
Poverty focus		−0.023***	−0.025***	−0.025***	−0.021***	−0.022***	−0.022***
		(0.005)	(0.005)	(0.005)	(0.005)	(0.005)	(0.005)
Discrimination		−0.021^{+}	−0.021^{+}	−0.018^{+}	−0.021^{+}	−0.021^{+}	−0.019^{+}
		(0.013)	(0.013)	(0.013)	(0.013)	(0.013)	(0.013)
Market institutions		0.351***	0.332***	0.375***	0.357***	0.358***	0.360***
		(0.075)	(0.075)	(0.075)	(0.075)	(0.075)	(0.076)
Microfinance institutions		0.215***	0.204***	0.230***	0.164**	0.215***	0.168**
		(0.055)	(0.055)	(0.056)	(0.057)	(0.055)	(0.058)
Professional management		0.884***	0.878***	0.879***	0.886***	0.839***	0.835***
		(0.035)	(0.036)	(0.035)	(0.035)	(0.042)	(0.042)
Poverty focus × discrimination			−0.022**				−0.020**
			(0.008)				(0.008)
Poverty focus × market institutions				0.128***			0.078*
				(0.041)			(0.043)
Poverty focus × microfinance institutions					0.089***		0.080***
					(0.024)		(0.024)
Poverty focus × professional management						0.058*	0.054*
						(0.028)	(0.028)
Constant	0.484***	0.613***	0.640***	0.594***	0.614***	0.582***	0.598***
	(0.069)	(0.095)	(0.096)	(0.095)	(0.095)	(0.096)	(0.097)
MFO-fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	4,348	4,348	4,348	4,348	4,348	4,348	4,348

Notes. We used a one-tailed test for directional variables and two-tailed test for controls. Standard errors are in parentheses.
$^{+}p < 0.10$; $^{*}p < 0.05$; $^{**}p < 0.01$; $^{***}p < 0.001$.

a 20.33% decrease in OSS. Also, while we did not predict main effects for the other four variables, results fit our arguments. Discrimination has a negative (albeit marginal) effect on sustainability, while stronger market and microfinance institutions have a positive effect, as does professional management.

Models 3–7 test Hypotheses 3–5 and show how discrimination, market-supporting institutions, and professional management moderate the relationship between poverty focus and financial sustainability. Model 3 tests Hypothesis 3 and shows the interaction between poverty focus and discrimination. As predicted, the trade-off between social outreach intensity and sustainability is more acute in nations with greater intergroup discrimination. When discrimination is one standard deviation higher, a one-standard-deviation increase in poverty focus produces a 28.37% decrease in OSS. Models 4 and 5 add the interactions for poverty focus and market institutions and poverty focus and microfinance institutions, respectively. Results support Hypothesis 4. Stronger market and microfinance institutions mitigate the negative effect of poverty focus on financial sustainability. When market institutions and microfinance institutions are

Figure 1. Interaction Plots: Significant Moderators of the Relationship Between MFO Poverty Focus and Operational Self-Sufficiency



Notes. Disc., discrimination; Mkt. Inst., market institutions; M.F. Inst., microfinance institutions; Prof. Mgt., professional management; OSS, operational self-sufficiency.

one standard deviation higher, the effect of a one-standard-deviation increase in poverty focus on OSS improves by 4.92% (15.41% versus 20.33%) and 8.14% (12.19% versus 20.33%), respectively. Model 6 tests Hypothesis 5. Per our argument, we see that when professional management is one standard deviation higher, the effect of a one-standard-deviation increase in poverty focus on OSS improves by 3.00% (17.33% versus 20.33%). Model 7 shows that all results hold in a fully specified model.

Figure 1 plots the significant interactions in Models 3–6 and compares the relationship between poverty focus and OSS at the observable minimum and maximum levels for discrimination, market institutions, microfinance institutions, and professional management. The first plot in Figure 1 shows that the negative relationship between poverty focus and MFO self-sufficiency is attenuated in countries with very low versus very high discrimination. Strikingly, the other three plots show that the relationship between poverty focus and financial sustainability is not only attenuated but actually becomes positive when market institutions, microfinance institutions, and professional management are sufficiently strong. Our results thus suggest that the hybrid ideal—a synergistic relationship between social outreach intensity and financial sustainability—is indeed possible in some microfinance contexts.

To help illustrate the implications of our findings, we plotted OSS and poverty focus values for each MFO in nations that exemplify very high versus very low discrimination, market institutions, and microfinance institutions. The plots are consistent with our reported results but should be interpreted as suggestive rather than as further evidence. We observe a strong, negative relationship between poverty focus and MFO self-sufficiency in nations with high discrimination, such as Kazakhstan. Yet this is largely attenuated in low-discrimination nations, such as Poland. There is also a general pattern by which MFOs can fiscally sustain more intensive outreach in nations such as Armenia and Bolivia that have strong market and microfinance institutions while sharp trade-offs are evident in nations such as the Democratic Republic of Congo and Haiti where these institutions are weak. Plots are available from the authors.

Test of Mediating Mechanisms

We followed the Baron and Kenny (1986) approach to test the mediating mechanisms proposed in Hypothesis 2, items (a) and (b). Given that we have established the baseline relationship between poverty focus and

Table 4. Models That Test Mediating Mechanisms—Lending Risk and Operating Efficiency

			Operational self-sufficiency			
	Lending risk	Operating efficiency	(1)	(2)	(3)	(4)
GDP per capita	−0.010	0.000	−0.015	−0.006	−0.022*	−0.017+
	(0.007)	(0.010)	(0.009)	(0.010)	(0.008)	(0.009)
ODA received	0.000	−0.001	−0.003+	−0.005**	−0.007***	−0.005**
	(0.001)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Democracy	−0.003***	0.002+	0.005***	0.004***	0.004***	0.004***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Political instability	−0.009**	0.018***	0.003	0.002	−0.004	0.001
	(0.003)	(0.004)	(0.004)	(0.004)	(0.003)	(0.003)
Communication infrastructure	0.000	−0.007	−0.012+	−0.004	0.002	0.011+
	(0.005)	(0.007)	(0.006)	(0.007)	(0.006)	(0.006)
Number of active MFOs	0.000**	0.000	0.000**	0.001***	0.000**	0.000**
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
MFO age	0.001	−0.002	0.004	0.002	0.001	−0.001
	(0.006)	(0.008)	(0.007)	(0.007)	(0.006)	(0.006)
MFO size	0.003	0.007	0.003	0.004	−0.002	0.012***
	(0.003)	(0.004)	(0.004)	(0.004)	(0.003)	(0.004)
Broad portfolio	0.005	−0.010	0.003	0.006	0.003	0.001
	(0.005)	(0.007)	(0.007)	(0.007)	(0.006)	(0.006)
Poverty focus	0.008*	−0.066***	−0.023***	−0.019***	0.002	
	(0.004)	(0.006)	(0.005)	(0.005)	(0.005)	
Discrimination	−0.002	−0.006*	−0.021+	−0.011	−0.012	
	(0.002)	(0.003)	(0.013)	(0.013)	(0.012)	
Market institutions	0.053	0.099	0.351***	0.299***	0.153*	
	(0.059)	(0.082)	(0.075)	(0.075)	(0.066)	
Microfinance institutions	−0.168***	−0.032	0.215***	0.188***	0.236***	
	(0.043)	(0.056)	(0.055)	(0.055)	(0.046)	
Professional management	−0.073**	0.709***	0.884***	0.877***	0.758***	
	(0.026)	(0.038)	(0.035)	(0.036)	(0.035)	
Lending risk				−0.225***	−0.265***	−0.299***
				(0.022)	(0.020)	(0.021)
Operating efficiency					0.282***	0.387***
					(0.014)	(0.014)
Constant	0.044	0.311**	0.613***	0.590***	0.626***	0.791***
	(0.078)	(0.107)	(0.095)	(0.102)	(0.088)	(0.062)
MFO-fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
Observations	4,708	4,294	4,348	4,084	3,661	3,661

Notes. We used a one-tailed test for directional variables and two-tailed test for controls. Standard errors are in parentheses.
$^{+}p < 0.10$; $^{*}p < 0.05$; $^{**}p < 0.01$; $^{***}p < 0.001$.

MFO operational self-sufficiency, two additional sets of regressions are required to identify mediating effects. The first step regresses the two mechanism variables (i.e., operating efficiency and lending risk) on MFO poverty focus to examine how our theorized mechanisms are affected by the focal independent variable. The next step regresses operational self-sufficiency on poverty focus while controlling for the two mechanism variables to assess whether or not poverty focus directly affects operational self-sufficiency once the mediating mechanisms are controlled.[2]

Results support our predictions. Regression output in the first two columns of Table 4 shows that poverty focus leads to lower operating efficiency and increased lending risk. Table 4, Model 4, shows that lending risk has a negative, significant effect on MFO operational self-sufficiency while operating efficiency has a positive and significant effect. Models 1–3 show that these variables attenuate the effect of poverty focus on OSS. As such, lending risk and operating efficiency appear to account for much of the relationship we observe between poverty focus and financial sustainability.

Robustness Checks and Supplementary Analyses

We conducted a number of robustness checks to add nuance to our findings and help rule out alternative

explanations. All models are available upon request from the authors.

Alternative Modeling Approaches. Although the inclusion of MFO-fixed effects and year dummies in our main models controls for unobserved temporal effects and time-invariant MFO-level heterogeneity, this does not fully establish causality or rule out endogeneity. We took a number of steps to strengthen our findings and address potential endogeneity concerns.

In one set of models, we added an MFO's lagged change in OSS as a covariate. This accounts for unobserved influences on OSS and allows us to further isolate yearly changes on the dependent variable. Results remain robust with this alternative specification. We also ran models using a matching approach with which we classified MFOs into treated (poverty focus above the population median) and control (below median poverty focus) groups and paired across the two using nearest-neighbor matching for continuous variables (i.e., MFO age, size) and exact matching for discrete features (i.e., nonprofit status). The mean difference in OSS across the two groups is the treatment effect—that is, the effect of poverty focus on sustainability. For our moderator predictions, we examined treatment effects at the 5th and 95th percentile levels of each theorized factor and compared the respective coefficients to see whether the effect of poverty focus on sustainability varied based on discrimination, market institutions, microfinance institutions, and professional management. Results are consistent with our reported findings (see the online appendix).

Additional Analysis of Underlying Mechanisms. The results in Table 3 show that the relationship between social outreach intensity and MFO financial sustainability is contextually contingent. To deepen this analysis, we ran supplementary models that examined how these contingent factors affected our key theorized mechanisms: lending risk and operating efficiency. Results align with and add nuance to our arguments. Discrimination interacts with poverty focus to create greater lending risk, but it does not significantly affect operating efficiency. This suggests that, in the face of high discrimination, MFOs may not be doing the extra work required to effectively address cultural differences and thus extending riskier loans. As expected, market and microfinance institutions moderate the effect of poverty focus on lending risk and operating efficiency although effect sizes and significance levels differ. Strong market institutions lead to greater reductions in lending risk, while microfinance-specific institutions have a weaker effect. This is consistent with the argument that the rule of law and enforceable contracts help an MFO with loan recovery, while stable markets benefit very poor borrowers and thus make repayments more likely. In comparison, microfinance institutions have a larger effect on operating efficiency, suggesting that sector-specific initiatives help to address the particular trust deficiencies and asymmetric information that can create frictions when lending to the very poor. As expected, professional management contributes to lower lending risk and greater operating efficiency.

Comparing Across MFOs. We acknowledge that MFOs may have varied reasons for shifting their poverty focus and that the underlying drivers of these shifts may have different implications for financial sustainability. To check, we reran our main models excluding MFOs that increased their poverty focus during our observation window (29% of our observations). Results of this analysis closely match our reported findings and thus suggest that the direction of change in poverty focus does not affect the relationship between social outreach intensity and financial sustainability.

Also, while our analytic approach isolates the relationship between poverty focus and financial sustainability for MFOs over time, results may vary among MFOs with different fixed characteristics. For instance, for-profit MFOs may be more financially oriented than nonprofit MFOs, extend larger loans, and be more professionally managed, on average. As such, there may be systemic variance in the social–financial trade-offs experienced by these MFOs. To check, we reran our main models using subsamples of for-profit and nonprofit MFOs. Overall, the pattern of results for the two groups is similar. Still, there are some differences. Most notably, the interaction of poverty focus and discrimination has a stronger negative effect on financial sustainability for nonprofit MFOs, while for-profit MFOs benefit more from market-supporting and microfinance institutions when their poverty focus increases. These results suggest that MFOs with an explicit focus on poverty reduction face greater barriers with regard to achieving sustainability, likely because of their commitment to serving high-need groups: they are more exposed to the challenges posed by discrimination and less likely to benefit from a strong institutional environment.

There may also be varying trade-offs among MFOs with different lending methods. Specifically, the efficiency losses and increased risk of lending to poorer clients may be attenuated by group lending because multiple loans are being made concurrently (reducing due diligence requirements) and social pressures help to ensure repayment (reducing risk). This may blunt the main effect of poverty focus on sustainability as well as the moderating influence of our other predictors. To check, we reran our analysis on subsamples of MFOs that reported issuing group versus individual loans. Results are similar for both types of MFOs. While we caution against drawing strong inferences from this analysis as it is based on a limited sample (only 16.8% of MFOs reported relevant data), results

nonetheless suggest that lending method does not significantly affect an MFO's ability to engage in sustainable outreach despite the varied positions taken on this subject in the literature (Karlan 2007, Mersland and Strøm 2009).

Alternative Variables and Explanations. To bolster our argument that discrimination affects social–financial trade-offs, we ran models using different discrimination proxies. To this end, we ran models using the *religious discrimination* measure created by the Religion and State-Minorities database (23 discrimination indicators for 566 religious minorities in 175 nations): results are robust to this alternative proxy. We also tried a *fractionalization* index (i.e., the probability that two random people in a nation will hail from different cultural groups; Alesina et al. 2003). Discrimination captures intergroup antagonisms and marginalization, while fractionalization reflects the number of groups that an MFO may encounter in its lending: both are associated with reduced trust and reciprocity (Fearon and Laitin 2003). Our specific variable is from Alesina et al. (2003): results closely match our reported findings.

We also distributed a survey to the MFOs in our analysis to further validate that discrimination is associated with cultural barriers to serving very poor borrowers. We received 133 responses, with no evident response bias. On the basis of responses to the questions "what portion of your [MFO's] borrowers are from marginalized minority groups" and "what portion of [your] loan officers are from marginalized minority groups," we see that the former is notably larger than the latter, on average, and that this pattern is stronger for MFOs with lower ALS and in nations with high discrimination. Respondents who reported a greater portion of loan officers and borrowers from different cultural groups also reported having more difficulty in developing trust, explaining loan terms, handling disputes, and ensuring repayment. These results should be interpreted as suggestive only but are nonetheless consistent with our theory.

Discussion

In this paper, we examined the relationship between social outreach intensity (i.e., a focus on high-need beneficiaries) and financial sustainability in social enterprise. Departing from the conventional approach of studying the nature and resolution of intergroup tensions (Battilana and Lee 2014), we argued that it is important to theorize and model the actual, underlying trade-offs that these organizations face: this is key to understanding the compatibility of social outreach and financial sustainability and thus the intensity of outreach that an enterprise can sustain in practice. To this end, we developed a framework comprising mechanisms suggested by previous studies, and we argued that it can be used to make baseline predictions about the relationship between outreach intensity and financial sustainability in specific social enterprise contexts. We then theorized contextual factors that may work through the same mechanisms to make social–financial trade-offs more or less acute. By linking to research on categorical inequality, we argued that it is important to consider the cultural causes of the problem that an enterprise aspires to address. Insights from institutional economics and strategy drew our attention to the potential effects of market-supporting institutions, and research on professionalization in the public sector led to predictions about the influence of professional management. Our approach thus links the social enterprise literature to a number of cognate domains and uses this to demonstrate that the potential to sustain high levels of social outreach can vary quite widely across enterprises and contexts.

We developed and tested our arguments in a study of global microfinance. As predicted, results indicate a negative baseline relationship between MFO social outreach intensity and fiscal sustainability that is mediated by increased lending risk and reduced operating efficiency. Results also support our argument that discrimination, market-supporting institutions, and professional management work through these mechanisms to create variance in the trade-offs that MFOs face in different contexts. Our findings have implications for the study of social enterprise, organization theory, and microfinance.

Implications for Social Enterprise and Organization Theory

A Focus on Trade-offs vs. Tensions. Much of the excitement about social enterprise owes to the allure of the hybrid ideal, where an enterprise pursues intensive social outreach and generates enough revenue to sustain and grow its operations. Understanding how outreach affects sustainability and how the two can be integrated have thus been central themes in the social enterprise literature. To date, most organizational scholars have approached this inquiry by focusing on the complexity that an enterprise is exposed to when stakeholders who adhere to different logics (i.e., shared beliefs that rationalize certain goals and practices) impose conflicting demands (Besharov and Smith 2014, Greenwood et al. 2011). In turn, this is linked to problematic tensions that scholars have argued must be addressed for an enterprise to sustain its operations. Studies that follow this line of thinking have cultivated a number of useful insights about how social enterprises can ameliorate tensions and foster strategic consensus (e.g., Battilana and Dorado 2010; Battilana et al. 2015; Pache and Santos 2010, 2013; Smith and Besharov 2017; Smith et al. 2013). Yet the actual, underlying trade-offs that these organizations face have received little attention. Our approach directly models the relationship between social outreach

intensity and financial sustainability and thus reminds us that efforts to address internal tensions take place against a backdrop of real, underlying trade-offs. Tensions may be addressed without making an enterprise any more viable in practice, and in some contexts, it may not be possible to sustain high levels of social outreach regardless of an enterprise's internal structures, strategies, or processes.

In this regard, our results also suggest there may be value in unpacking the relationship between tensions and trade-offs in social enterprise and the factors that give rise to each. Indeed, while we found that strong market institutions and professional managers help to blunt social–financial trade-offs, other studies have suggested the same factors induce mission drift (Simons and Ingram 1997) and create tension within a social enterprise (Battilana and Dorado 2010). As such, a supportive enabling context may or may not lead to higher levels of social outreach and may, in fact, catalyze moves in the opposite direction. Future studies should examine how internal organizational processes are shaped by the external environment and the conditions under which this is likely to result in a greater social mission pursuit versus emboldening commercial interests within an enterprise. Such inquiry would likely benefit from considering how tensions and trade-offs work jointly and independently to affect the distribution of power, attention, and resources within an enterprise (Ocasio 1997, Wry et al. 2013).

The Contingent Nature of Social–Financial Trade-offs. To date, organizational scholars have theorized social enterprises, and the challenges that they face, as being quite similar (Battilana and Lee 2014, Battilana et al. 2017). In comparison, our approach highlights the contingency of social–financial trade-offs. In this regard, the framework we used to predict the relationship between social outreach intensity and fiscal sustainability in microfinance also suggests that trade-offs vary in patterned ways across social enterprise models. For instance, enterprises that produce and sell socially beneficial products should face less acute trade-offs than those that integrate beneficiaries in their core operations. As Table 1 shows, the former encompass fewer mechanisms that are associated with trade-offs and are more likely to benefit from social–financial symbiosis. Thus, in addition to the typical approach of studying individual organizations and specific types of social enterprise, we see considerable promise in research that compares across social enterprise models (Santos et al. 2015). This has the potential to yield a richer understanding of how different enterprises conceptualize and experience the relationship between social and commercial goals while bringing the boundary conditions of extant studies into sharper focus.

Our results also demonstrate that contextual factors greatly affect an enterprise's ability to sustain high levels of social outreach. This complements studies in the specialist social enterprise literature that have shown there are differences in what social enterprise means and how various models are developed and supported in different geographies (Kerlin 2010, 2013). More importantly, though, it provides a corrective to studies in the management literature that have assumed poor places are all essentially the same and that social enterprise can work its magic anywhere (Battilana and Lee 2014, Zahra et al. 2008).

We developed our theory by linking insights about discrimination and market institutions to mechanisms that are relevant for understanding social–financial trade-offs in microfinance. While our findings are specific to MFOs, our theory is more broadly generalizable. In addition to poverty and financial access, discrimination unduly exposes the members of marginalized social groups to a host of culturally entrenched pathologies (Kabeer 2005, Tilly 1998). As such, it is reasonable to assume that discrimination will amplify the challenges that a social enterprise faces when focusing on high-need beneficiaries in areas such as addiction, unemployment, and homelessness and when it targets groups such as women (Zhao and Wry 2016) or refugees (Tracey and Phillips 2016). We also expect that the moderating effects of market institutions apply beyond microfinance. Economic stability should help enterprises to reduce transaction costs (Meyer et al. 2009) and avoid downturns that can lead to a glut of costly, high-need employees/beneficiaries (Cooney 2012). The idea that specific types of social enterprise benefit from tailored policy initiatives is also broadly relevant and should be studied in other contexts.

Taken together, these findings suggest that the utility of social enterprise as a tool for addressing societal issues is highly variable. On one hand, we show that intensive social outreach is indeed viable in some contexts. Yet in harsh environments—where the need for innovative, sustainable solutions to social problems is high—social enterprise appears to have less promise. Our approach suggests that it is difficult for enterprises to sustain themselves in such contexts without significantly sacrificing their social mission. In the most disadvantaged places, social enterprises are thus likely to be either ineffective or untenable. Asking entrepreneurs to launch sustainable social ventures under such conditions is not realistic without large ongoing subsidies, and traditional nonprofit models may be more effective here, as they focus on social mission pursuits without the competing pull of revenue-generating activities. Moreover, a wide range of efforts and initiatives are likely required to address deep-seated problems, such as discrimination and market voids. Social enterprises may benefit from such efforts—becoming more effective and viable as the external context becomes supportive—but fiscally viable approaches are unlikely. Other types of organizations are likely better suited to

engaging in this work (Mair et al. 2012). Future studies should attend to the broader ecology of organizations that pursue such change initiatives and further consider how the sustainability and effectiveness of social enterprise is entwined with institutional and cultural entrepreneurship (Dacin et al. 2011) as well as with social movements (King and Pearce 2010).

Returning to theory, our approach adds to the study of contradictions, paradoxes, and tensions in organization theory. To date, this research has followed related but largely separate tracks: one portrays oppositional demands as innate to organizations (Smith and Besharov 2017); the other advances an institutional complexity perspective that locates competing demands in the external environment (Greenwood et al. 2011). Yet while the two approaches locate contradictions and paradoxes in different sources, the main focus for each is on understanding how organizations respond to these issues. To this end, studies in both research streams portray the external environment as essentially fixed, treat external pressures as more or less static, and study how contradictions and paradoxes are perceived and addressed within an enterprise (Battilana and Lee 2014, Smith and Besharov 2017). We extend this by showing that context profoundly affects the nature of these problems and how they are experienced by organizations. We thus direct attention to an overlooked source of variance that has important implications for understanding when and where competing demands can be managed synergistically versus when and where they would require trade-offs with major repercussions for organizational effectiveness and mission attainment. Engaging with contextual factors also has the potential to reconnect the study of strategic paradoxes to its intellectual heritage in contingency theory (see Smith and Besharov 2017), while helping scholars who adopt a complexity lens connect their work to other strands of institutional theory that emphasize environmental dynamism and change (Wry et al. 2013).

Implications for Global Microfinance

Despite microfinance being hailed as a sustainable approach to poverty reduction, there have been mixed findings about this relationship (Reichert 2018). We help to reconcile this ambiguity by showing that the outcomes of social outreach are contingent. We find a negative relationship between poverty focus and financial sustainability, but we show that this is amplified in some contexts and mitigated or even reversed in others. Indeed, our results suggest it is possible for some MFOs to pursue intensive outreach and generate positive returns while other MFOs likely face steep trade-offs. In this way, our findings point to the importance of professional management for enabling intensive social outreach—especially in very challenging contexts—and suggest that institution building is likely required in many nations to create the enabling conditions for a financially healthy and socially effective microfinance sector. Our findings also suggest that, in many nations, serving the very poor is not possible without external funding support. We thus caution against viewing commercial microfinance as a blanket solution to poverty reduction: nonprofit MFOs, public funders, regulators, and others who are not primarily motivated by financial concerns have important roles to play as well (Cobb et al. 2016, Zhao and Lounsbury 2016).

We also note that some have questioned the efficacy of microfinance, even suggesting that MFOs trap people in poverty and contribute to inequality (Duvendack et al. 2011). Our study does not speak to such issues directly, but it suggests that the potential for positive impact is greater in some contexts than others. There is evidence that the very poor benefit the most from microfinance (Morduch 2000), and reaching these people should be more viable when an MFO is well managed and operates in a nation with low discrimination and strong market institutions. MFOs should also be able to sustain their operations in such situations while charging lower interest, thus making it less likely that borrowers will be trapped by very expensive loans (Yunus 1999). Strong market institutions may also decrease the likelihood of MFOs unknowingly lending to financially strained borrowers and thus contributing to cycles of indebtedness.

Limitations

As with all studies, ours has limitations that point to opportunities for future research. For one, our analysis focused on isolating the relationship between outreach intensity and fiscal sustainability, but this does not speak to the strategies that MFOs or other social enterprises use to balance the two. For instance, cross-subsidization may be an effective way to serve high-need clients and generate sustainable revenues. An enterprise may also sacrifice short-term outreach intensity to pursue efficiencies that come with scale: over time, this may allow the enterprise to support sustainable increases in social outreach. We expect that future studies will build on our work and examine these possibilities.

Also, as is common in cross-national research, our analysis emphasizes generality over detail, and some measures are coarse indicators of underlying mechanisms (Henisz et al. 2005). This yields useful results but limits the nuance of our findings. For instance, despite evidence that ALS is a valid proxy for poverty focus, the measure is noisy. There are opportunities to build on our findings as more direct indicators become available. Also, our professional management and microfinance institution variables do not let us examine specific regulations or management practices. We are also unable to observe factors such as the underlying trust between loan officers and clients. There may also be situations

in which weak market institutions benefit MFOs by making it easier for clients to set up small businesses or by enabling the use of informal agreements that are cheaper to enforce than formal contracts. We were unable to investigate this nuance. Qualitative research may be useful to investigate these issues.

Finally, despite our efforts to isolate the relationship between outreach intensity and financial sustainability, we acknowledge the difficulty of establishing causality in a nonexperimental setting. Still, there is value in demonstrating a solid baseline correlation between the two variables and the conditions under which their relationship varies. Given the paucity of empirical evidence for this relationship in extant studies, our findings represent an important contribution to the social enterprise literature.

Conclusion

Social enterprise holds the promise to address societal problems in a financially sustainable manner. Yet the deep integration of financial and social aims exposes these organizations to potentially problematic tensions and trade-offs. Unlike studies that have focused on the former, we modeled the actual, underlying trade-offs between social outreach and financial performance. In an analysis of global microfinance, we showed that trade-offs exist and that their acuteness is moderated by internal and external organizational forces. We thus draw attention to the importance of contextual forces in shaping the compatibility of social outreach and financial sustainability and, in so doing, provide guidance for practitioners and policy makers regarding pathways toward a synergistic integration of the two in social enterprise.

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Endnotes

[1] The index comprises responses to questions about an MFO's (1) use of formal rules and procedures, (2) internal financial controls, (3) employee training, (4) internal efficiency, (5) risk management, and (6) accountability practices.

[2] This standard approach of mediation tests has been challenged because of its lack of account for potential missing variables and measurement errors, which may bias coefficient estimates (e.g., Shaver 2005). In our case, given the inclusion of a comprehensive list of controls as well as MFO-fixed effects, this concern is reduced. Still, we took steps to address this issue by following the two-stage least squares (2SLS) approach suggested by Shaver (2005). Specifically, we first regressed lending risk and operating efficiency on poverty focus, and then in the second step we included the predicted values of the two mechanism variables in estimating operational self-sufficiency. In this second step, we removed the contextual contingency variables for the equation to be identified. Our findings are robust to this alternative approach.

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