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THE VALUE OF NETWORKS IN ENTERPRISE DEVELOPMENT: CASE STUDIES IN EASTERN EUROPE AND SOUTHEAST ASIA

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This study proposes that cooperative efforts in microlending aid economic development and poverty alleviation in transitioning and developing countries by creating networking systems in which people can expand their businesses through working capital and community cooperation. Two field studies are used to validate the authors' claims. The first examines a microfinance cooperative structure in Bulgaria as a means to secure credit, savings, technical support and networking opportunities for cooperative members. The second looks at a cooperative microfinance institution in the Philippines that appears to create greater socio-economic growth for poor entrepreneurs as well as NGO financial viability. Both studies suggest that cooperative microlending leads to high survival rates and success of self-employed entrepreneurs by facilitating social capital through their organizational processes.

Keywords: Micro and small enterprise; cooperative; self-employment; social capital; Eastern Europe; Southeast Asia.

1. Introduction

Our purpose is to present the development strategy of cooperative microlending as a solution to the impending problems that are being made more apparent through globalization. Little research exists on different organizational forms found within the microfinance organization. We claim that cooperative lending offers one organizational form that allows a microfinance institution (MFI) to reach poor entrepreneurs and increase self-employment success rates by fomenting social capital through the institution's lending structures and processes.

The next part of the study offers an overview of traditional economic development strategies being used in transitional and developing countries with the accompanying positive and negative results. Section 3 goes further than Section 2 by looking at self-employment as a major viable option in spurring social and economic development of the poor. The fourth section looks to microfinance as a strategy to help poor self-employed entrepreneurs succeed and is exemplified by two case studies on cooperative microlending.

The case studies investigate the effects of cooperative microlending on self-employed entrepreneur clients from two microfinance institutions located in Bulgaria and the Philippines. Since it can be difficult to test a theory or even develop one without enough understanding of the situation, the case studies provided us with an opportunity to become intimately familiar with cooperative microlending. We observed microlending meetings and operations as well as interviewed and spoke with microlending entrepreneurs and microfinance employees. These case studies served to formulate theory regarding the factors that seemed to be driving self-employed entrepreneurial success. We chose Bulgaria and the Philippines in order to understand cooperative microlending effects in both the second world (transitional economies) and third world (developing economies) settings, respectively. The fifth section expounds the implications of the case study findings, which seem to indicate that cooperative microlending leads to greater self-employed entrepreneur survival rates. The last two sections address the study's limitations and offer conclusions.

2. Traditional Economic Development Strategies

Struggling for economic stability and fiscal discipline, Eastern European and many Asian economies are in a transitioning phase that improves their prospects for sustainable economic development. Throughout the world, multilateral organizations and governments propagandize hope. Structural adjustment policies are liberalizing financial sectors and replacing government regulation with private and voluntary regulation. The underlying assumption of structural adjustments is that deregulation creates an enabling environment for private initiative and investment (Versluysen, 1999).

There are two sides to the story when a country undergoes trade liberalization and structural reforms. On one hand, a strong infrastructure and globally competitive economy is a necessary pre-condition for the development of any nation; economic growth fosters sustainable financial development. On the other hand, economic growth created by trade liberalization and structural reform per se does not guarantee better living standards, a greater number of choices or a more secure existence. In fact, nearly all countries that have undergone structural adjustments and trade liberalization experienced massive unemployment, higher prices for basic food and necessities, and the reduction or elimination of social programs for the needy (Versluysen, 1999). The high rates of unemployment have sent many of these countries' workers to the informal labor sector in search of employment opportunities (De Soto, 1989; De Soto, 2000; Portes, 1994).

The informal labor sector is essentially comprised of small and micro businesses operated by self-employed entrepreneurs who do not pay taxes nor respond to governmental regulations. As Woodworth (2000, p. 20) claims, entrepreneurs in the informal sector subsist by "hustling, or other forms of sweat equity, making up for the lack of formal jobs." In Latin America, Africa, Asia and former communist countries, the informal sector on average makes up 42, 41, 26 and 38 percent of the countries' GNP, respectively (Schneider, 2002). As such, many researchers believe encouraging self-employment activities in the informal sector would likely accelerate the developing country's economic and socio-economic development (Pisani and Patrick, 2002; Portes and Schauffler, 1993).

3. Need for Self-Employment

Though difficult and fraught with many disadvantages, self-employment becomes one of the most viable strategies available for entrepreneurs in transitional and developing economies. In fact, several policy makers and economists view self-employment as a global way for individuals to leave poverty by securing employment (Light, 1972; Light, 1979; Sowell, 1981). In first world nations such as the United States, many government leaders are promoting self-employment as a way to help individuals leave welfare and unemployment insurance rolls (Benus *et al.*, 1995; Fairlie, 2002; Guy, Doolittle and Fink, 1991; U.S. Department of Labor, 1992; Vroman, 1997). Moreover, many development institutions are already experimenting with this idea. The World Bank and the United States Agency for Development (USAID) have recently created their own Small and Medium Enterprise divisions to provide funding and entrepreneurial training in developing nations (USAID, 2005; World Bank, 2003).

In the process of fomenting self-employment, it is important to look for development measures that help the unemployed at lower levels of the labor market to participate and compete in the growth of the nation's economy. Cooperative microfinance is one economic alternative that helps create employment by offering loans and entrepreneurial training to self-employed entrepreneurs.

4. Microfinance and the Cooperative Model

In its short history, microfinance has generated much hope for alleviating poverty throughout the world by encouraging self-employment and enterprise development (Brau, Hiatt and Woodworth, forthcoming; Hiatt and Woodworth, 2006). Offering these financial services to poor entrepreneurs has improved individual lives and served as an engine of growth for entire economies. According to Franks (2000) of the IMF, microfinance has proven that it can not only help people pull themselves out of poverty, but also achieve macroeconomic importance for entire nations. In 1995, the World Bank's Consultative Group to Assist the Poorest estimated that the demands for microfinance would total $90 billion by 2005 (that is 30 percent of the world's low-income entrepreneurs), or alternately between 100 and 200 million persons (Christen *et al.*, 1995).

To date, microfinance has experienced great success in staying with its founding principle of doing well and doing good, but its future is clouded by a strong ideological gap that has widened among key players in this industry. Microfinance is a hybrid of two competing and seemingly contradictory perspectives adopted from banking and humanitarian aid — banking, in that it is concerned with providing a needed financial service for profit maximization; and humanitarian aid, in that it provides these services to a less profitable client base in hopes of social change. Each individual perspective represents a logic that justifies how an organization acts. Thus, a debate has been generated around how microfinance services might best be delivered (e.g., Morduch, 2000; Woller, Dunford and Woodworth, 1999). Such disputes have both ideological and practical implications.

One organizational form that helps microfinance to reach its seemingly competing goals of profitability and pro-poor advocacy is found in a cooperative model. The core characteristics of most microfinance cooperatives are twofold: (1) to act as a financial institution by offering loans and savings as well as collecting repayments with interest high enough to be profitable; and (2) to create cooperative groups among borrowers in order to ensure payment and increase solidarity and social ties. Thanks to the ideas of Muhammad Yunus and other cooperative microfinance pioneers, development has taken a further stride in switching from a strictly top-down, macro strategy, to an integration of more bottom-up methods that create strength in the community while eliminating poverty (Woodworth, 1997).

The following two case studies demonstrate the benefits of cooperative microlending in transitional and developing countries. We chose Bulgaria and the Philippines in order to understand cooperative microlending in second and third world economies, respectively. Since both countries represent different economic backgrounds — the former transforming itself from a command economy to that of a capitalist and the latter having been capitalist yet struggling with the typical problems associated with a developing country — they allow us to understand generally how cooperative microlending affects self-employed entrepreneurs in former communist states and in developing economies.

4.1. *Case one: Bulgarian microlending cooperatives*

The first case presented in this paper is that of the Catholic Relief Services (CRS) Microfinance Program located in Bulgaria. The CRS microfinance program seeks to promote self-managing, financially sustaining institutions that can continue to serve the financial and non-financial needs of member entrepreneurs in a permanent manner. By contributing share capital into their respective cooperative's mutual assistance fund, relending those funds to other members and earning dividends on contributions, each credit cooperative can increasingly satisfy members' financial requirements from its internal fund.

CRS is an NGO; therefore, it cannot lend money according to Bulgarian law. However, it has set up a structure to allow the borrowers to each form their own cooperative, where they can give and receive loans from within the legal entity. The program coordinator is responsible for helping form borrower cooperatives. CRS uses the standard cooperative model promoted by Grameen Bank. The cooperative must consist of at least 10 people, but no more than 24. Within the cooperatives are solidarity groups of three to five people. Each solidarity group elects a representative. These representatives work with the program coordinator — in this way the coordinator only has to work with a few people to make sure that everyone pays back their loans. Figure 1 uses a diagram to explain this structure.

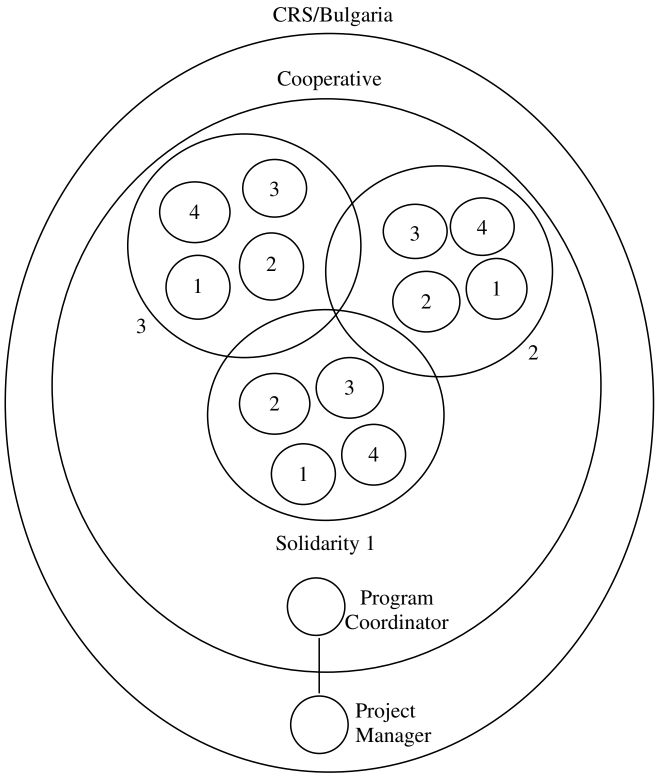

Fig. 1. Cooperative network structure.

To receive a loan, the entrepreneur must first visit the business center and get the basic information on the microlending process. If he or she is still interested after being debriefed, then he/she will leave contact information. Once the project coordinator has received enough people to form a good-sized cooperative, he calls the people who left their names. He invites them to a meeting where they must bring a business plan and a copy of their business registration. The meeting is used to weed out less dependable people — those who do not attend this first meeting are most likely not allowed to join the new cooperative.

At the meeting, the coordinator informs people about what needs to take place to create a cooperative and receive a loan. After the meeting, the people mingle together and join with those people with whom they would like to be in a cooperative. They need at least 10 people (12 is preferable) to form the cooperative. If there are any who are not a good fit for the cooperative being formed, then they may still be eligible, but they must wait until the next meeting to get into another cooperative. The meetings are called whenever there are enough people to form a cooperative. Sometimes this takes a week or two.

After the groups are formed, the coordinator gives them the information they need to start a cooperative under CRS. While the potential clients are getting the documentation ready, the coordinator visits each business to determine its validity. After all businesses are verified, the group must open a joint account at a local bank. At this point, they create a cooperative with the help of the program coordinator by registering with the Statistical Institute, the Social Security Office and the Tax Administration Agency. Once the cooperative is established, the members form their own solidarity groups of three to five people each and they pay a membership entry fee of US$50 each. The leader of the solidarity group reports to the program coordinator. Once the cooperative and solidarity groups are formed, the members are eligible for their first loan. To receive the first loan, members must show that they already have saved ten percent of the loan.

The maximum initial loan size is the Bulgarian Lev equivalent of US$500 for a loan period of six months. The interest rate for all loans is a flat monthly interest rate of two percent (24 percent APR). Members of the cooperative who remain in good standing by paying back the loans on time may apply for larger loans, up to $2,000 maximum, as credit experience and capacity to repay loans increases. Of each monthly payment, part is the loan repayment and part stays within the cooperative's Mutual Assistance Fund. The borrowers are allowed five cycles of increases in loans. If they do well with all of these loans, then they are eligible for an increase in the number of loans. The repayment process is seen in Table 1.

The Mutual Assistance Fund is the only thing that resembles any type of savings program in all Bulgarian MFIs. The mutual savings fund is used for emergencies and future borrowing from the members in the cooperative. The cooperative members can decide if they want to charge interest on the internal funds or if they want to be able to lend it out to each other interest-free. With the savings from the fund, people can enhance the amount of money that can be borrowed. Further borrowing is only contingent upon the member's repayment history. Self-employed entrepreneurs who participated in CRS over a one-year period experienced a survival rate of over 90 percent.

There is no credit discipline measure taken by CRS for loans that are not repaid. If a loan is not repaid, it is the responsibility of the cooperative to pay off the loan or to make sure the member pays back the loan. If they fail to make sure all payments are in, the cooperative will not be eligible for another loan.

There has been much criticism in Bulgaria regarding group lending methodology. While speaking with people of other microfinance organizations that do offer loans through cooperatives, they expressed the view that group lending would not work in Bulgaria because

Table 1. Loan repayment process.

Month	1	2	3	4	5	6	Total
Principal	$83.33	$83.33	$83.33	$83.33	$83.33	$83.33	$500.00
Interest (2% flat monthly)	$10.00	$10.00	$10.00	$10.00	$10.00	$10.00	$60.00
Required for Mutual Assistance Fund (10% of loan size)	$8.33	$8.33	$8.33	$8.33	$8.33	$8.33	$50.00
Total	$101.67	$101.67	$101.67	$101.67	$101.67	$101.67	$610.00

of the individualistic attitudes of the people. While this argument may be true to an extent, there is obviously a large percent of the population that does not mind working in a group setting. With an above industry repayment rate, CRS is leading the pack in reaching the poor while remaining economically viable. Though follow-up research is needed to declare that CRS is a total success, it seems to be defying the odds and succeeding against the other Bulgarian MFIs that use only the individual lending methodology.

4.2. *Case two: Philippine cooperative training and lending*

The second case to be examined is that of Enterprise Mentors International (EMI). In 1990, EMI started its program in metro Manila by creating Philippine Enterprise Development Foundation. In 1993, a second indigenous NGO was established in Cebu, the central region of the country, and it was registered as Visayas Enterprise Foundation. Yet a third non-profit organization was established in the southern islands of the Philippines in 1995, Mindanao Enterprise Development Foundation. Today, each of these groups has its own board, staff and clients. All have close ties with EMI's U.S. base, which provides funding, staff training and help in strategic planning.

EMI's focus on assisting small-scale enterprises, or would-be enterprises, that have the potential for microbusiness success has generated jobs and increased self-employment among the Filipino poor. Generally, the range of services offered by EMI are intended to address microenterprise needs for start-up, growth, productivity and profitability, with the ultimate objective being individual, family and community self-reliance.

So far, over 20,000 Filipinos have received small loans ($100 to $300) to start and/or expand microenterprises. Nearly 61 percent of the borrowers are female, resulting in a payback rate of 95 percent. Most loans are offered to a group of microentrepreneurs who commit to paying back everyone's loan, not just one's own. This process functions as a type of social collateral.

EMI provides services of training, microlending and networking by building collaborative partnerships through its cooperative credit model. The cooperative model encourages total strangers to join together to establish a crafts co-op or start a credit union, using the money pooled to launch new businesses. The additional income from microbusiness expansion and access to credit, as reported by EMI, leads to more family revenue for food and a reduction in malnutrition; more money for education and a better future; savings for future medical needs; and greater economic self-determination.

The loans offered through EMI are processed by a credit cooperative formed by the borrowers themselves. The cooperative members are responsible for one another to pay back the loans. This is also known as a village banking approach of microfinance. A person will access a loan with her peers even though they have no collateral or credit history. The borrower works with people she knows or trusts. The group members pay interest and principal daily, but not at exorbitant rates. After the first round of paying back a small loan, the borrower qualifies for a larger loan each successive time. Being mutually responsible for the total amount of the loan ensures a payback rate of 97 percent. The self-employed entrepreneurs who participate in the program for more than a year boast of over 93 percent survival — an outstanding success rate for self-employment. Because of the high repayment rate of loans, EMI's three Filipino NGOs are 100 percent financially self-sufficient.

Coupled with the microenterprise training and hands-on consulting programs of EMI and its NGO partner groups, this strategy to assist poor Filipinos is important, perhaps because it helps people collectively borrow to establish a co-op as a group, thereby leveraging their skills and energy. We found that through EMI's cooperative model, many social ties and networks were established with potential suppliers and customers from references from the group members. Moreover, the cooperative model seemed to create a safety net that group members could use to solve problems that confronted their businesses and personal lives.

In EMI's cooperative groups, we witnessed on certain occasions that when a group member experienced problems either related to his or her business or even with his or her personal life, many of the other members would approach the individual to find out how they could help and to offer solutions. In other group settings, babysitting and accompanying children to school became a shared responsibility among many of the women entrepreneurs. In summary, EMI's cooperative model not only helped the NGO itself to become economically viable, but it also encouraged firm growth and survival due to what we argue to be the social ties and relationships among self-employed entrepreneurs it has fomented.

5. Implication of Findings

These case studies present examples of how cooperative microlending can lead to self-employment success in transitional and developing economies. An important entrepreneurial factor to which both of these case studies seem to allude to is the importance of social capital in self-employment survival and success. Our studies in Bulgaria demonstrated that cooperative microlending had greater success than individual lending in a society where social ties are few and cooperation is rare. We argue that the reason cooperative microlending is more successful than individual microlending is due to the differences in the amount of social capital. We contend that cooperative microlending foments greater social capital than individual microlending. This in turn leads to greater self-employed entrepreneurial success.

Social capital has been defined as an asset embedded in relationships that facilitates instrumental action among people and the sharing of knowledge and resources from one person to another (Burt, 2000; Coleman, 1988; Leana, 1999; Nahapiet and Ghoshal, 1998). In essence, social capital establishes connections that allow people to exchange resources and manage knowledge effectively (Tsai and Ghoshal, 1998). It increases performance by enhancing commitment, increasing flexibility and fostering intellectual capital (Shaw, Duffy, Johnson and Lockhart, 2005). Social capital also reduces organizational costs by increasing an organization's ability to acquire new knowledge. Nahapiet and Ghoshal (1998) identify three dimensions of social capital: structural, relational and cognitive. The structural dimension of social capital manifests itself as social interaction ties; the relational dimension of social capital refers to the assets rooted in personal relationships such as trust and trustworthiness; and the cognitive dimension refers to shared codes and languages or shared paradigms and goals that facilitate a common understanding.

Research on the structural dimension of social capital shows that entrepreneurs often use social ties and networks to seek information, social support and advice from others (Birley, 1985; Nohria, 1992; Zimmer and Aldrich, 1987), to access financial capital and resources (Adler and Kwon, 2002; Shane and Cable, 2002; Uzzi, 1999) and to secure legitimacy through endorsements from prestigious actors (Aldrich and Fiol, 1994; Batjargal, 2003; Rao, 1994; Stuart, Hoang and Hybels, 1999).

In the case of cooperative microlending, social capital is actually created, facilitated and stimulated through the organizational processes inherent in the credit operations. In both case studies, entrepreneurs who wanted access to capital and business training had to join with others to form a group. Once the group was formed and a common level of trust was achieved, loan money became available to group members who divided up the money into individual allotments. In this way, every member in the group became responsible for everyone's repayment and their enterprise success. By requiring group members to work together in a cooperative fashion, the MFI's organizational processes created a social capital that extended beyond the credit level. In our case studies, we witnessed on many occasions during cooperative group events that when a member of the group seemed to have a problem not related to credit, many group members approached the individual to offer help and solutions to the problem. In some cases, almost every group member proffered assistance in one form or another.

We argue that these social ties created from the credit processes offer the self-employed entrepreneur greater access to resources and knowledge in order to recognize profitable ideas and to exploit them (Shane and Cable, 2002; Shane and Venkataraman, 2000). Additionally, these social ties become a safety net to the entrepreneur — a resource from which he or she can draw upon in times of difficulty or adverse environments. This, in turn, seems to realize greater entrepreneurial firm success. Based on these case studies, we argue that social capital becomes as or even more important for survival and firm growth to self-employed entrepreneurs in transitional and developing economies than to entrepreneurs in the developed world.

6. Study Limitations

Although we have presented two case studies that suggest that cooperative microlending creates and increases social capital among self-employed entrepreneurs, our study is limited because the sample consists of microlending cooperatives from only two countries. Further qualitative and quantitative research might look at microlending cooperatives from a wider range of countries, including those from Africa and Latin America. While our purpose was to present more of a theoretical grounding for future research, to generalize this theory, further research with larger sample sizes needs to be conducted.

Furthermore, while the ideas presented in this paper are rooted in theory and observations from the field, empirical research is needed to determine to what degree microlending cooperatives affect social capital among their participants and to what degree social capital affects self-employed entrepreneurial growth and survival in microlending cooperatives. If cooperative microlending can be empirically proven as a more effective way to foment self-employment success than traditional individual microlending, governments, banks, NGOs and other institutions, then a stronger argument can be made for the importance of cooperative microlending efforts in enterprise development throughout the world.

7. Conclusion

This paper has presented the development strategy of cooperative microfinance as a solution to the impending problems that are being made more apparent through globalization, using two case studies of cooperative microfinance structures. By conducting case studies on transitional and developing nations, we were better able to understand the impact cooperative microlending has on self-employment success in both second and third world economies.

Social capital appeared to be an important success determinant in both areas as greater entrepreneurial survival and growth seemed to be correlated with increased social capital. Cooperative microlending establishes processes that seem to create, facilitate and foment social capital among group participants. Even in transitional economies where social networks and ties are few and difficult to establish, cooperative microlending appears to be breaking the cultural and historical barriers that prevent entrepreneurs from developing needed social ties and relationships in order to survive and grow their enterprises. Microfinance cooperatives not only offer economic hope for the bottom rungs of a society, but also seem to generate stronger communities and solidarity among poor masses. This approach to cooperative microlending gives entrepreneurs a chance to help one another and build up each other. The result is a stronger community and economy.

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