

Mutuality and the Potential of Microequity

Muhammad Meki, Kate Roll, and Simon Quinn

Introduction

Work on building more mutual business practices is under way in busy streets and rural markets across Kenya. Through Mars-Wrigley Confectionery's Maua Business, initiated in 2013 by Mars Catalyst, over six hundred micro-distributors take part in a route-to-market programme selling Wrigley chewing gum products alongside other goods. These sellers purchase bags or boxes of gum at a small discount from local wholesalers and then sell either directly to consumers or to small shops, where the packets are sold to consumers. Pursuing joint goals, the programme enables the company to access areas of the country that it had been unable to reach with conventional distribution practices, as well as providing a new source of sales and training for low-income sellers. In explicitly bringing together social and business goals, the programme is a site of social innovation at Mars, and encourages those who manage the programme to think in new ways about the relationship between sales and the social and human capital of sellers. For Mars, the Maua programme is an opportunity to try out new ideas around mutuality and expand the boundaries of their business.

The Maua Business is also the site of academic research into mutual business practices. This research, which is being led by a team of economists and social scientists at the University of Oxford, empirically

tests the performance of a novel mutuality-driven instrument against conventional practices. This is important for providing an empirical basis to work on mutuality in business as well as potentially bringing greater nuance to our understanding of how individuals with different measured levels of social and human capital respond to such interventions. To do so, we are focusing on providing microequity to sellers interested in purchasing a productive asset—in this case a bicycle suited for carrying cargo. We view microequity as embodying core ideas of mutuality, specifically the focus on joint flourishing and the interdependence of a firm's stakeholders. Microequity, as compared to dominant forms of microcredit, better shares the risks and rewards of the investment. So, does this lead to better outcomes? Along what measures? And for whom? These are the questions that we are investigating in this ongoing research.

The concept for the microequity study arose through qualitative interviews with Maua sellers in 2014 and 2015, as well as surveys on human and social capital conducted by Mars Catalyst. This work revealed that micro-distributors considered transportation to be a key constraint to productivity; surveys showed lower satisfaction with 'materials and equipment', which at the time primarily consisted of backpacks for carrying the goods and promotional materials. Indeed, micro-distributors who were walking complained of long days and back pains, for example, and aspired to carry their goods either on bicycles or motorbikes. Sellers who were able to buy such vehicles reported significant increases in income. Vehicles have the potential to reduce the sellers' fatigue and dramatically increase their range—essential for increasing the number of small shops or *dukkas* that they serve—and allow them to offer a wider range of products.

The expressed need for better access to transport created the opportunity for our team to work closely with Mars Catalyst, the Mars-Wrigley business, and microfinance partners to develop and test a new, more mutual way of financing these assets. As noted above, mutuality demands attention to the extent to which benefits and costs are shared equitably. In order to translate mutuality into a business practice, we focused on the distribution of risk and reward within microfinance contracts. For the study, we have designed multiple types of contracts—both

conventional and microequity driven—which we are able to offer to interested participants, for whom we will then track a range of different outcomes in order to rigorously measure impact. A pilot in 2017 with thirty-two participants showed that the mutuality-inspired microequity product is viable; we are currently testing the effects of this product in a larger study that is under way and includes just under a hundred participants at the time of writing.

This study is novel in its use of field experiments to identify the causal effect of more mutual practice on performance. However, rather than presenting the technical aspects of the study, this chapter instead discusses our work conceptualizing and testing the new, more mutual, approach to microfinance. We examine two core questions that emerge from the case: What are the prospects for scaling the microequity model? What have we learned about conducting field experiments in the context of a corporate programme? The chapter concludes by discussing how the effort to capture and test the idea of mutuality enabled us to engage more deeply with the concept itself.

The Evolution of Microcredit

Microcredit, which is often defined as the provision of small-scale loans to low-income individuals in developing countries, had been heralded as a key poverty-alleviation tool with the potential to stimulate the growth of credit-constrained microentrepreneurs. For the purposes of this discussion, we define microentrepreneurs as individuals who engage in non-agricultural commercial activity, with the majority working alone or hiring at most one other employee. These individuals pose particular challenges to lenders, as they often lack collateral and credit histories, and the loan amounts that they require are often too small to justify the effort and administrative costs for a large bank. The question of how to overcome this challenge has been the subject of intense study and experimentation over the last two decades.

In 2006, Muhammad Yunus was awarded the Nobel Peace Prize for his contributions to microcredit through Grameen Bank. The success of the original Grameen model—with its very high repayment rates—can

be attributed to a number of features that instilled discipline and leveraged local knowledge and peer pressure, including joint-liability group lending, high-frequency repayments with group meetings in public, and dynamic incentives through graduated loans. The bank also focused on women. The Nobel Prize Committee stated that ‘Yunus and Grameen Bank have shown that even the poorest of the poor can work to bring about their own development... in the continuing efforts to [eliminate poverty], micro-credit must play a major part.’

Initial reporting based on success stories and studies based on observational data suggested that microcredit created large positive social and financial effects for borrowers.¹ However, more rigorous recent research has revealed a different story. A number of large-scale RCTs have shown that microcredit has not, in general, had a transformative effect on poverty. Across a number of settings, these studies reveal low demand for microcredit and no substantial increases in household income, educational outcomes, or female empowerment (Banerjee, Karlan, and Zinman, 2015). While most of the studies do show expanded business activity, these investments rarely resulted in increased profits. This may reflect the fact that many of the small business owners are likely to be in subsistence-level entrepreneurship and are not ‘growth-oriented’, or reluctant entrepreneurs who would prefer to have a wage job (Banerjee and Duflo, 2011; De Mel, McKenzie, and Woodruff, 2010; Schoar, 2010).²

While these results have disappointed many practitioners and led to a lively debate over the benefits of microcredit, recent academic work on microenterprises has shown more promising results. In particular, scholars have seen positive results from the provision of cash or capital grants to microentrepreneurs (De Mel, McKenzie, and Woodruff, 2008; Fafchamps, McKenzie, Quinn, and Woodruff, 2014) and when introducing more flexible microcredit products that allow repayment grace periods (Field, Pande, Papp, and Rigol, 2013).

While the investigation of flexible credit products has certainly provided promising results, and recent progress in mobile banking now allows lenders to assess creditworthiness by observing transaction behaviour, concerns with the underlying model remain. One hypothesis for the failure of microcredit to lead to microenterprise growth relates to the debt-based structure of microcredit. Microcredit contracts typically feature

a very rigid repayment structure and high interest rates. Requiring a fixed repayment amount regardless of the performance of the business may not be the optimal financing method to stimulate the investments of high-potential but risky microenterprises. A more mutual way of financing may be to provide the implicit insurance of performance-contingent payments, which can better allow microentrepreneurs to make the higher-risk, higher-reward investments that are necessary to accelerate the growth of their businesses. Recent work has shown the potential for equity financing to stimulate investments with a greater expected return, using a 'laboratory in the field' experiment (Fischer, 2013).

Mutuality Meets Microequity

Equity-based contracts have the potential to provide a more mutual form of financing. Rather than requiring a fixed rate of return regardless of the performance of the business, microequity contains implicit insurance through performance-contingent payments. A performance-contingent payment simply means that repayment is linked to earnings; a borrower repays more when her business is performing well and repays less when business is slow. Equity-based contracts explicitly allow for loss-sharing in the case of lower incomes; concomitantly, in return for the capital provider taking greater risk, they require higher payments when business incomes are high. Such contracts may be particularly valued by more risk-averse entrepreneurs, who may be concerned about losing their wealth under a debt contract when their business receives a negative shock.

Reflecting the idea of growing businesses through creating mutual benefits, microequity contracts seek to align the incentives of capital providers and users. With debt contracts, microcredit loan officers may be incentivised to lend to lower-risk, lower-reward entrepreneurs who repay their loans. They also may be less interested in financing higher-risk entrepreneurs who may make a lot of profit but may also make some losses before that, because loan officers are exposed to the downside risk and do not share any of the upside. In microequity, the more successful the entrepreneur, the better the result for the capital provider.

In this study we are interested in whether a more mutual contract, in this case microequity, can out-perform a conventional contract—for example in terms of repayment rates—as well as if microequity can produce better outcomes across multiple capitals, one of the central concerns of Mars’ economics of mutuality approach. In examining outcomes, we could imagine contract A and contract B performing identically as finance instruments; however, if we could observe greater gains in social or human capital in contract B, we could also think about that contract as having more holistic, mutual effects. Similarly, as we used baseline surveys to capture elements of participants’ human and social capital, we will be able to see how these endowments affect performance in a contract, all else being equal.

One of the major challenges in implementing equity-based contracts is access to accurate information on performance, on the basis of which income-sharing payments are linked. In the unique context of the Maua Business, in which uplifters directly purchase the stock from Maua-approved stockpoints, and we are able to estimate incomes based on the price sold to customers, we can credibly link repayments to performance. We can then use a careful experimental design to investigate the preference for equity contracts of entrepreneurs with different levels of income and risk aversion, with the ultimate question of interest being the impact of such contracts on the lives of entrepreneurs.

The Maua Study

A pilot study, conducted as a randomized controlled trial (RCT), was launched in January 2017, involving thirty-two participants; the RCT design allows researchers to measure causal impact. Five of the uplifters from the pilot received a bicycle financed by a fixed-repayment loan contract, while thirteen received bicycles using our mutuality-inspired microequity contracts, where repayments were linked to uplifters’ sales. The rest formed a control group. Administrative data from the pilot revealed that the microequity contracts significantly outperformed the fixed-repayment debt contract in terms of repayment performance, with very few missed payments compared to a relatively large number of

missed payments for the debt contracts, although we are careful not to put too much interpretation into the results from such a small sample.

Nonetheless, the viability of such contracts was demonstrated, and we are now testing them in our larger ongoing study. In January 2018, after delays due to post-election violence, we returned to Nairobi to launch the roll-out of the full-scale RCT, which is ongoing, with just under a hundred microentrepreneurs admitted into the programme at the time of writing. Looking at data from our (pre-intervention) baseline survey, 90 per cent of entrepreneurs are male, and the median entrepreneur is aged 30, married, and comes from a household containing four members, typically with only one member of the household earning any income. Median business profits are approximately 65 GBP per month, and median monthly household income and expenditure from all sources is 137 GBP and 130 GBP respectively. This low level of net household income is reflected in relatively low levels of savings at the household level (approximately 280 GBP for the median household, which indicates that a bike costing 90 GBP would constitute a very large share of total household savings).

We are currently expanding the programme (and have recently included entrepreneurs from the coastal area of Kenya, Mumbasa), and are collecting follow-up data for all entrepreneurs. Preliminary data reveals a high take-up rate for all of our contracts, in the region of 82–92 per cent, which compares very favourably with take-up rates from all other prominent microcredit studies (where take-up ranges from 13 per cent to 31 per cent). As yet, there is no statistically significant difference in take-up rates between most of our contracts, but we expect this to change as our sample size increases. One exception to this is that take-up does seem to be lower for our income-sharing contract that has a fixed duration, which is unsurprising since such a contract requires entrepreneurs who are very successful to share a very large amount of money in comparison to other contracts. We look forward to investigating take-up patterns in more detail as our sample increases, for example exploring the correlation between contract preference and risk aversion. As mentioned, we also intend to test the hypothesis that more mutual contracts can more effectively help entrepreneurs grow their business, by measuring the impact of our contracts on a range of difference outcomes

including human and social capital indicators; for example, we hypothesize that providing more mutual contracts that share in risk and reward with entrepreneurs could lead them to better identify with the values of mutuality and increase their reported levels of trust in their business and other relationships.

The conceptualization and design of the Maua microequity RCT raises a series of important questions about the positive potential for this type of microfinance product and randomised evaluations more generally. But can either contribute on a wider scale? As discussed above, a core challenge for the implementation of a microequity contract is securing credible information on income. A particular advantage of working with the Maua programme has been the availability of reliable, high-frequency sales data, as the business records micro-distributors' sales in order to calculate bonus payments. By contrast, many micro-distributors are not part of similar programmes and there is not a system to ensure reliable, centralized, frequent sales collection. This includes workers in small shops, for example, who may or may not keep accurate records of their earnings.

But is this something that will soon change? Innovations in financial technology and digital payment systems mean that it may be more common for entrepreneurs to have detailed and accurate records of their earnings, which would allow models such as ours to scale. As more workers and entrepreneurs use digital platforms to transact, thus producing accurate records of their activities and sales, the potential sites for offering microequity—and more mutual ways of doing business—appear large. The ability to measure performance, given progress in financial technology, can therefore allow the design of more mutual sharing arrangements in the future.

Conclusion

At the centre of the concept of mutuality are relationships. In the business context, this challenges us to re-imagine business practices as a means of creating shared and sustained benefits for consumers, workers, suppliers, and investors. This demands attention to the conditions

that allow for flourishing in the long term, as well as reflection regarding the extent to which benefits and costs are shared equitably. Mutuality distils a relational, embedded view of the firm that stands in sharp contrast to the model of business as a zero-sum game. In a system in which corporations shape markets, this question of what a more mutual way of distributing the costs and benefits of business activities gains urgency.

This experimental study gives us an opportunity to test both whether a more mutual approach, in this case microequity, can out-perform conventional approaches in terms of performance, as well as drive more mutual outcomes for Maua sellers in terms of their human and social capital. The comparison of microequity and conventional debt contracts will help us better understand the optimal financing structures to help micro-distributors grow. This is an important question, as microfinance is an increasingly common feature of the lives of low-income individuals, and yet it continues to leave expectations for transformation unmet. More broadly, this study also speaks to big-picture questions about how the balance of risk and reward influences behaviour and how best to design products or practices with sensitivity to the needs and concerns of multiple parties. These questions touch on the key intuitions behind work on mutuality in business.

The challenge of translating the complex and multi-faceted concept of mutuality into an intervention that could be tested in a 'fair horserace' against conventional practice has been, in and of itself, an important exercise in thinking about what mutuality means at the practical level. Indeed, asking, 'How can microfinance be made more mutual?' demands the distillation of the characteristics of a mutual relationship. This needed to go beyond simple benefit—the provision of at least a marginal benefit is the theoretical basis of any non-coerced transaction—and to engage with the idea of joint, even interdependent, prosperity over the long term. How can this be baked into a microfinance product? We focused on the sharing of risk and reward in the relationship between the lender and borrower (or investor and investee), hypothesizing that a more mutual sharing of risk could enable sellers to do more to grow their businesses. Microequity captures these key features. We are confident that the results of this research will help to shed light both on the

performance of microequity contracts as well as, more broadly, the potential for creating more mutual relationships between corporations and workers within their supply and distribution systems.

Notes

1. See Roodman and Morduch (2014) and Banerjee, Duflo, Glennerster, and Kinnan (2015) for a discussion.
2. These empirical studies have been complemented by anthropological work that has examined the way in which peer lending functions, with some authors raising concerns about intense social pressure being placed on borrowers (Karim, 2008; Montgomery, 1996; Rahman, 1999).