The Impact of Political and Cultural Factors on the Success of Microfinance Institutions

by

Minglu Xu

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Approved by

Murray Jardine, Chair, Professor of Political Science
Valentina Hartarska, Co-chair, Professor of Agricultural Economics
Kalu Kalu, Distinguished Research Professor of Political Science and National Security Policy (AUM)
Paul Harris, Professor of Political Science

Abstract

This research focuses on the survival context of microfinance institutions from a political and cultural perspective. Compared to other methods of poverty alleviation, microfinance, as a new financial channel, seems more resilient, independent, and full of vitality for innovating the inner power of grassroots movements. This dissertation addresses the dynamic relationship between the performance of microfinance institutions (MFIs) and states' actions from a bird's eye view and explores the best political conditions for MFIs. Panel data from around 8957 microfinance institutions (MFIs) based in 113 countries has been utilized in the quantitative analysis of this dissertation. More specifically, a fixed effects model is used to test the impacts of the time-variance variables while a random effect model is used to explore the time-invariance variables. Moreover, a qualitative analysis of three countries--China, Indonesia and India—is undertaken to provide examples of how the dynamic relationship between external environment and performance of microfinance institutions works in practice. For both quantitative and qualitative analyses, regime type and democracy, governance quality, decentralization and culture are the main indicators to study as impacts of the macro-political environment. Geert Hofstede's six culture dimensions have been applied to study cultural factors and provides a complementary view and support for the findings about political indicators. Overall, both cross-national regression models and detailed case studies indicate that a higher level of decentralization and a lower level of government control of markets could help the performance of MFIs. Regulations and good governance do not help the performance of MFIs significantly. Regimes with higher levels of democracy tend to help MFIs reach more borrowers but there is no significant impact on sustainability and depth of outreach. Some cultural factors have proven to have significant influences on the performance of MFIs.

Keywords: microfinance, institutions, political environment, culture, regime type, decentralization, regulation, economic freedom, globalization, governance

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List of Abbreviations

ACCION	Americans for Community Cooperation in Other Nations
BPRs	Indonesian People's Credit Banks
CGAP	Consultative Group to Assist the Poor
EIU	Economist Intelligence Unit
GDP	Gross Domestic Product
GNI	Gross National Income
HDI	Human Development Index
HIPC	The Heavily Indebted Poor Countries
IDV	Individualism
ITOWVS	Long-term Orientation
IVR	Indulgence
MAS	Masculinity
MFIs	Microfinance Institutions
NGO	Non-governmental Organizations
NNI	Net National Income
PDI	Power Distance
ROA	Return on Assets
SEWA	Self-Employed Women's Association
SHG	Self-help Group
UAL	Uncertainty Avoidance

UN	United Nations

Chapter One

Introduction: Conceptualization and Epistemology

Background of the study

The situation of a large number of people who live in poverty and the high levels of inequality are concerns of all governments around the world. Not only for economic development, poverty alleviation is also a vital task for improving the safety and equality of a society. Meanwhile, the financial services industry seems like a remarkable microcosm, which is growing rapidly and creating more opportunities for ordinary people. Both academic research and experience have proven that microfinance, as a new financial channel, helps poor households by increasing their income, starting their own small business and securing their future through reducing their vulnerability to external shocks. Muhammad Yunus, the founder of Grameen Bank, promotes microcredit as a social objective with the task to help people get out of poverty and he believes that "Credit is of fundamental importance if we are to build a just society where all human beings can live with dignity. I am convinced that credit is a basic human right. All other basic rights - food, shelter, education, health - are denied when a person is poor. Credit unlocks the door (Yunus 1997)."

New institutionalism believes that institutions are operated in an open environment consisting of other organizations and every institution could influenced by their external broader circumstance and institutional peer pressure. “Under what kind of political and cultural environment can microfinance institutions (MFIs) have the biggest success?” is the main research question of this dissertation. To answering this question, this dissertation attempts to provide a bird’s eye view of the impact of governments’ actions and the potential influences of cultural indicators and aims to add new academic ideas for microfinance study by finding the dynamic relationship between Microfinance Institutions (MFIs) and their political and cultural environment:

First, there have been a few studies that focus on the performance of microfinance institutions. However, microfinance studies in political science are still rare (Hudak, 2010). To date, much of the literature on microfinance has come from sociology, economics or the industry itself (Brau and Woller 2004; Morduch and Haley 2002; Sebstad and Chen 1996). In political science, this study has drawn a connection between state-led (top-down) approaches and bottom-up approaches to analyze the political environment. The top-down approach believes centralization of power is necessary and individuals act selfishly so they have to be artificially incentivized via external legal and social structures, while bottom-up approaches state that a decentralized society is better, which is more flexible and should allow for a wider variety of solutions. Society could be improved incrementally by the aggregate of individual peoples’ actions. Some scholars think microfinance itself is a “bottom-up” approach to ending poverty by giving small loans so that the borrowers can start their small business.

Second, this dissertation includes Geert Hofstede’s six culture dimensions as the independent variables to explore their impact on the development of microfinance institutions, which is rare in both political science area and microfinance research. In chapter five, a random effect regression model has been used to test cultural variables after the fixed effect model, which was applied to test the political indicators. Culture refers to the values, ideologies, beliefs and history of a country, which could help us understand the function of the political environment in society and the conflicts within a country, which could be great supplements when we analyze the influences of political indicators and the potential reasons of our findings.

Third, microfinance, which focus on grassroots development, gives us a viewpoint for small-scale development of households and its impact. At this point, we could further explore the importance of decentralization and economic freedom. Then we can find the best balance of government involvement in the market and the degree of economic freedom that could make MFIs more successful.

Last but not least, this research focuses on institutions and the quantitative analysis uses a newer panel database with information from close to 8957 microfinance institutions from 113 counties for the period of 2003-2014, which could contribute to the academic field on the methodological and technological level. More data becoming available by a few research organizations such as MIX Market, EIU, and the world bank, which is of great importance for this dissertation in the operation of data inquiry and in the progress of research to explore more new findings about the microfinance industry worldwide.

Brief Overview of Microfinance and Its Development

Microfinance developed around the world as a strategy and innovation that aimed to benefit poor households who lack access to traditional formal financial institutions for improving their livelihoods through their own efforts and labor. Many microfinance institutions (MFIs) provide services beyond credit in different forms such as: stand-alone savings products (credit unions and cooperatives), personal skill training and life insurance or health insurance etc.

Microcredit, the earliest form of microfinance, has existed in various forms throughout economic history. Both informal savings and credit groups are the prototype of microcredit since the Middle Ages. An Italian monk initiated the first official pawn shop in order to counter usury practices in 1462 CE. After pawn shops developed, small loans were provided to farmers to use for agricultural development and was operated through the Irish Loan Fund System in the eighteenth century. Credit unions and rotating credit associations (ROSCAs) also have a long history. Friedrich, the pioneer of rural credit unions, started his first credit society in southern Germany. During the nineteenth century, the cooperative movement expanded widely in Germany, and formal savings and credit institutions emerged. Microlenders such as Bank Rakayat Indonesia (BRI) counter the conventional ways to finance the poor by using cost-recovery interest rates to increase repayment rate, which result to increase the long-term sustainability and reach a larger number of clients (Helms, 2006). Then, in the twentieth century, “Microcredit” started to be replaced by “Microfinance”. Furthermore, many new microfinance banks were owned by government agencies in the early twentieth century, and the state-led, top-down approaches dominated microfinance until the 1960s. However, people found that these interventions were rarely successful because subsidized lending rates could not cover the operation costs, and customers had poor repayment discipline and saw their loans as gifts from the government. (Novotel, 2009). Considering the inefficiency of “trickle-down” economics, some researchers started to advocate grassroots projects, which focused on small-scale, local community-driven approaches in order to serve the poorest people (Friedman 1992; Kingsbury 2004; Schumacher 1973). Moreover, in the 1970s, modern microcredit was born, in the time period that emphasized on neoliberal policies and hands-off approaches in the economic area. Some modern microfinance institutions were established at that time. For example, Americans for Community Cooperation in Other Nations (ACCION) International, which is a global nonprofit organization that provides financial services to low-income clients in 32 countries was established in 1961; Self-

Employed Women's Association (SEWA), a trade union and an organization of poor, self-employed women workers registered in 1972; and Grameen Bank was established in 1976, receiving the Nobel Peace Prize for successfully practicing credit delivery system while being credited with the start of the current microcredit movement (Mersland, 2008). Afterwards, microcredit was replaced by microfinance during the 1990s and started to involve more private investments, new technology, and a diverse array of institutions. The year 2005 has been declared by the United Nations (UN) to be the "International Year of Microcredit," which has reflected the booming of the Microfinance industry. In 2005, there were more than 350 international microfinance conferences that more than 100 countries participated in. ("International Year of Microcredit 2005: Final Report" 2006). Finally, microfinance institutions have developed from specific donor projects to a whole financial system.

Brief Overview of Microfinance Institutions

Microfinance institutions (MFIs) are the organizations that provide a microfinance services. The traditional non-profit NGOs funded by donors and development agencies have turned into a global industry and increasingly organizational forms have emerged such as credit unions, group lending institutions, for-profit cooperatives, sectors of government banks, non-bank financial institutions and commercial banks (Dieckmann, 2007). Moreover, MFIs provide various services as well. Recent events have shown that institutions for the poor no longer just exclusively offer microfinance service, but also provide insurance, savings, trainings and so on. The emergence of “for-profit” MFIs is growing. Increasing consumer durables companies are targeting the poor with microcredit schemes, and even Wal-Mart is offering remittances services (Goldstein, Skoufias, 2007).

In today’s highly diverse range of organizations, people identify the institutions as “Microfinance” through several characteristics such as the small size of transactions including loans, savings or insurance; entrepreneurial loans; collateral-free loans; group lending; poverty-relief programs that target the poor or female clients; the services provided for underserved communities, and market -level interest rates (Karlan, Goldberg 2011).

Recent International Monetary Fund’s states that the systematic and comprehensive data relating to MFIs are still lacking (Wrenn, 2005). However, there are increasingly authoritative data of the number of MFIs and the populations served provided by many resources such as MIX market. The recent data indicates that over the last two decades, the microfinance industry has achieved significant growth in terms of both number of institutions and the gross loan portfolio. At the same time, the MFIs’ landscape has become more complex and pluralistic. The development of MFIs is an inevitable requirement of social needs. Because microfinance beneficiaries are spread out in large areas and utilizing small-sized loans, it creates the obstacles for government and state banks to reach them. Thus, organizations which provide microcredit loans directly to villagers, micro-entrepreneurs, impoverished women and poor families appeared. However, it needs to be mentioned that, in order to achieve this considerable development, microfinance institutions have to face quite a specific set of challenges and need to achieve a double bottom line—provide financial services to the poor (outreach) and cover its cost (sustainability). (Hartarska, 2004).

According to recent reports, microfinance is a significant and growing industry. Recent figures reporting to MIX indicate that there are 1112 microfinance institutions reaching 132 million customers worldwide in 2016, for a loan portfolio of $102 billion. In terms of the geographical distribution, the findings indicate strong growth in southern Asia, and India was the leader in southern Asia with 47 million borrowers and roughly $15 billion in outstanding loans. Beyond southern Asia, Latin America and the Caribbean also had a remarkable development in 2016, with $42.5 billion in outstanding loans, compared with $9.3 billion in Europe and $8.7 billion in Sub-Saharan Africa. Overall, in 2016, MFIs reached an annual growth of over 9.4% in the global portfolio of loans and more than 9.6% was recorded in the number of active borrowers. However, according to the data provided by the reporting MFIs to MIX Market, there are still around two billion adults that do not have accesses to financial institutions (Microfinance Barometer 2017).

Why This Research Focuses on Institutions

Focusing on institutions is one of the features of this dissertation. Why does this paper consider institutions so important for measuring the performance of MFIs and testing the impact of the political environment?

Firstly, in the microfinance industry, microfinance institutions appear to be a connection between the microfinance industry and governments. Most MFIs operate with subsidies, which come from three main resources: financial markets, public funds and individual donors. Those donations and funds flow to institutional investors then come to microfinance institutions. After that, MFIs supply the small loans and services to their clients. MFIs are at the center that connects the donors/investors and clients/self-help group (SHG).

Second, governmental institutions especially the tiers and numbers of local government institutions, are important factors to be considered in this dissertation. There are some reasons: first, studying the impact of degree of decentralization in a country is one of the research questions and requires us to pay attention to local government institutions. Second, the microfinance services need to reach poor households, who are closer to the local governments. Third, the needs of residents such as infrastructure, land use planning, roads, internet, public transit, economic development promotion, education, welfare, healthcare, and infotainment are provided and dependent on those government sectors, which comprise of municipal governments, boards of education, district health boards and a variety of other special purpose institutions (Rahman, 2010). Last but not least, political institutions have a direct impact on the business environment and activities of a country, and could help us understand more about the policies, economics and society of a country. Every society must have a type of political system so it may allocate resources and ongoing procedures appropriately (Boddy-Evans, 2017) and the characteristics of those political systems reflect the culture, ideology, and history of a country.

Third, Neo-institutionalism emphasizes the theoretical importance of institutions and states that institutions shape and are in turn shaped by the social structures around them (Mader, 2016). According to this line of thinking, studying the way institutions interact in a society could help us to study the influences of the political and cultural environment around the institutions. For the microfinance industry, political factors, such as government assistance and donor agencies, a supportive policy, or a regulatory environment, must be operated through institutions. At the same time, institutions can also influence policy making. Institutions include certain types of policy, which in turn stipulates rules that assign normatively backed rights and responsibilities to actors. Institutions constitute rules not only for actors but also for policy makers themselves (Streeck and Thelen, 2005).

Last but not least, institutions are the evidence for the complex connections and relations between every actor in the microfinance industry. Scholars have identified that institutions shape not only actors' strategies, but also their goals (Steinmo et al, 1992). The influence of institutions could be determined by the distribution of power among the actors, which helps to shape the outcome of this process (Koelble, 1995).

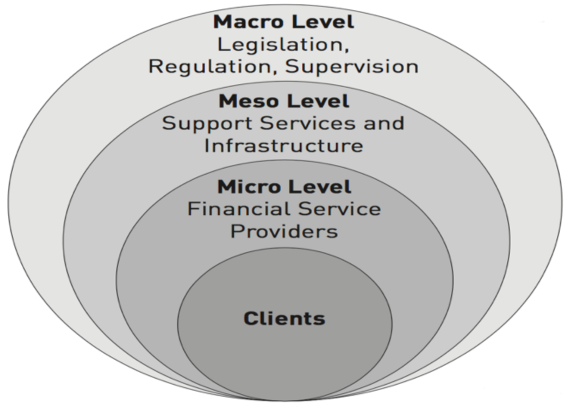
Brief Overview of the Political Environment for Microfinance

The government comes into play when markets may fail to achieve an efficient result. Likewise, the microfinance industry is a response to the failure of formal financial systems to reach the poor (Schumacher, 1973). The big difference between the government and microfinance institutions is that microfinance operates through the financial market, while governments play a role by intervening in the market through making public policies and regulations, providing public goods and so on. Government institutions and microfinance institutions both play a role in the financial system and the interaction and dynamic between microfinance institutions and governments has been formed their own living environment.

The questions of the role of governments and what is the optimum balance of state intervention are necessary to be considered for a political economic theory of microfinance. Looking at the researches before, from the early twentieth century to the 1960s, state-led, top-down approaches dominated microfinance and most MFIs dependent on the governmental subsidies. Then, after noticing the negative impact of subsidies for MFIs', there is increasing consensus that it is better for states do not provide financial services directly. Instead, governments can focus on developing sound policy frameworks and political environments that can encourage vibrant and competitive microfinance. Governments do have a constructive role to build a better financial system that work for the poor (CGAP, Duflos, 2004).

The governments' roles can be identified in each level of the financial system. A financial system is a set of implemented processes and procedures used by institutions to track financial activities. Consultative Group to Assist the Poor (CGAP) provide a description of three levels financial system in 2006: The macro-level financial system reflects the activities by players such as central banks, ministries of finance, and other national governmental entities; the meso-level system related to the functions of financial support and locally available market infrastructure and the micro-level financial system, which are the backbone of financial systems, is about the process of retail financial institutions provide services directly to the poor. The goal of "access for all" can only be achieved if microfinance services are integrated into all three levels of a financial system (CGAP, 2006). According to the three levels of the microfinance system, this paper analyzes the governments' role (national to local) in each level (see figure 1).

Figure 1:



(Note: Reprinted from Good Practice Guidelines for Funders of Microfinance by CGAP, 2006)

Firstly, at the macro-level, government functions refer to maintaining macroeconomic stability, protecting rights and promoting equity, and regulations/supervision. Policies and regulations are two primary methods for governments to realize their functions, which are expressing the will of the state and the execution of that will (Goodnow, 1900). Policies are not mandatory but need to be implemented by governmental organizations, while laws are compulsory and need to be supervised by a legal operation department. The political indicators studied in this dissertation, such as regime type (depends on the degree of democracy), regulation quality and culture, are related to the states' actions on the macro-level.

Secondly, in contrast to the political factors explored at the macro-level, meso-level places emphasis on physical or organizational infrastructure mostly. For example, information transport networks, general public infrastructure and services, and support systems for business and finance to make financing transactions more efficient, and thus cheaper. More specifically, the IT support and roads provided by the government, or the credit reporting provided by credit bureaus[1], are all related to meso-level activities.

Thirdly, retail financial institutions and their clients are the primary actors at the micro level of microfinance system. The roles of government include reaching poor households and collecting detailed information, providing funds or credit to strengthen financial services when the supply of commercial financing is limited, or training programs operated by governmental institutions that help improve sustainability of microfinance projects. For example, China issued a new microfinance policy called "targeted poverty alleviation" in 2017. To avoid poverty-returning, the government is still going to help some clients who have the potential for self-employment, basic-skills capability, and an acceptable credit history even when they have a delayed debt, which requires the retail local government to reach the poor households, interview to know more about their

[1] Credit bureaus, also called credit reporting agencies, are companies that collect and maintain consumer credit information then resell it to other businesses in the form of a credit report. They're all publicly-traded, for-profit companies—they're not owned by the government. The government does, however, have legislation—the Fair Credit Reporting Act (FCRA)—that regulates how these, and other credit bureaus can and must operate. https://www.thebalance.com/what-you-should-know-about-the-fcra-960639

situation and collecting data and information for their credit history. At the micro-level financial system, the degree of decentralization, tiers of governments, E government and economic freedom could reflect the structures and policies of local governments.

Ideological Conflict Issues in Political Science: Top-Down vs. Bottom-Up.

Generally, from a political science perspective, the top-down policy is an approach that relies on centralized leadership and a hierarchal organization, which emphasizes the law, rules, and rights of citizens and believes that society can be fixed by grand architecture. Governments have been seen as the consciously created organizations that are responsible to make the decision of tasks and goals, put in place laws, and provide a framework to influence citizens to act in a certain way. On the contrary, a bottom-up perspective believes that society can only be fixed by individual actions. The bottom-up perspective emphasizes the decentralization and freedom and believes individual people could build a better society incrementally through their efforts and the aggregate of actions. Governments, in the bottom-up style need to be responsible to various needs and conditions and this leadership style allows for communication and continued fluidity to be responsible for a greater number of opinions rather than to be a overarching leader with singular decision. In the following, a general theoretical outline of top-down and bottom-up is going to be introduced:

Classical liberalism, now usually referred to as "conservatism," which developed in the 18th and 19th centuries, saw itself as putting forward a bottom-up conception of society in opposition to the top-down structures of the aristocratic systems it wanted to overthrow. Society should be a collection of independent individuals free to pursue their own goals, particularly within the context of the market economy. But by the late 19th century, a new type of top-down social order has appeared results of the huge concentrations of corporate capitalist power and extreme inequality in the liberal markets.

Reform liberalism, now usually just called "liberalism" (and its European cousin, social democracy), which developed in the early 20th century, initially saw itself as a bottom-up solution to the problem of corporate power. Reform liberals wanted greater government regulation of the market economy (and particularly of large corporations) and redistribution of income. They saw these policies as promoting a more bottom-up social order because government itself was subject to democratic control. But as early as the mid-20th century, it was becoming apparent that reform liberalism had not so much shifted power from corporations to the people via democratic government as simply shifted power from capitalists to government bureaucracies, or, more precisely, to a "technocracy" of public and private managers. (Full-fledged socialism suffered this fate to an even more extreme degree.)

Neoclassical liberalism, or "libertarianism," usually referred to as neoliberalism in Europe, again attempts to articulate (albeit with somewhat different philosophical presuppositions) a bottom-up model of society similar to that of classical liberalism, with individual participation in the market as the basis for freedom, and has had widespread influence since the 1980s. But, as with classical liberalism, the neoliberal order has in short order produced an increasingly monopolistic global economy and severe inequality–and thus now seems to be generating extreme, top-down ideological reactions on both the left and the right.

Communitarianism is a political theory, derived from both classical Greek political theories and various elements of Christian, particularly Catholic, social teaching, that attempts to create a bottom-up alternative to liberal individualism and its ironic tendency toward state or market dominance. Communitarians stress the social nature of humans and their need for community; liberal individualism produces paradoxical results because it has a flawed conception of human relations. Economically, communitarians tend to recommend a system of what Karl Polanyi calls "embedded markets," in which markets exist but are not allowed to dominate society. Limitations should be placed on markets in terms of their scope and particularly in terms of the size of the companies operating in markets, and worker ownership of companies should be particularly encouraged. To avoid any tendency toward statism these limitations should be enacted as much as possible at local levels and by non-government organizations such as professional associations. At this time, communitarian ideas have had little effect on public policy anywhere in the Western world, but this could change if people become increasingly disenchanted with global capitalism, and there are significant possibilities for communitarian approaches to economic policy in the global South.

Microfinance could be a very communitarian approach to helping poor people and more generally to the question of economic organization. Whether it would depends very much on how microfinance institutions are organized. Obviously a bottom-up approach would fit more with a communitarian outlook. This study will give some indications about which approaches to microfinance would accomplish this and how successful they would be. The indicators that affects both features of the above approaches will be studied in this dissertation such as the application and implement of laws, regulation qualities, political rights, degree of decentralization, financial freedom, investment freedom and so on. When the traditional "top-down" approach focus on developing infrastructure and building a national financial system as a mechanism, this research assumes that microfinance needs more local development and a trickle up rather than trickle down approach. However, this does not mean top-down approach is not needed. National policies determine the environment for local development (Snow and Buss 2001) After studying on the influences by the political indicators from both sides' perspectives, we can draw a connect line between the "trickle-down" theories of development and trickle-up perspectives.

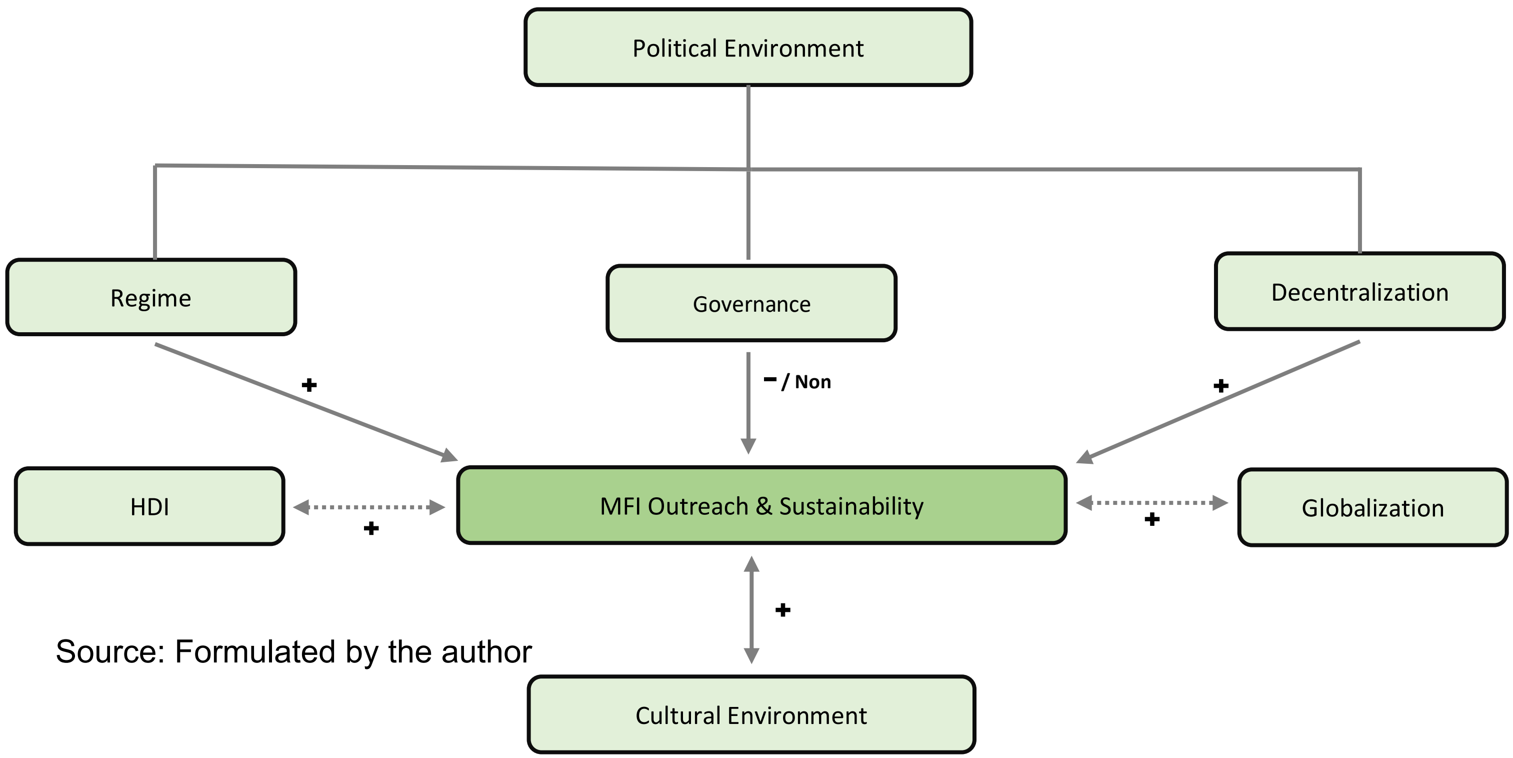
Framework

According to the role of government in financial systems and the research goals illustrated previously, this research is going to ask more specific research questions: Under what kind of political approach (top-down or bottom up) could microfinance institutions (MFIs) have the best performance? Are centralized or decentralized governments better for the performance of MFIs? What is the best balance of government involvement for MFIs? Could the cultural environment affect the success of microfinance institutions in a country? What trends emerge when looking at the development of global microfinance institutions from a bird's eye perspective?

In order to answer the above questions and based on the theoretical illustration above, both qualitative analysis and quantitative analysis were used in this dissertation to draw a connection framework between the performance of microfinance institutions and its political and cultural environment. The arrangement of chapters is as following:

Chapter Two explores provides a literature review of the political and cultural factors in the study of microfinance institutions. Chapter Three is the qualitative analysis, which focus on three Asian countries including China, Indonesia, and India. The introduction of these three cases focuses on the research priority of this dissertation including the four factors such as regime type and democracy, governance capability, decentralization and culture. Chapter Four begins with an empirical study of the quantitative analysis with institutional-level panel data. A fixed effect model and a random effect model are both used here. The success of microfinance institutions will be considered as the dependent variable of this research. The independent variables include political indicators and six cultural dimensions and control variables, which are broad and complex. All the political and cultural variables point to four factors: regime type, governance quality, decentralization, and culture (see below: figure 2). Because MFIs have different characters and microfinance has been applied in a wide variety of countries of varying economic development levels, thus macro-economic variables, MFI dummies, and two political indicators such as HDI index and globalization are controlled for in the analysis. The results and findings of this quantitative analysis are going to be discussed in Chapter Five. Finally, Chapter Six concludes the previous analysis and the prospects of the Microfinance scheme for each of the countries and explains the lessons learned from the research and suggestions for future research.

Figure 2: **Framework**



Source: Formulated by the author

Chapter Two

Literature Review

Overall Review

In terms of the microfinance study, more than 70 studies have been reviewed. The research typically crosses different academic fields such as economics, sociology and the field of political economy. Most of the studies are from economic journals and a few are from political science journals. Comparing with the development of microfinance industry, academic research in microfinance is hysteretic, but it is growing rapidly after the end of 20 century (Brau, 2004). The impact of microfinance is one of the hot issues in focus of the microfinance industry. Many research projects have assessed the impact of microfinance globally in Asian, Latin America, Africa and so on. To choose one case as an illustrative example, Bangladesh accepts a heavy concentration of assessment because it is the birthplace of Grameen Bank, which is the origins of microfinance.

It needs to be mentioned that some authors have their doubts to the capability of microfinance to pull people out of poverty and they even think microfinance may have the opposite effect. Boudreaux and Cowen (2008) think the role of microfinance may be overstated. “Microfinance does not always reach the poorest” conclude Hulme and Mosley (1996). If most of the micro-loans are used for consumption instead of investment, there will not be any long-term benefits (Dichter, 2007). However, at the same time, most scholars think microfinance has significant benefits for poor households especially when targeted on women (e.g. Pitt and Khandker 1998; Singh, 2013 on India; Deloach and Lamanna, 2011 on the health of children in Indonesia).

Studies on the Performance of Microfinance Institutions

According to the literature, the success of MFIs is related to how many countries, institutions, and clients they are reaching; the extent they can reach the poorest people; the effectiveness of MFIs to overcome the poverty problem in a society and help clients; and whether or how they could achieve sustainability (Hartarska and Dadolnyak, 2011), and 2018). Generally, most articles view the success of microfinance as the independent variable to focus on measuring its effectiveness of achieving a social objective and its influences for the economy development and less research test the factors affecting performance of MFIs. But with more data becoming available, there is a trend that increasing research especially in the economic area uses the collected data and empirical studies to explore the impact of indicators (e.g. Golesorkhi, Mersland, Randoy, and Shenkar, 2019; Hartarska, 2006, 2007, 2009; Gul, Podder, Shahriar, 2017 and Hudak, 2010). According to all the research reviewed here, this dissertation believes that although the impact of microfinance is mixed by advantages and disadvantages, generally it is positive. Even microfinance cannot solve all the poverty problems, it can provide more opportunities for the poor.

In terms of measuring MFIs' performance, studies have been done by many researchers and several different institutions like the World Bank, International Pool Policy Research Institute, and other various NGOs. The Consultative Group to Assist the Poor (CGAP) states that the main goal of MFIs is creating permanent accesses to provide high quality financial services for as many poor and near-poor households as possible (Hudak, 2010). Furthermore, CGAP initialed the following four dimensions, which indicate the performance of MFIs to achieve that goal: breadth of outreach, or providing access to as many clients as possible; depth of outreach, or trying best to reach more poorest households; service quality, or offering a suitable variety of financial products that better meet the real needs of borrowers such as savings, loans, remittances, and insurance; and financial sustainability, or making sure that their spending can be covered by their incomes of service and could survive without any governmental subsidies (Helms 2006). Furthermore, Zeller and Meyer also state that there are three policy objectives: the financial sustainability of the financial institution, outreach to the poor, and the welfare impact, which is the critical triangle in achieving the overall economic sustainability of the microfinance system (Zeller and Meyer, 2002). That is why microfinance institutions' performance is measured along these aspects of performance (Hartarska et al 2007, 2009, 2012, 2013, and 2018). That is why this dissertation focuses on the outreach and sustainability aspects:

Outreach. Yaron (1997) states that outreach presents how many people who are underserved by financial institutions. Then he also mentioned that outreach can be measured by the depth and breadth of the services. Depth of outreach means “the socioeconomic level of clients that MFIs reach”, while breadth of outreach means “number of clients served and volume of services”. Zeller and Meyer state that the number of female clients, and the total number of loans made or outstanding are regularly reported as indicators of the breadth of outreach by most MFIs. Women often face greater problems than men in accessing financial services, so the number of women served is often measured as another criterion to evaluate how well MFIs reach the very poor. Less information is provided about the depth of outreach (Hudak, 2010). Depth of outreach is about the poverty level of the clients served and represents the degree to which the MFIs can reach especially the rural area, female clients, and illiterate clients (Paxton and Cuevas). Furthermore, Meyer (2002) advocated that, addition to the outreach of providing small loans, if the government also effort on the services including secure savings, insurance, remittance transfer and so on, both of the poor’s demand and their welfare will be improved.

Sustainability. Generally, sustainability is the capability to generate sufficient funds to cover the cost and maintain the activities of a program. From the banker’s perspective: sustainability of an MFI is dependent on whether the operating income from the loan is sufficient to cover all of the operating costs (Sharma and Nepal, 1997). Bell and Morse (1999) stated that sustainability of institutions represents both of “the long-term availability of the means and the long-term achievement of goals” (Fitamo, 2014). Sustainability of an institution means the capacity of the institution to maintain its output at a level that is approximately equal to or greater than its historical average input (Bell and Morse, 2008) However, some researchers like Shah (1999) think the bankers’ perspective, which sticks to an “accounting approach” of sustainability, is too narrow. The sustainability of MFIs should include both of “financial viability” and “institutional sustainability” (self-sufficiency) Additionally, the criteria of financial viability include “repayment rate, operating coast ratio, market interest rates, portfolio quality, and so on (Sharma and Nepal, 1997). Broadly, the sustainability of demand, the set of MFIs’ mission, sustainability of its ownership and even the governance structure and the legal and regulation framework around these institutions all contribute to the overall sustainability of an MFI. (Mahajan and Nagasri,1999). Another major part of the literature evaluates MFIs’ performance broadly in terms of their efficiency) (Hartarska et al 2010, 2011, 2014, 2018; Caudill et al 2009 and 2012, Delgado et al 2015). As an extension of Mahajan and Nagasri’s conclusion, Githinji (2004) further discussed the different dimensions of sustainability of MFIs such as institutional sustainability, mission sustainability, program sustainability, human resource sustainability, financial sustainability, market sustainability, policy environment sustainability and impact sustainability. Consistent with the literature we will focus on the most widely used measure of financial performance of sustainability, namely the return-on-assets ratio.

Political Perspectives on Microfinance

Studies focusing on microfinance from a political science perspective can contribute to build a bridge between grassroots practices and political institutions development. However, political studies of microfinance are rare and most of the work come from economics, sociology, or the industry itself (Hudak, 2010). Specifically, sociologists have studied the behaviors from the perspective of groups and individuals to explore the nature of group-lending schemes, which characterize many MFIs (Anthony 2005; Woolcock 1999). The social impact of microcredit and influences of female clients have also attracted sociologists' attentions (Anthony and Horne 2003). Likewise, economic researches focus on a very broad area, such as the impact of microfinance on GDP or the efficiency and performance of the institution (Rai and Sjostrom 2004, Hartarska, 2004, 2007, 2009).

In political economy, the central issue is the role of government and who should make decisions about allocation? Should it be the state, institutions of civil society allocation or the market (Best and Connolly, 1982). The right balance of regulation and freedom, and the sustainability of microfinance institutions are the center of discussions. Woller et al. (1999) and Morduch (2000) were among the first to discuss the existence of a "schism" in the study of microfinance (Moon, 2007). Some hold that Governments have frequently attempted to use financial markets to pursue a broad range of nonfinancial objectives, with disastrous consequences (Adams, Graham, and Von Pischke, 1984). On the other hand, many practitioners doubt that unsubsidized credit delivered through the market can be cheap enough to benefit the poor, who are most often conceived as the target of microfinance (Moon, 2007). Woller (1999) states that there are two divided approaches – welfarists and institutionalists. The "welfarist" approach is defined by the idea that microfinance is a tool to achieve broad-scale social or human development. On the other hand, "institutionalists" views microfinance from the perspective of banking practices and its adherents remain transfixed by the potential of microfinance to surmount the four great problems of small-scale lending: high transaction costs, the difficulty of measuring risk, the cost of monitoring clients, and the absence of collateral. Welfarists are concerned with the poorest while institutionalists tend to emphasize the entrepreneurial poor (Moon, 2007). Moreover, although the literature on microfinance is growing, they seem to be separate dialogues (deAghion and Morduch 2005).

Political Variables

Regime Type and Democracy. This dissertation considers regime as an important indicator to see the impact of larger political environment. According to the international relations theorists, regime has been defined as "principles, norms, rules, and decision-making procedures around which actor expectations converge in a given issue area" (Krasner, 1983; Porter, 1993). Additionally, Porter (1993) further explained that regimes normally presents some formal highly organized features such as writing constitutions, explicating voting procedures, and implying tacit understandings, unwritten conventions, and implicit power relations. In terms of the standard of classification for regime types, this research chooses to follow the research of the Economist Intelligence Unit's democracy index, which provides a summary of the situation of the state of democracy over the world, covering the vast majority of the world's independent states (not including micro states) and has been updated almost every year from 2007 until now. Depends on the overall score of democracy, countries are placed within one of four types of regimes: full democracies; flawed democracies; hybrid regimes; and authoritarian regimes.

The degree of democracy is an important factor to consider in the study of the performance of MFIs. Regime type presents the degree of democracy of a country and MFIs are important institutions in the financial system and economic sectors. The research concerned about the relationship between regime type and economic development can be traced back to 1960s (Tiruneh, 2006). There are several different perspectives: First of all, some people like New York Times columnist Friedman holds that more democratic political rights will reinforce economic rights and therefore will be beneficial to economic development. There is evidence from a panel of countries between 1960 and 2010 stating that democracy does cause growth (Acemoglu, 2014). Secondly, on the contrary, some scholars have the different opinion. For example, democracies are concerned with getting political support, they could choose economic policies that may increase the electoral chances of political elites but that may slow economic growth. And dictators may add pressure to labor unions or freeze wage increases to create a false appearance of economic growth. (Kohli, 1986). As what the neoclassical model of convergence suggested, a lower starting level of gross domestic product (GDP) promotes a higher predicted growth rate (Barro,1997). Thus, the economic development of autocracies is likely to grow faster results of their poorer economies level. Thirdly, some studies argue that the relationship between democracy/political freedom and economic development is affected by the economic level. There are two different situations: democracy could be an unfavorable element at lower stages of economic development level, while at the higher levels, democracy would do a better job to promote economic growth than non-democracy (Guo,1998). De Schweinitz (1964) argues that less developed countries should limit democratic participation if they wish to achieve a higher level of economic performance. This is because democracies –particularly new ones— face distributive pressures from citizens, leading to weaker economic growth (Barro, 1997, Haggard & Kaufman, 1995, Remmer, 1990) As Barro concluded, "the middle level of democracy is most favorable to growth, the lowest level comes second, and the highest level comes third"(Barro,1996). Fourthly, many authors argue that democracy itself is not the key to economic growth. Robert Barro’s seminal research in this area concluded that “more political rights do not influence growth" (Barro 1997). Tiruneh (2006) found that regime type has some but not very strong impacts on the economic growth in African countries. Pereira and Teles (2017) state that identical democratic regimes could yield completely different results.

This dissertation is going to control the macro-economic variables and MFI character variables to test the impact of regime type including full democracies, flawed democracies, hybrid regimes and authoritarian regimes through a fix effect analysis model. Furthermore, this research is also going to test the following indicators relative to regime type specifically such as the functioning of government, political participation, and political culture. Because these indicators are subgroups of regime type I will look at their influences separately and using a stepwise choose to avoided the co-relationship between regime type and each of them.

Governance Capability. The capability of governance reflects the ability of governments to protect citizen’s rights through making the law or implementing policies. Improving governance means two important factors: improving public administration and political participation, both emphasizes the cooperation between government and citizens. The objective of “good governance” has been stated by Sir Adrian Cadbury (2002): keeping good balance between economic and social goals and between individual goals and communal goals. The rule of law, accountability, and transparency are not only the technical and legal issues but also important for governments’ effectiveness and capability. (Johnston, 2016). Considering the good governance definition from the research did by Kaufmann, Kraay and Mastruzzi (2005), the world Bank has grouped the governance index in six pillars: accountability and responsibility of governance; political stability and lack of violence; governance efficiency; legal framework; law enforcement and corruption control. Knack (1995) determines five main indicators characterizing good governance such as corruption, legal framework, public administration efficiency, lack of contract execution by the government and expropriation (Pere, 2015). This dissertation holds that governance is more related to a top-down perspective.

Many authors see good governance as a key element for economic progress, especially in developing countries. This may result in the limited market infrastructure in developing countries which requires governments to play a role to speed up free market initiatives and raise production (Khan, 2007; Pere, 2015). At the same time, there also some authors are critical of this thought. For example, Kurtz and Shrank (2007) think there are not enough evidence to support the relationship between good governance and economic development. Furthermore, they think good governance may only can improve economy in developing countries or in a very long time period. According to literature and the definitions of governance, this dissertation seeks to test the impact of governance capability for microfinance development through an empirical study. Governance capability componence here is broken down to functioning of government, rule of law, regulatory quality, political stability, government effectiveness and corruption perceptions, as measured by Transparency International.

Functioning of government. Henri Fayol (1916) defined the five functions of management as to forecast and plan, to organize, to command or direct, to coordinate and to control (Bourne, 2014). The law and order provided by state is a necessary component of civilized life and certain functions of government such as the protection of individuals or their property should be necessary to enhance economic growth (Hobbes, 1651). However, there are some authors like Rothbard (1973) provides an interesting argument that the private sectors could more effectively undertake all the functions of governments (Gwartney, Lawson, Holcombe, 1998).

Rule of law and regulatory quality. Knack and Keefer (1995) have proved that the legal system relies on rule of law principles. Furthermore, rule of law could help the settlement of disputes among parties and does indeed promote economic growth Gwartney, Lawson, Holcombe, 1998).

About the role of regulation/laws of MFIs to help in achieving higher outreach and operational self-sustainability, there are different ideas in the research area. Some researchers think regulations play an important role to ensure the financial soundness of an MFI, reducing the chance of failure, reinforcing the public's trust in these financial institutions and serving to protect borrowers by preventing profit maximization at the client's expense, which enhance the depth of outreach in the long term (Harris 2005). To the contrary, other scholars argue that government intervention and interactive effect even no influence was observed especially when the impact was decomposed into capitalization of MFIs. Regulatory costs are large, but invisible (Beales, et al, 2017). External governance mechanisms only auditing affects outreach, whereas regulation and rating do not affect performance (Hartarska, 2005).

Political stability. The Political Stability Index was determined after the Economist Intelligence Unit surveyed a total of 165 countries, rating each for its economic distress and underlying vulnerability to unrest. There has been little research exploring the impact of political stability on microfinance. Cassimon and Vaessen (2006) found that a higher level of political stability benefits microfinance development by releasing more new funding of microfinance industry through opening the door for more donor intervention and funding and enabling the country to become eligible for global debt reduction under the heavily indebted poor countries (HIPC) initiative. However, according to a comparative study of three countries, Ross (2012) found that political instability in and of itself is not a direct determinant of microfinance success. Instead, microfinance success depended strongly on the ability and dedication of the government to use legislation to regulate the industry. Warby (2007) even found that microfinance has the greatest poverty reduction effect under conditions of instability by using a large N analysis of Latin-American states from 1990- 2010 and a case study analysis. Warby explained that the results may be due to higher risk functions preferring the most lucrative uses of microfinance for use by people who are near or above the poverty line.

Government effectiveness. The government effectiveness indicator used here represents several factors including the quality of the civil service and its independence from political pressures, the quality of public services, the quality of policy decisions and implementation and the credibility of the government's commitment to its stated policies (WGI).

There are many authors who focus on the relationship between government effectiveness and economic development. In terms of poverty alleviation, Gupta, Sanjeev, Davoodi and Alonso-Terme (2002) illustrated that efficiency in the delivery of public services has a direct impact on poverty. Furthermore, scholar has approved that on average, countries with more effective governments have better educational systems and more efficient health care (Lewis, 2006). Both of the educational level and healthcare quality are important concerns of microfinance researches. However, critics like Daniel Mitchell (2005) argues that over-regulated labor markets probably contribute to the high unemployment rates in Europe. And there is a correlation between bigger government and diminished economic performance. This dissertation believe that literatures cannot answer every question about the relationship between governance effectiveness and the results may affected by the indicator you use, and we may need to involve the time factor as well. These are why this dissertation is going to use a new panel data to test the impact of effectiveness for MFIs again.

Corruption. Classical economic theory assumes that people are rational, and their actions are based on full information and an individual's perception of deterrence is determined by the joint function of monitoring and punishment (Jain, 2001). Thus, any existence of discretionary power in governments along with staff perceptions of a rigid and controlled regulatory framework may create opportunities for corruption.

Corruption has attracted researchers' attention in political science. However, what is the impact of corruption in microfinance industry? Hugh Sinclair (2012) debunks the image of microfinance industry as a "do-good industry" by telling a story of idealism, callousness, greed and corruption of microfinance industry to show that this industry has been overrun by rampant corruption, extortionist interest rates, cover-ups and a lack of transparency. And as a result of these characteristics, microfinance exploits poor families. This dissertation is going to test whether corruption affect the success of MFIs significantly. The corruption in the country will be measured bases on Work Economic Forum Index and many economic variables.

Decentralization. Pandey stated that a country's change from centralization to decentralization is a multidimensional reform process, composed by political, fiscal, and policy reforms. The decentralization in an organization means a design in which senior management shares decision-making and management authority with employees in the lower level department, or delegates this authority and responsibility to them. Summarily, decentralization is a matter of degree and relates to authority and responsibility in the operational and administrative processes, especially at the branch or sub-branch level. There has been many literatures agree with that decentralization can be a viable solution for enhancing efficiency and building institutional capacity to manage growth and diversification. Decentralization structure in the political environment is necessary for the microfinance industry because as it continues to grow in size and complexity, microfinance institutions (MFIs) are facing the challenge of maintaining high-quality services while expanding to new regions and markets (Dempsey, Swire, 2006). This dissertation is going to use indicators such as tiers of government, investment freedom index, and financial freedom index to illustrate the impact of decentralization which is opposite to the centralized and strong government involved political environment.

Tiers of government. Ties of government present how many levels of governments are organized in a country. For example, the federal government in the United States is composed of three distinct branches: legislative, executive, and judicial. Thus the power of federal government is vested by the U.S. Constitution in the Congress, the president, and the federal courts, respectively (Khemani,2001). In Canada, government is organized into three and quite often four levels and consists of federal, provincial or territorial, and municipal (itself often subdivided into regional and local) tiers. Each level of government is charged by either the Constitution or a higher level of government with various responsibilities. Few studies have focused on the impact of ties of government especially in microfinance area. Sheng, Zhou and Li (2011) focused on the effects of business and political ties on firm performance in China and found that political ties lead to greater firm performance when general government support is weak.

Investment freedom index & Financial freedom. The extent of freedom for individuals and firms to use their resources to invest into and out of specific activities both internally and across the country's borders, this is called investment freedom. In practice, most countries have a variety of restrictions on every kinds of investment. Some countries have different rules and policies for foreign and domestic investment; some countries restrict access to foreign exchange; some countries impose restrictions on payments, transfers, and capital transactions; and in some countries, certain industries are closed to foreign investment. Labor regulations, infrastructure quality, degree of corruption, red tape, and political and security conditions can also affect the freedom that investors have in a country (Miller, Kim and Roberts, 2018). Financial freedom index is another important indicator for market openness in this dissertation. A formal financial system that is accessible and efficiently functioning ensures the availability of diversified savings, credit, payment, and various investment services to individuals and businesses. Miller, Kim and Roberts (2018) believes that an open banking environment can provide the most efficient financial intermediation between families and firms as well as between investors and entrepreneurs because a flexible banking environment can expand financing opportunities, promote entrepreneurship, and encourage competition. (Miller, Kim and Roberts, 2018).

The investment freedom index and financial freedom index are subsets of economic freedom index[2]. Many researchers argue for the significance of the freedom of economic and financial markets. For example, Mathai (2017) states that although monetary policy is one of the government's most important economic tools, a large number of economists believe monetary policy is best conducted by a central bank (or other similar agency) that is independent of the related government. This belief stems from academic research 30 years ago, which emphasized the similar findings that monetary policymakers who were less independent of the government would find it in their interest to promise lower inflation to keep down inflation expectations among individuals and businesses (Mathai, 2017).

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[2] The index of economic freedom is measured according to 12 quantitative and qualitative factors, grouped into four broad categories: rule of law (property rights, judicial effectiveness, and government integrity); government size (tax burden, government spending, and fiscal health); regulatory efficiency (business freedom, labor freedom, and monetary freedom); and market openness (trade freedom, investment freedom, and financial freedom). https://www.heritage.org/index/about

However, even some actions of state are necessary for individuals to defend their rights and can promote the evolution of civil society, but when government action rises beyond the minimal necessary level, it can potentially infringe on individuals' economic freedom. The government's excessive intrusion will result in neither equality nor freedom depending on the specific kind of activities. One such example is rent-seeking, which means seeking for the economically unearned benefits. The result is lower productivity, economic stagnation, and declining prosperity (Miller and Kim,2018).

The Theory of Culture

The success of MFIs can also be influenced by cultural factors. There is a large body of social science literature on the effects of culture. Culture conceived as a tool kit of symbols, stories, rituals, and world-views provide people resources with which to analyze, perceive and solve problems. In this way, culture does not affect decisions through value enforcement, but through shaping a repertoire of habits, skills and styles from which to derive strategies of action (Swidler, 1986). Culture is how the norms of behavior derived from that set of values (Batista, 2008). There are three focal areas in the culture study area: some researchers see cultures as adaptive systems: studies of hominid evolution and human social life shows that culture can be viewed in evolutionary perspective. From the cultural theory standpoint, culture is not only socially constructed but also affected by human biology. Cultural behaviors will evolve over time due to biological impulses, such as prioritize survival, maximize reproduction, etc. Many scholars such as Leslie White, Sahlins, Rappaport, Vayda, Harris, Carnerio see the foundations of culture as adaptive systems in an evolutionary sense. Furthermore, some schoolers think of cultures as structural systems of consciousness. This structural approach views cultures as shared symbolic systems that are cumulative creations of minds, which seeks to discover in the structure of cultural domains, such as myth and art. The third approach treats the cultures as symbolic systems. This approach interprets humans' engagement in symbolic events or behaviors, such as funerals. Moreover, some other authors think of cultures as a sociocultural Systems**.** Kessing (1974) states that sociocultural systems represent the social realizations or enactments of ideational designs-for-living environments. A settlement pattern, or a mode of subsistence technology is classified as part of a sociocultural system.

Culture in Political Science Political culture is defined as set of widely shared beliefs, values, and norms concerning the relationship of citizens to the government and to one another (Almond and Verba, 1963). Three types of political culture have been identified that describe the nature of people's attitude toward politics: parochial (citizens are remotely aware of the presence of central government), subject (citizens are heavily subjected to the central government), and participant (citizens are able to influence the government through various channels) (Almond and Verba, 1963).

Timothy Lim states that there are three major approaches to understanding politics: structuralist, rationalist, culturalist. The culture school emphasizes the influences of culture on policy making, particularly public opinion (Adolino and Blake, 2010). Lim (2010) explains that some types of culture are more skeptical about government than others. This skepticism reduces the probability of government policy creation and expansion. Furthermore, Adolino also notes that cultural factors in a country present unique policy making environments and the nature of liberal culture can present barriers for social policy. For example, American states have high affinity for individualism versus collectivist states.

Stone discusses the differences between political community and cultural community: A political community is a group of people who live under the same political rules and structure of governance and share status as citizens. A cultural community is a group of people who share a culture and draw their identities from a common language, history, and traditions. The political community can include many diverse cultural communities, and policy politics is faced with the question how to integrate several cultural communities into a single political community without destroying or sacrificing their identity and integrity.

Applicability to Microfinance Dululio argues that culture's impact is that people are not only rational, but also social animals; good performance of individuals does not only follow economic incentives but also depends on norms, values and social habits.

This is related to the conception of trust. When people protect their credit by being responsible, they can contribute to “trust”, which is the foundation of microfinance.

In the book *Cultural Constraints in Management Theories*, Geert Hofstede (1993) proposes a “theory of culture in management” in which there exist “six culture dimensions” that are not the same in every country. Geert Hofstede initially identified six primary dimensions of culture and has been the leading thinker on this subject since the 1970s (Hunt, Weintraub,1993). The position of a country on these dimensions allows us to make some predictions on the way their society operates, including their management processes and the kind of theories applicable to their management. This evolves from his recognition that culture is a construct: it is not visible but can be inferred from the actions and behavior of a society. In that the dimensions of Power Distance, Individualism, Masculinity-Femininity, Uncertainty Avoidance, and Long-term/Short-term Orientation of each country can vary, practices and systems should also vary and adapt to the construct of culture. There is something in all countries called "management," but its meaning differs to a larger or smaller extent from one country to the other, and it takes considerable historical and cultural insight into local conditions to understand its processes, philosophies, and problems (Geert Hofstede. 1987, 1993). According to Hofstede’s explanation, management is not a phenomenon that can be isolated from other processes taking place in a society, which means political, cultural, and institutional factors all interact with each other. This dissertation aims to find this dynamic to help improve the performance of MFIs.

Economic research usually treats cultural identity and individual preferences as exogenous fixed factors on which to develop analyses and draw conclusions (Olivier, 2015). Several culturalists theorists have argued that it is the Confucian ethic that has been the driving force behind the economic miracle of Japan and the Four Little Dragons in Asia. Additionally, there are some researchers focus on the relationship between culture and MFIs' human resources practice, which could help recruit qualifies talent to their companies. For example, local staffs tend to instill confidence in clients and make it easier for them to communicate with the MFI (Legderwood,1998).

There is only a small amount of literature focusing on the connections and relationships between culture and the performance of microfinance. Deubel (2003) studied how cultural variables can be integrated in the process of the microcredit development in Mali. Varghese (2001) argues that the bank's understanding of cultural aspects and the decision to take women as its main client are the primary reasons for the success of Grameen Bank in Bangladesh. Banasz and Csepregi (2018) used a panel data of 35 countries and an empirical study to explore the dynamic between Hofstede's six culture dimensions and success of MFIs. According to the situations of the top five countries, this paper found that MFIs are successful in countries characterized by high level of power distance, collectivistic culture, high level of uncertainty avoidance and restraint culture from most a sociology perspective.

Neo-Institutionalist Theory and Its Applicability to Microfinance Institutions

The institutional context in which MFIs operate can also affect their performance. The connections between grassroots level development and the macro-political context, play a key role throughout the whole operational lifetime of the microfinance industry. This dissertation employs neo-institutionalist theory to argue that MFIs can be used as a "receiving station" of government instructions and as a "processor" to deal with both state-side and client-side information. Institutions with certain types of policies and rules could be affected by their external environment, and at the same time also have counterforce to their operation environments. This is why this dissertation focuses on the context of MFIs and this idea is inspired by the theory of neo-institutionalism.

In order to understand new institutionalism (neo-institutionalism), it is necessary to look back at the "old". Generally, institutionalism theorists believe that human behavior is affected by formal structures and their standard operating norms. The focus of this institutionalism is on the formal and legal aspects of government as well as the role of non-governmental institutions (e.g. corporations). Policy-making is conceived as the interaction of institutions who structure decision making. Elinor Ostrom argues that the interaction of actors within and across institutions is crucial to determining what policy outcomes emerge from a formal institution. Similarly, institutionalism, which focuses on institutional arrangements and how rules operate, believes that individuals are rational and individuals' behaviors are affected by formal structure as well as informal norms of the organization. And interacting within and across institutions produces policy (Scott, 2014).

Attempts in recent years to refine institutionalism resulted in neo-institutionalism which argues that institutional rules, processes, and structures are still significant but they are not static; as actors within institutions change, so can policy. Some scholars think new-institutionalism equals to formal rules plus informal rules (Winter, 2011). This approach is based on a belief that values, interests, and institutional rules vary from actor to actor and that individual actors bear an influence on the policy making process (Heidenheimer, 1985). One of the most important contributions provided by neo-institutionalism was to add a cognitive influence. Indeed, neo-institutionalism has developed from focusing on the "institutional rules of the game: customs, laws, politics" to a broader conception, which is considering the questions of "the comparative efficacy with which alternative generic forms of governance: market, hybrids, hierarchies," and the economic transaction costs (Scott, 2014).

Furthermore, neo-institutionalism argues that every institution is impacted by the broader environment because it operates in an open environment which consist of other organizations. Institutions need to survive and gain legitimacy under the institutional peer pressure, which is the main goal for them (Scott, 1995). Mader (2015) states that every institution shape and are in turn shaped by the social structures around them.

According to this line of thinking, studying the way institutions interact in a society could help us to study the influences of the political and cultural environment around the institutions. For the microfinance industry, political factors, such as government assistance and donor agencies, a supportive policy, or a regulatory environment, must be operated through institutions. At the same time, institutions can also influence policy making. Institutions include certain types of policy, which in turn stipulates rules that assign normatively backed rights and responsibilities to actors. Institutions constitute rules not only for actors but also for policy makers themselves (Streeck and Thelen, 2005).

Neo-institutional theory in Political Science. The study of institutions has been accepted in academic area since the end of 19th century and early 20th century and one of the influential researchers is Max Weber, who has been known as a scholar who provided the theory of the “ideal type” and examined bureaucratic structures in detail. Furthermore, the organizational sociologist Richard Scott stated that neo-institutionalism in political science may be viewed, at least in part, as a reaction to the behavioralist emphasis. However, the neo-institutionalists in political science and political sociology have classed themselves into two distinct camps: the historical and the rational choice theorists (Scott, 2014). Rational choice institutionalism and historical institutionalism are two important types of institutional studies, both of which are applied throughout this paper. Both of them are compatible and necessary for the study of the political influences and the effectiveness of those institutions.

Specifically, from a historical perspective, these studies focus on the critical junctures and developmental pathways (Thelen,1999), which allows us to find out the complexity of interacting factors and the impact of policy diffusion inherent in a country. Historical institutionalism is primarily interested in the path-dependent evolution of institutional forms (Pierson, 1997; Steinmo & Thelen,1992). On the other hand, In rational-choice institutionalism, institutional rules are understood as external constraints and incentives structuring the purposeful choices of self-interested rational actors (North, 1990; Shepsle,1989). This approach believes there is an interaction effect between institution and actors' choices and actions, which supports my ideas on why institutions matter and allows us to consider the importance of institutional development and environment.

Some authors have applied institutionalism theory to the policy making process. Adolino and Blake (2010) discuss theories of policy making through cultural, economic, political, and institutional factors and state that the cultural school emphasizes the influences of culture on policy making, particularly a family of nations phenomenon or public opinion approach to policy influence, while the institutional school examines the impact of formal government rules as well as the impact of informal norms in governmental and nongovernmental institutions. This realm of theory evaluates the role of formal government institutions, the bureaucratic politics approach, and the new institutionalism. Also, Lim (2010) advocated that institutional school emphasizes the relationship between executive and legislative relationship and bureaucratic politics.

How neo-institutionalism applies to microfinance. This project partly draws upon neo-institutionalism, which takes a sociological view of institutions. Institutionalist literature focuses on following one of two directions: some research focuses on how institutions emerge from and are embedded in concrete temporal processes, while others focus on how institution or institutional rules affect the actors inside and outside, shape policy making institutions itself, and influence policy responses. There are few studies that explore the institutional environmental constraints on MFIs systematically.

Microfinance institutions emerge and are shaped by a desire to improve livelihood, but they are affected by the larger social interest conflicts and government regulations, institutions, and policies that impact the whole microfinance industry. Thus the microfinance institutions are critical for our understanding of the development of both microfinance industry and politics in a country. It is not just a matter of how microfinance clients or service providers respond to those institutions, as the rational-choice approaches to institutionalism would argue, it is also a concern of the relationship between poor households and the capacity of governmental institutions.

Additionally, there is a need to continue to explore the links between history and traditions of a country and the performance of MFIs. The study on Geert Hofstede's six culture dimensions is an important application. According to historical institutionalism, there could be path dependence tends for policy making. Culture in a country is hard to change and is affected by the history of the country. Thus understanding the culture and ideology could help us have a better understanding of how the state influences economic actors.

Steimno (1989) states that political institutions play a very important role in public policy. The political structures that exist in each of the states are those that reflect the preferences of that particular state and these structures exert influence and is reflective of political choices and values. This is why we choose the indicators such as democracy, regime type, and level of decentralization as the key political variables. The different characteristics of political institutions could influence microfinance policies such as interest rate cap, restrictions for both MFIs and clients, and various regulations directly or indirectly.

“Since institutions determine the choices of actors, the sequence of moves, as well as the information they control, different institutional structures will produce different strategies of the actors, and different outcomes of their interactions” (Tsebelis 1999) Institutional structures, culture, norms, and practices within different contexts can affect the implementation of public policies to a great extent. In this research, we need to understand the different characters of government, such as structures, norms, and ideologies, which could influence the shaping of policies. Meanwhile, when we focus on the performance of MFIs in each country, the basic factors such as their political environment, culture, economic situation, regulations, and governance, which may impact the practice of the MFIs on the ground are need to be considered carefully as well. According to the institutionalism, the perspective of institutional environment should be carefully considered. The institutional environment can cause for special challenges for the countries, cities or communities.

Chapter Three

Countries and Illustrative Cases

Why These Three Countries?

In order to explore what the best political environment for the success of microfinance institutions is, this dissertation is going to use both qualitative and quantitative analysis. Three countries--China, India, and Indonesia--are going to be introduced in this chapter. Meanwhile, a quantitative analysis is going to be operated at the institutional level, including 8957 observations of 113 countries in chapter four. The qualitative analysis helps us to see the development process of microfinance institutions in practice, the differences between the three countries, and to understand how microfinance institutions succeed on the ground, while the quantitative analysis could provide us the indicators that have statistically significant effects. The cross-national trends of MFIs' performance, microfinance providers, regulation/supervision and interest rates in China, Indonesia and India will be introduced in the following section. Once again, regime type, democracy, centralization/decentralization, governance and culture and ideology will be discussed in each of these three countries.

It can be seen that all three countries are located in Asia. Choosing cases in the same region could control for the influence of location. We see that a clear pattern emerges to present trends of outreach across regions. Hudac (2010) provided us these trends by collecting outreach data of outreach from all regions in 2010, and he found that the development of Asia's MFIs have consistently led the way, while the development has seen steady growth in the Middle East and North Africa and those in Eastern Europe have typically been much smaller.

Furthermore, these three countries are representative and typical for comparison. For example, Indonesia transitioned toward a Democracy and had a change in party power at the national level; the incumbent had been threatened by another political party or regional interests. China is the only one of these three countries that has never changed party power or was threatened by another political party and kept a centralized political structure. India is a democratic country with a high degree of heterogeneity and inequality across regions and across levels of economic well-being.

Cross-National Trends

According to the literature, some research divided these three sample countries into South Asia (India) and South-East Asia (China, Indonesia) (Haq, Hoque and Pathan, 2008) and this dissertation uses Asia as an overall region. Asia plays an important role in the international microfinance industry. According to the data from Microfinance Information Exchange (MIX) Market in 2011, Asia leads the world in both number of active borrowers (percentage of world total) and Gross loan portfolio (percentage of world total), which are 69 percent and 44 percent, respectively. Furthermore, Asia, especially South

Asia, has the largest percentage of female borrowers of MFIs in 2011 with 93 percent of MFI borrowers. However, another trait is that the indicator return on assets (ROA) in Asia (2011) is the lowest one of the global regions, which presents sustainability of MFIs (Zhang and Wong, 2014).

Generally, the existing literature on the development of MFIs in China, Indonesia and India are still limited. China is a relative newcomer to microfinance, which started in the 1990s (see table 1) with rapid growth in recent years. Jeffrey Riecke (2014) studied the different kinds of microfinance institutions that exist in China and explains that there are 6,000 microcredit providers in 2012, but only 25 percent had been operating for more than three years. India's microfinance industry started in the 1960s, earlier than that of China. Both China and India are large agrarian countries and both countries have tried to limit most forms of informal finance using policies, regulations, and supervisory agencies (Tsai, 2004). Indonesia has the longest history in microfinance among these three countries, which originates in the 1890s. Additionally, Indonesia has the highest level of democracy and decentralization compared to China and India. The following is going to compare the performances of MFIs in China, Indonesia, and India and then further discuss detailed cases studies in these three countries.

Sustainability. As shown in table 1 (Zhang and Wong, 2014) China has a relatively low level of MFIs' sustainability in Asia, with the return on assets at 1.07% in 2011. Bai Chengyu, secretary general of the China Association of Microfinance said, "Although the payment rate in China is very high in some microfinance institutions (MFIs), most are not running efficiently and not financially stable."

Comparatively, India's sustainability is low or moderate (-10.1% in 2011; an average of 2.67% for 2005-2010). The obvious changes that happened in India could have been a result of the microfinance crisis in 2010. Kaur (2014) studied sustainability and outreach of MFIs in India in pre- and post-Andhra Pradesh Microfinance Crisis and found that the Operational Self Sufficiency (OSS) of India has declined from 2008 to 2011, and it has deteriorated after the crisis. Despite the influences of the Crisis, Ferdousi (2017) found that worse economies of scale in both China and India is one of the reasons for their relatively low sustainability and by studying the performance of MFIs in China, India, and Bangladesh, Ferdousi also found that improving management skills are required by countries to ensure the efficient utilization of input, which can further increase sustainability (Ferdousi, 2007). Additionally, Seibel and Parhusip (1998) state that technical assistance has often played a key role for MFIs to transfer from subsidized institutions into savings-driven viable programs.

On the other hand, Indonesia's sustainability is relatively high among Asian countries regarding the percentage of return on assets (ROA), at 4.03% in 2011. It has to be mentioned that Indonesia is different than China and India in that its microfinance industry has been largely commercialized and the majority MFIs are for-profit formal institutions such as the Bank Rakyat Indonesia (BRI) (Zhang and Wong, 2014). Compared to Indonesia, states in China and India have made more attempt to make their MFIs underregulated (Tsai, 2004).

Table 1: The Comparison of MFIs in Five Asian Countries

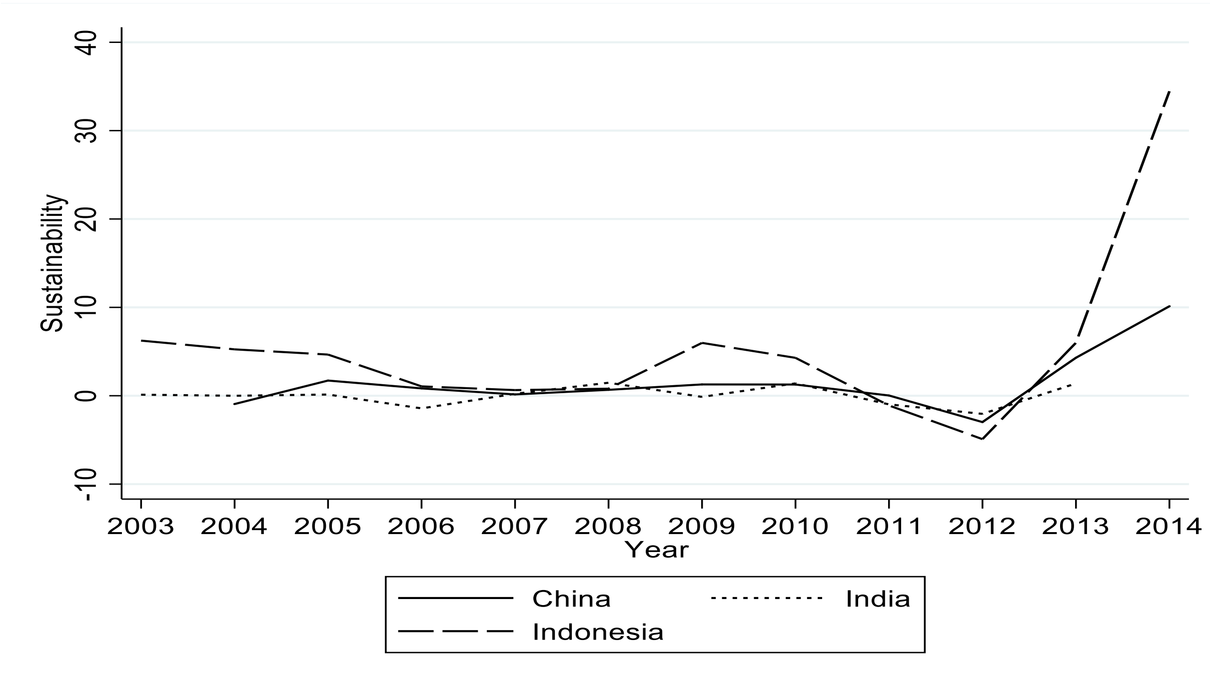
Country	History (startin g from)	MFIs' penetration rate (active borrowers to the extreme poor population)	ROA and main sources of funding	Regulatory authorities
Bangladesh	1970s	Relatively high (32.5%)	ROA: Relatively high (3.67%) Sources of funding: Equity, deposits, Palli Karma-Sahayak Foundations (PKSF) funding, debt	Microcredit Regulatory Authority
China	1990s	Very low (0.4%)	ROA: Low (1.07%) Sources of funding: Government funding, international grants, deposits, People's Bank of China (PBC) funding	People's Bank of China (PBC), China Banking Regulatory Commission (CBRC)

India	1960s	Low (6.7%)	ROA: Low or moderate (-10.1% in 2011; an average of 2.67% for 2005-2010) Sources of funding: Debt, commercial banks funding, government funding, grants	Reserve Bank of India (RBI)
Indonesia	1890s	Very low (1.2%)	ROA: Relatively high (4.03% - among the highest in selected Asian countries) Sources of funding: Debt, commercial banks funding	Bank Indonesia (BI), Financial Services Supervisory Agency (LPJK)
Pakistan	1950s	Low (5.2%)	ROA: Low (0.46%) Sources of funding: Grants, donor funding - Pakistan Poverty Alleviation Fund (PPAF), commercial banks funding, deposits	State Bank of Pakistan (SBP)

Note: ROAs in this table are as of 2011 unless noted otherwise.
Table reprinted from "Sustainable Microfinance In Asia", by Zhang and Wong, Milken Institute, January 2014.
Data Source: Microfinance information Exchange Market, International. Monetary Fund, World Bank, Economist Intelligence Unit, Milken Institute.

Figure 3 shows the development and changes of MFIs' sustainability in China, Indonesia and India from 2003 to 2014. The panel data comes from MIX Market. We can see that Indonesia maintains the highest level of sustainability in the long term as well, and the period after the microfinance crisis from 2012 to 2013 is the turning point for all of these three countries. Furthermore, a rapid increase of sustainability happened in all those countries in recent years after 2013.

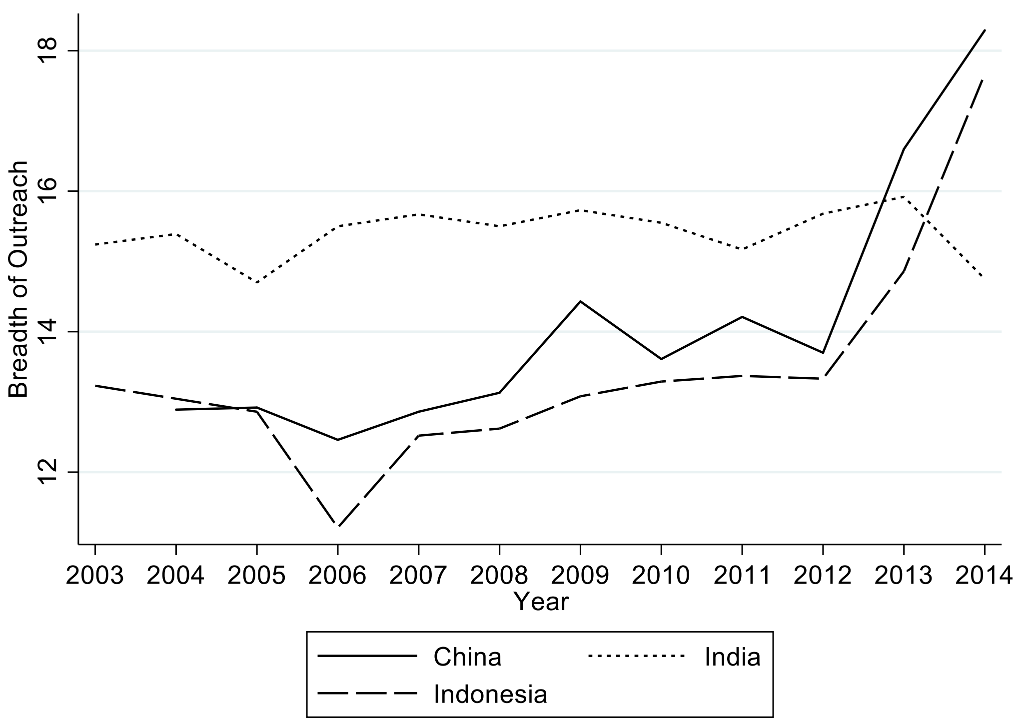
Figure 3: Sustainability from 2003 to 2014



Note: Data from MIX Market.

Breadth of Outreach. According to the literature, the degree of outreach in Asian countries varies widely and Zhang and Wong (2014) calculated the top Asian countries in terms of numbers of active MFI borrowers in 2011 and India is at the top with 26.49 million active borrowers, China is the 9th with 0.57 million borrowers and Indonesia is 10th with 0.46 million borrowers. The reason that India was not obviously influenced by the crisis at breadth of outreach is because the rate of loans given to female clients remains the highest in India compared to other countries in South Asia, which helps India maintain the level of breadth of outreach (Kaur, 2014). Bassem (2008) advocated that the number of female clients is like a proxy for the breadth of outreach. The trend graph in 12 years tells a similar story. As shown in Figure 4, India has an obvious largest number of active borrowers from 2003 to 2013 and then a decline occurred in 2013. Meanwhile, China performs a little bit better than the breadth of outreach in Indonesia. Both China and Indonesia had a rapid increase on breadth of outreach after 2012.

Figure 4: Breadth of Outreach from 2003 to 2014



Depth of Outreach As shown in Table 1, MFIs' penetration rate (active borrowers to the extreme poor population) was very low in China in 2011, at 0.4 percent; while this rate was marked as very low and low in Indonesia and India at 1.2% and 6.7% respectively. Compared to other Asian countries, Bangladesh had a relatively high level of depth of outreach in Asia, which is 32.5 percent (Zhang and Wong, 2014). Generally, there are some factors that can influence the level of depth of outreach. First of all, the lack of impetus for MFIs to reach the poorest clients because higher transactional costs incur when a microfinance program reaches out to the poor. The low level of depth of outreach could also happen when MFIs are more focused on making profits, instead of reaching out to the poorest of the poor (Shu and Oney, 2012). Furthermore, the lack of demand from the poor households to get involved with microfinance programs. Cheng (2007) studied the depth of outreach in China based on the demands of clients by interview and found that many poor households have rationed themselves out of the microfinance market. Overall, enhancing social responsibilities, raising the demand for micro-loans and using direct fiscal support should be good for increasing the depth of outreach.

China----MFIs in a centralized, authoritarian country in transition to economic freedom.

Microfinance in China. China's remaining poverty is primarily located in rural, mainly scattered among remote, mountainous, and minority nationality areas in the northwest and southwest. Lack of access for famers and poverty in those large areas was always a concern by researchers and practioners for a long time. China's microfinance industry is very young. The first microcredit institution was started in 1993 by the Chinese Academy of Social Sciences. Then China started the small loans service in rural credit cooperatives (RCC) in 2000 and the practice on for-business microcredit in five provinces in 2005 (Du, 2005). After a rapid growth since 2012, microfinance services have developed domestically in every province.

There are three kinds of microfinance programs in China: project-based microfinance programs funded by international NGOs (World Bank, AusAID, etc); programs run by state funds through the Agricultural Banks; and programs run by the Rural Credit Cooperatives using their own savings and refinancing facility of the People's Bank of China (PBC) (Lau, 2008; Du, 2005). Among these institutions or programs, Rural Credit Cooperative has the largest amount of loans which occupy 60 to 70 percent of market shares with 400 billion China Yuan(RMB). The next largest is Agricultural Bank, which is directed by the government to provide small loans to farmers and agriculture-related businesses in poor areas. And the entities servicing at the terminals of the market are Rural Credit Coops (RCCs), Micro Credit Companies (MCCs), Village and Township Banks (VTBs) and small loan cooperatives.

The funding of formal microfinance institutions in China mainly come from governmental funds, international grants, savings, and the refinancing facilities of the People's Bank of China (PBC). For informal MFIs, grants are the primary sources of funding (Zhang and Wong, 2014). In a centralized governmental and social structure, MFIs in China have fewer incentives to seek profits and depend largely on the states' grants and subsidies, which may be reflected by the relatively low ROA of MFIs in China.

Microfinance Regulations and Policies. Compared to other countries, the oversight capacity of government is stronger in China. MFIs and other institutions in the Chinese financial system are well-regulated under the control of the PBC and the China Banking Regulatory Commission's authority. Table 2 (Haq, Hoque and Pathan, 2008) shows the detailed key aspect of regulation and supervision among China, Indonesia, and India, while Table 3 (Haq, Hoque and Pathan, 2008) illustrates the situation of various policies about the restrictions of interest rate in these three countries.

Table 2: Microfinance Regulation and Supervision in Three Countries

Country	Registration	Administrator for registration and other related issue	Regulator	Supervision method
China	1995 Commercial Banking Law, 997 Regulations for the Management of Rural Credit Cooperatives, Regulations for the Management of County Level Rural Credit Cooperatives Union, Provisional Management Rules for Rural Credit Cooperatives at Provincial, Municipal Directly Under the Central Government and Autonomous Regional Level.	Operation permit granted from Banking Supervision and Management Bureaus then register with Industrial & Commercial Administration Authority for license and the legal form requires minimum of 500 members.	RCCs: China Banking Regulatory Commission, Department of Cooperative Finance supervises	Random onsite and offsite inspections from the CBRC. Each RCCs' internal Board of Supervisors monitor
Indonesia	Banking Law of 1992.	Bank Indonesia	Bank Indonesia (rural banks and village credit institutions, provincial government LDKP	Offsite and onsite inspection

India	Andhra Pradesh Mutually Aided Cooperative Societies Act 1995, Societies Registration Act 1860.	State and National Credit Cooperatives: Reserve Bank of India & Central Registrar respectively, NGOs and MACS - state government, fees determined by the state government.	Central bank (RBI)	Offsite and onsite inspection

Note: this table reprinted from Haq, Hoque and Pathan, 2008, Regulation of Microfinance Institutions in Asia: A Comparative Analysis. International Review of Business Research Papers Vol.4 No.4. Aug-Sept 2008. PP. 421-450

Table 3:

Country	Formal Institutions (p.a.)	Semiformal institutions (p.a.)	Informal institutions (p.a.)
China	The government fixes the deposit and the lending rate although the RCC have some flexibility around that range. In 2005, the benchmark one-year bank deposit rate is set at 2.25% and the flexibility is that their deposit rate can be 0.9 times lower. The one-year lending interest rate is 5.58%. The maximum upper limit of RCCs' lending interest rate is 2.3 times this benchmark rate.	Interest rate ceilings exist 8% - 18%	No restriction imposed.
India	Interest rates restrictions on commercial bank for retail loans below US$5,000 (all microfinance and beyond) remain and caps on deposit rates exist.	Restriction on interest rate 20% - 40%	SHG own interest rate determination. 24% - 120% depending on state.

Indonesia	BRI sets prices, procedures and interest rates for village credit institutions (BKDs); cooperatives' interest rates are set by the members typically around 18%; rural banks charge: 36% - 48%	Restriction on interest rate 28% - 63%	Informally charged by the money lenders. 120% - 720%

Note: this table reprinted from Haq, Hoque and Pathan, 2008, Regulation of Microfinance Institutions in Asia: A Comparative Analysis. International Review of Business Research Papers Vol.4 No.4. Aug-Sept 2008. PP. 421-450

Challenges. First of all, as what was introduced previously, the sustainability of MFIs is too low. Most for-profit loan institutions in China are small and medium enterprises and most of the micro-credit loans for poor households are less than 100 thousand yuan (Guangwen He et al., 2009). The mall average loan could increase the transaction cost, which could affect financial sustainability of MFIs. Second, there are too many restrictions for the microfinance industry. For example, restrictions do not allow "ProCredit," which actually runs banks in 19 different countries and could help provide training in accounting, to operate business in China loan management and risk analysis for MFIs. Third, the depth of outreach in China is relatively low as well and it is still very hard for famers to get small loans form middle and small-sized enterprises. There are several reasons, which cause problems for MFIs to reach the poorest households such as there is no innovation for microfinance institutions to reach the poor; there are still no powerful global microfinance institutions operating in China, and there is a lack of awareness of social responsibility for Chinese corporates in their business operations. Last but not least, there are no standards and self-discipline system for the whole industry (microfinance institutions controlled by different provinces in China).

Innovations for microfinance. Rural economic systems and a series of poverty alleviation programs have been operating since 1978. The focus of poverty alleviation shifted from regional development projects to household-based projects, which was initially directed at women. In 1989, Luliang Prefecture Women's Federation (LPWF) began experimenting with non-collateralized credit and technical training and launched its "Poverty Alleviation Chain" with seed capital funding to initiate identified "demonstration" households that would be provided subsidized one-year loans for pig farming with the provision that each household chosen would provide training and supervision to two severely poor neighboring families. Right now, LPWF has evolved its methodology into a group-lending approach based on the Grameen model, which is supported by an annual provincial government loan of $625,000 per year plus a $1 million grant from the World Bank. The program's outreach has reached 165,900 participating families. Compared to LPWF, there is another poverty alleviation practice in Nanjie village. Nanjie used to be a model of communism and tried to make everyone in that small village rich, which was considered a symbol of success and happiness. At first, the government funneled money into the town to help build hospitals, large companies, factories and other facilities, and all these organizations are state owned. Laborers have no salary and they think they do not need a salary because everything is distributed in a unified way. The government built beautiful apartments for the citizens for free if they get married; the citizens have many bonuses if they got an offer from colleges; and many other social welfare programs that provide for all the citizens of Nanjie. At first, people were very happy and proud to live in Nanjie. However, along with the performance of the open economic policy and reform, most regions in China had made very great progress while the economy in Nanjie is still lacking innovation and energy. Nanjie was not financially successful in the end, even though the government invested an enormous sum of money (Harries, 2002).

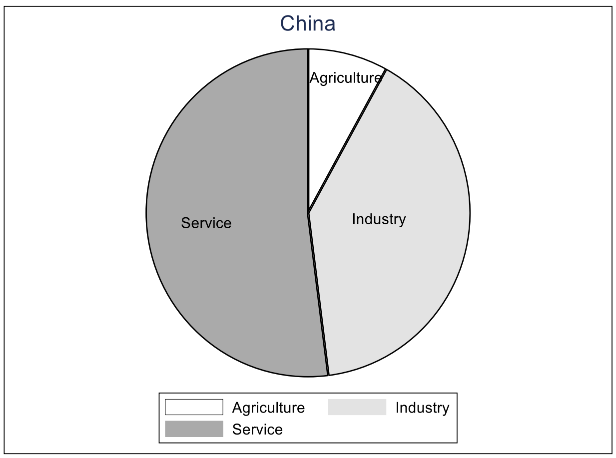
Above is the analysis of the development of microfinance in China and the more detailed information of the Chinese political and cultural environments are going to be discussed as following:

Basic Information of China (regime, population & economy): ***Regime.*** Porter (1993) described the definition of regime in that it includes formal organized features (writing constitutions, explicit voting procedures) and informal features (tacit understandings, unwritten conventions, and implicit power relations). According to the research of Economist Intelligence Unit's Index of Democracy, which has been published since 2007, countries are placed within one of four types of regimes: full democracies; flawed democracies; hybrid regimes; and authoritarian regimes. The overall score of democracy is based on the score of subgroups including electoral process and pluralism, functioning of government, political participation, political culture and civil liberties. The rank of overall score of democracy for China is 139 in the total of 165 countries (EIU, 2017). The system of the people's congress is the fundamental political system in China. The National People's Congress (NPC), local people's congresses and their standing committee are the central organizations for election, interpret the Constitution and supervise the enforcement of the Constitution. The National People's Congress (NPC) is normally elected for a term of five years. The Communist Party of China (CPC) is the sole governing party within mainland China and there are eight subordinated parties that co-exist to make up the United Front. Democratic Centralism is the base of CPC, as was conceived by Lenin, the Russian Marxist theoretician. Lenin holds that one-party unity could prevents factionalism (Smith, 1976). The party's leader holds the office of General Secretary (responsible for civilian party duties), Chairman of the Central Military Commission (CMC) (responsible for military affairs) and State President (a largely ceremonial position) (Wikipedia).

Population. China has the largest population in the world with 1.4 billion, which is almost one quarter of the total population of the world. From the change in rural population, we can see a rapid process of urbanization in China. According to data from the World Bank, the percentage of the rural population in China was 83.80% in 1960 and 42.04% in 2017 (World Bank, 2017). In order to control the incredible increase of population, the one-child policy (OCP) was introduced in 1979 (after a decade-long two-child policy) and then lasted three more decades before being eliminated at the end of 2015. The policy also allowed exceptions for some other groups, including ethnic minorities. Discussion on the effects of OCP is still ongoing. It has curbed the potentially problematic population boom in China, though researchers also state that it has also brought problems such as an unbalanced sex ratio, increased crime, problems of taking care of retired parents, and individual dissatisfaction toward the government (Huang, 2017). According to the World Bank, more than 500 million people were lifted out from extreme poverty in China from 1981 to 2012 and China's poverty rate fell from 88 percent in 1981 to 6.5 percent in 2012 (poverty line measured by the percentage of people living on the equivalent of US$1.90 or less per day in 2011 purchasing price parity terms) (World Bank).

Economy. After the economic reforms in 1978, which focused on opening a domestic market and increasing economic freedom, as proposed by Xiaoping Deng, China experienced an average GDP growth of nearly 10% per year until 2014, a raise of the per capita GDP almost 49-fold, from 155 (current US Dollars) to 7,590 (current US Dollars) from 1978 to 2014 (Eckart, 2016). China has become the world's manufacturing hub and the world's second largest economy right now. In terms of the structure of the three main industries in China, agriculture occupies a small percentage of the GDP (8.20%), the secondary sector, comprising industry and construction, represents a large share of the GDP (39.5%), and the service industry occupies 52.20% of the GDP (see figure 5). It is obvious that the tertiary sector now makes up the majority of GDP.

Figure 5: Three Main Industries in China:



(Data come from Wikipedia (2017); Figure drawn by author)

Thinking about the figures and development of Chinese economy, the first thing I would like to introduce is the household-based model, which plays an important role in the earlier time before the Chinese civil war. Especially for agriculture, there were no plantations or large landed estates. For example, one of the first successes of a “globalizing” China was the tea export industry in Fujian Province since 1880. A couple of hundred pounds of tea produced by individual households was then processed by hundreds of small tea factories. However, not only agriculture depended on household products; most nonagricultural productions were also small-scale and done by rural households such as textiles, leather goods, and iron tools—as well as food products such as wine, sugar, and edible oil. Many households live on farming, manufacturing and marketing their own output, thus the Chinese traditional economy was a small-scale, household-based, “bottom-heavy” economy (Naughton, 2006)

However, such household-based economy is mainly locked in a traditional low skilled, labor-intensive industry, which is hard to meet the demands of a global market and competitions from the West or other countries like Japan. China’s economy had followed a path of evolutionary growth from traditional economy to state-run economy (the planned economy), which added the socialist industrialization strategy under the control of the Communist government. Later, China has shifted from a centrally planned to a more market-based economy since initiating market reforms by Deng Xiaoping in 1978. The goal of economic reform is to establish a social market economy with Chinese characteristics (Naughton, 2006). This reformed system is based on the predominance of public ownership and state-owned enterprises within a market economy (Ding, 2009). There were two steps to this reform.

The time period during the late 1970s to early 1980s was the first stage, Chinese economic reform experienced a process of de-collectivization of agriculture, the opening up of the country to foreign investment, and permission for entrepreneurs to start businesses (Engardio, 2005). However, in 1978, three quarters of the country’s industrial production was still accounted for by centrally controlled, state-owned enterprises, following centrally planned output targets. Collectivized agriculture was the norm (Morrison, 2018).

The second stage of reform happened from the late 1980s to 1990s, and privatization is one of the most important reforms. Many state-owned industries have been changed and there are many movements whose effort is to lift the Chinese economy out of price controls, protectionist policies, and regulations, although state monopolies in sectors such as banking and petroleum remained. Later, between 2001 and 2004, the number of state-owned enterprises decreased by 48 percent and the domestic private sector first exceeded 50% of GDP in 2005 and has further expanded since (Schoenleber, 2006). Furthermore, between 2005 to 2012, Chinese President Hu Jintao and his conservative administration began to reverse some of Deng Xiaoping's reforms and adopted more egalitarian and populist policies (Naughton, 2008) by increasing subsidies and control over the health care sector, halting privatization and adopting a loose monetary policy (Chovanec, 2009). The state sectors with primary government investment grew rapidly and became more competitive with foreign corporations. The next generation of Chinese leaders, President Xi Jinping and his administration, from 2012 to now, are working on three issues of economic reforms: the first issues is the Comprehensively Deepening Reform, which means to limit the involvement of government for market control and thereby achieve its definitive goals by 2020. The second issue is the promotion of a new type of urbanization, which aims to give more spots of urban family registry to people who moved from rural to urban areas. The Chinese household registration system is the base for citizens to have the right to receive a particular city's public services, including residential security, social security, public schools for children and pension system. The third issue is the innovation of macro control. This reform aims to specify a rational range for economic control from the state level, set the inflation rate goal as the upper limit and the growth rate and employment goals as the lower limit; if the economy is within the expected range, short-term economic stimulus measures will not be taken, but economic system reform and economic structural adjustment are given priority (Tanaka, 2015). "The New Normal" became a catchphrase in 2014. Chinese economics shifted from the "Old Normal", which has features such as: first, economic growth driven by infrastructure construction and real estate investment; second, GDP-dominated macro control, other goals centering around GDP growth, third, unilateral raising of real estate prices; and fourth, unilateral appreciation of RMB. Chinese president Xi Jinping has clarified the basic characteristic as "a shift from high-speed to medium-to-high-speed growth. Economic optimization, structural upgrades, and a shift from investment to innovation as the driving force for growth" (Deng & Chen, 2015).

Additionally, there are some other aspects of the Chinese economy that need to be mentioned, such as the macro control of regional economy and high savings rates. China's economic development has a long-term regional imbalance. The coastal east has the fastest economic growth, while development in the rural west is lagging behind.

Equally important, China is well known for having very high saving rate. In 2014, the saving rate was about 50 percent of the GDP while the saving rate in United States was just around 7.5 percent of the GDP (data from www.ycharts.com). There are several reasons for the high saving rates including weak social security, lack of access to a financial system, lower level of economic freedom and so on.

Political Culture & Ideology: ***Political culture.*** The political culture before Mao was highly traditional in China. In traditional Chinese culture, the core value was "the absolutely submission to authority" (Hsu 1949, 1953), whether in the extended family or in the local community. In political culture, authority means a social culture permeated a rigid structure, consisting of layers upon layers of bureaucrats, in which subordinates bowed unquestioningly to their superiors (Chu, 2001 p43 "Chinese Political Culture" Shi ping Hua editor). Officials rarely interacted with the people except to collect taxes and levies, deal with breaches of law and order, and facilitate conscription for public services, for example military service. There were few government services to speak of, and the people had no meaningful role in the political systems. Their duty was, simply, to submit to the authority. Moreover, people did not have high material aspirations and they considered acceptance of poverty to be a means of achieving peace in life (Chu, 2001).

After the establishment of New China in 1949, Karl Marx's German Ideology came into China: "Let us revolt against the rule of thoughts" became a national catchphrase.

And both Mao and Deng were veteran Red Army leaders who fought their ways to victory in the communist revolution. Mao was a revolutionary throughout his life, who advocated to the "continuous revolution" at all fronts, even long after the establishment of the People's Republic in 1949. By contrast, after 1949, Deng became a pragmatic politician whose primary concern was national reconstruction by way of economic development, which is the fundamental political ideology for the economic reforms in Chinese socialism until now (Liu, 2004).

Ideology. The present Chinese culture has a long history of evolution and has a huge collection of various components. Most Chinese cultural elements come from three major factors including its officially imposed communist ideology, Western thoughts honored and popularized by intellectuals, and the civilly transmitted Chinese mentality mixed with Confucianism, Buddhism, and feudalism (Shaw, 1996). The communist ideology was imported from the West, having developed out of a rational critique of Western capitalism (Marx, 1976). Ideological diversity is obvious in China and Confucianism is the fundamental one that has infiltrated to society, education, politics and family in East Asian countries. Compared with "Individualism" in Western countries, Confucianism sees "family" as the unit. In practice, "fatherhood" is respected deeply. Being respectful toward parents and being loyal to the government are important to keep one's place in a society. The Confucian ideas have been viewed as the driving force behind the economic miracle of a lot of Asian counties including Japan and the Four Little

Dragons. However, Weber has a different idea that the Confucian ethic is the resistance for economic development in China due to the absence of tension between nature and deity, between ethical demand and human shortcomings, consciousness of aim and the need for salvation, conduct on earth and compensation in the beyond, religious duty and socio-political reality (Diamond, 1993).

Based on the traditional Confucianism ideology, men have been seen as the core of a family and the people pursue the links and history of a family only through men. Confucius greatly generalized family virtues such as filial piety, which indicate that male and female, high and low, old and young, would learn to fulfill the duties of their roles. Mencius, as Confucius's follower, declared that the worst of unfilial acts was a failure to have descendants. In later centuries this emphasis on the necessity of sons led many to be disappointed at the birth of a daughter (Ebrey, 2018)[3]. However, in today's China, the status of women has improved dramatically throughout reforms in the late Qing Dynasty, the Chinese Civil War and rise of the People's Republic of China. According to the Human Development Report by The United Nations Development Program, the "Gender Equality Ranking" for China is 38, which is just below the US (37). However, O'Sullivan (2012) indicated that women's positions of leadership in employment can be graphed as a

[3] Ebrey, P. Women in Traditional China. *Center for Global Education. www. asiasociety.org*

pyramid: fewer women are found near the top. Thus, gender inequality still can be seen in work places.

Government structure (Centralization/Decentralization): The Chinese governments have a vertical structure with five levels. The central government of China is divided among several state organizations including the legislative branch (the National People's Congress and its Standing Committee), the presidency (the President and the Vice-President), the executive branch (the State Council), the military branch, the supervisory branch (the National Supervisory Commission) and the judicial branch (the Supreme People's Court and the Supreme People's Procuratorate). The National People's Congress, the President, and the State Council are the primary organs of state power.

Furthermore, there are five levels of government that give rise to a complicated inter-governmental financial relationship in China. The overall principle for inter-governmental relationship is "one-level-down management." In terms of the financial system, each level of government is responsible for formulating the financial system of the government at the level right below it. There are 34 provincial units, 333 regional and municipal units, 2862 county units, and 37,334 township units. Thus, the financial system varies with the level of government. Numerous governmental levels and units have complicated the huge financial system. However, despite the diversities of financial systems, financial systems have to follow three main principles stated by Zhou and Tan, (2017) including: First, the "symmetry" principle, which means one level of government should be furnished with appropriate budget revenues and expenditure responsibilities, so that its authority of finance and office could be proportionate or symmetrical. Obviously, if the authority of office far exceeds its authority of finance, this level of government will suffer from a financial deficit and lack the ability to fund public goods and public services. The second principle is the "equalization" principle. For example, if local governments with comparatively limited financial resources are unable to provide their residents with public services, thus governments of higher levels need to enhance the financial expenditure ability of these local governments by way of offering subsidies or transfer payment. Also, the vertical financial redistribution is an important component of the financial system. The third principle is the "efficiency" principle related to financial expenditure. The subsidies could be used for general purpose or earmarked special purpose, which means the lower levels of government should try to not use fiscal funds with poor efficiency and the higher-level government may consider "supervision" and incentive methods for raising the efficiency of financial expenditure.

Economic Freedom (Supervision, Regulation & Globalization): The data of reports from the Heritage Foundation shows that China ranked 105 in the index of economic freedom and 136 in the index of financial freedom in 2018; both made some progress since 2008 but are still below the world average. China's rapid economic growth was accompanied by a relatively undeveloped legal system and financial system, a lack of economic freedom, and a high level of corruption (Wu, 2011). Obviously, China seems to be a notable exception to the findings in the law, institutions, economic freedom, and economic growth literatures. Wu (2011) tried to find the secret of China's economic miracle and found that state control, if intelligently applied, can boost growth. Sometimes, competition could not always be related to economic growth because of market failure and excessive competition (Cao, 2008). Moreover, Wu (2011) also states that the limited freedom in Chinese financial markets and cross-border capital flows may well have shielded China from the recent financial crises that took place over our sample period.

By the end of 1990s, major components of the Chinese financial system were identified, which included the state Council, the People's Bank of China, the Banking Sector, the non-banking sector, and the financial market (Cecil, Zhang & Ma,1994). Financial supervision in China is conducted in a vertical structure of the financial system with multiple levels and follows the laws and regulations in force. The People's Bank of China (PBC), the Insurance Regulatory Commission of China and the Securities Regulatory Commission of China are the three major supervision authorities. Before the South-East Asian financial crisis, the financial system in China was established in line with the administrative structure, which meant that the supervisory department supervised the commercial financial sectors at the same level of administration, and this may have made it difficult for supervisory sectors to realize the overall situation and thus make it easy to ignore the risks a commercial bank may confront. After reforming, the financial supervision is more flexible to change towards risk evaluation of the legal person of a commercial bank and the supervision of the management structure inside every financial institution. However, Chinese financial supervision still needs to be improved during the process of the "planned economy to market economy transition," including improving the function of PBC (the central bank), and other supervised entities to meet the demands of the "planned economy to market economy transition," enhancing information disclosure (not only information but also advices for investors), facing the demands, and a requirement of international experience (Sheng, 1999).

Though according to the globalization index, China ranked 21 out 46 Asian countries, however, China has made substantial progress by transforming itself from the opponent of globalization into an advocate for globalization (Overholt ,2015). This process depended on the adoption of the rule of law, of commitment to competition, of widespread use of English, of foreign education, and of many foreign laws and institutions that are not just updating Chinese institutions, but transforming Chinese civilization (Overholt, 2005).

Indonesia----MFIs in a democratic country with a high level of decentralization

Microfinance in Indonesia. ***Status quo***. Indonesia has been considered as a model country of microfinance by the World Bank and some authors refer to the long history of its microfinance development, the commercialization of its microfinance sectors, the diversity of its MFIs, and the economic liberalization policies published in 1983 (Seibel and Parhusip, 1998). As shown in Table1, both the Bank Perkreditan Rakyat (current largest local bank) and the Indonesian People's Credit Bank (IPC) were established by the end of 19th century. Furthermore, commercialization is another important label for the microfinance industry in Indonesia. Large -scale commercial microfinance systems have developed in Indonesia since 1907. As shown in Table 1 (Zhang and Wong, 2014), the primary capital source of MFIs in Indonesia is the debt and commercial banks funding. For example, Badan Kredit Desa (BKD) is a village bank, which offers microloans commercially under the supervision of the People's Bank of Indonesia and Bank Rakyat Indonesia (BRI) (Zhang and Wong, 2014). What is more, MFIs in Indonesia have various forms. Both formal institutions and informal institutions play an important role. Informal institutions such as cooperation, NGOs, and credit associations are all active and contribute to the microfinance industry (BWTP, 2009).

Moreover, it should be mentioned that Indonesia is the fourth largest country in the world in terms of its population with 266.79 million people in 2017, and that 88% of the population are Muslims. As of August 2013, there were 11 Islamic commercial banks, 24 Islamic business units, and 160 rural banks existing with conventional MFIs in Indonesia, which makes this country a big laboratory of microfinance models in the world (Masyita, 2017).

Microfinance regulations and policies. Compared to China and India, financial regulations in Indonesia are relatively liberalized. Especially in recent years, the central bank relinquished its supervision jobs to a new independent financial institution, which is the Financial Services Supervisory Agency called Lembaga Pengawas Jasa Keuangan (LPJK). What is more, as shown in Table 3 (Haq, Hoque and Pathan, 2008), there are interest rate caps in Indonesia but the range of restriction on interest rate is much larger than the range of restriction in China.

Challenges. As we introduced earlier, there are both Islamic MFIs and conventional MFIs in the Indonesian microfinance industry. However, the performance of Islamic MFIs is worse than the performance of conventional MFIs, which is less than satisfactory. Furthermore, the majority of micro-loans in Indonesia are lent for profit by formal MFIs, which is the reason for its comparatively high level of sustainability. But in terms of the depth of outreach, the microfinance in Indonesia is rare to serve the extreme poor because of the lack of social amelioration of its financial system.

Innovations for Microfinance. Innovations and policies play an important role for the development of an industry in a particular region and could also mirror the political characteristics and environment of a country. In terms of Indonesia, first, I would like to mention the Bank Rakyat Indonesia – Unit Desa (BRI-UD). The Bank Rakyat Indonesia (BRI) is one of the five formal banks and the oldest bank in Indonesia, which operates a full range of banking services. BRI-UD, established in 1984, is a State-owned rural bank and an independent profit-center of the BRI. BRI-UD is a type of Village Bank and an example of high efficiency. And according to the research of World Bank, the outreach of BRI-UD places it among the world's largest institutions offering services to rural areas. BRI-UD's success was attainted by several reasons including focusing on rural financial intermediation rather than credit to agriculture alone; focusing on increasing access to financial services and not on targeting poor people or resolving gender issues; keeping independent from State subsidies and donor funds; stressing profitability, management autonomy and adequate management information systems (MIS): village banks have specific targets to become subsidy independent and staff incentives are connected to branch profitability; and introducing incentive schemes for clients. Additionally, village banks provide significant interest rates rebates which are offered for prompt loan repayments and also offer flexible saving products to introduce highly positive on-lending interest rates (Yaron, 1997). However, the extremely high interest rates of BRI-UD is a concern by researchers. The financial reforming and policy adjustment occurred in 1983. Governments decided to relax the control of interest rates and marketized the interest rates progressively. Thus BRI-UD became more independent from State subsidies and charged a real interest rate of 21.1 percent in 1994. The Subsidy Dependent Index (SDI) of BRI-UD is negative (-43 percent), which indicates that the BRI-UD could lower its real lending rate to 8.2 percent while maintaining sustainability. Moreover, the surplus income generated by this program is used to support other activities such as lending to richer classes in urban areas, which of course decreases ethical satisfaction (Yaron, 1997).

Furthermore, a biometric identification system is an innovation of Indonesian financial systems, and its appearance helped to decrease the cost of administration of MFIs in Indonesia. Normally, active borrowers of MFIs have a comparatively low education level, which could increase the cost for administration. A biometric identification collecting the credit score and other individual information could help with identifying and analyzing personal information efficiently.

Additionally, the regulatory change in Indonesia needs to be mentioned as well. The New Branchless Banking rules, which aimed to rapidly expand the reach of banks to the micro-segments and the new Microfinance Law was implemented in Indonesia, which focused on consolidating and adding greater regulatory oversight of MFIs. The changes and reforms of Microfinance policies and regulations in recent years include Bank Indonesia (BI) introducing Credit (a 70% credit guarantee) for Business program (KUR) for MFIs to land to micro-segments in 2007 because of the lack of access to sufficient capital; in 2009, BI rules that at least 20% of bank loan portfolios be dedicated to micro-segment loans by 2018 because of governments' perception that financing MFIs is high risk; a more relaxed regulation on fund transfer easing cash-out regulations and P2P transfer requirements for agents to solve the problem of excessive regulatory hurdles in 2012; a new Microfinance law drafted, which aims to increase oversight of smaller MFIs in 2013; BI pilots branchless banking with five state-owned banks and three telecom companies to solve the problem of inadequate outreach to remote and marginal areas (2013-2014); and introducing New Branchless Banking to ease agent use and documentation requirements for all commercial banks to increase the competition power of private institutions to State owned MFIs (2014); and developing a regulatory framework for smaller MFIs (Hadad, 2015).

Basic Information (regime, population & economy): ***Regime.*** Indonesia is a presidential representative democratic republic whereby the president is both head of state and head of government, and it has a multi-party system. Executive power is exercised by the president. In the legislative system, power is vested in both the president and the two People's Representative Councils and the judiciary is independent of the executive and the legislature (King, 2009). The New Order is the term coined by the second generation of president, Suharto, to define his regime. President Suharto held the office from 1967 to 1998, sat on the highest levels of the political hierarchy and has been identified as the most corrupt leader according to Transparency International's corrupt leaders list (BBC)[4] in Indonesia's history. Rieffel (2007) states that the Asian financial crisis played an important role to force President Suharto to resign in May 1998 and set the stage for a spectacular transition to a democratic political system. Indonesia today is one of the most democratic countries in all of Asia. The political transition has been underway since 1998, which has three outstanding features: electoral reform, decentralization of government authority, and freedom of the press (Rieffel, 2007). Right now, Indonesia has come far on its road to democracy and according to the research of Economist Intelligence Unit's (EIU) Index of Democracy in 2017, the rank of overall score of democracy for Indonesia is 68 in the total of 165 countries, which means India is identified as a Flawed democracy.

Population. Indonesia, a Southeast Asian nation made up of thousands of volcanic islands, is the fourth most populous nation in the world, with 266.79 million in 2017. There are hundreds of ethnic groups speaking many different languages (World Bank). Similar to the situation of China, Indonesia experienced a rapid process of urbanization as well. According to data from the World Bank, the percentage of the rural population in Indonesia was 85.41% in 1960 and 42.04% in 2017 (the World Bank, 2017). Furthermore, Indonesia has a relatively young population compared to Western nations with a median age of 30.2 years in 2017 (CIA World Factbook). 81.5% of Indonesians are

[4] Suharto tops corruption ranking. BBC News. 25 March 2004.

at the bottom of the economic pyramid. Like the poor people in the Western countries, these poor Indonesians who are living in poverty need access to financial services in order to find opportunities to improve their lives and their communities. Without having salaries and sufficient collateral, about 35.10 million (41.97% of the total population) live on less than USD 1.90 per day in 2005 and 37.17 million Indonesians (20.58% of the total population) live on less than USD 1.90 a day in 2007[5], and thus are considered poor loan risks or live in locations too remote for formal financial services (Hadad, 2015).

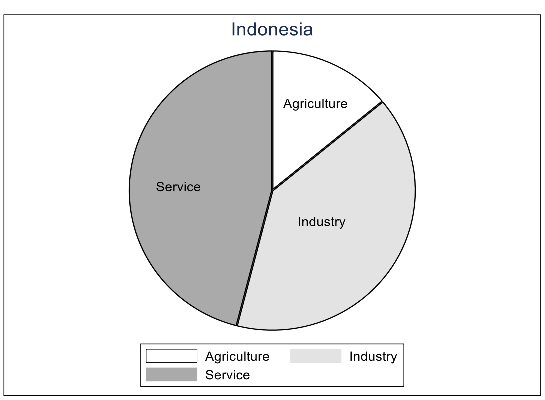
Economy. For the past three decades before 1997, the Indonesian economy has grown at an average annual rate of 7 percent. The market in Indonesia is comparatively open and Indonesia is the only member of OPEC in Southeast Asia. A large number of foreign investments flowed into Indonesia, particularly into the rapid developing export-oriented manufacturing sector in the recent years. However, Indonesia suffered the most damaging blow in the Asian Financial Crisis of 1997: it lost nearly 80 percent of its currency value; many of its banks and corporations went bankrupt; unemployment rose rapidly, and inflation ran at an annual rate of 50 to 60 percent during the economic crisis. After the crisis, Indonesia's recovery was not as good as the other countries in Asia. Indonesia posted only a mere 0.2 percent of growth in 1999 while some other Asian

[5] www.wikipedia.com

nations (such as South Korea with 10.7 percent of growth) registered far better growth rates. (Feng, Y., Hsiang, A.C. & Lee, J., 2002).

As has been mentioned, the crisis forced Indonesia to have a political reform and transition to a more democratic political system. Meanwhile, there are also economic reforms that involved monetary policy to control inflation and fiscal policies to reduce the tax burden of the nation and so on. The Indonesian economy is estimated to grow stably at around 6 percent of GDP in recent years. In terms of the structure of the three main industries in Indonesia right now, agriculture occupies 13.9 percentage of the GDP, the secondary sector, comprising industry and construction, represents 40.30% of the GDP, and the service industry occupies 45.90% of the GDP (see figure 6 below). The percentage of the economy accounted for by agriculture is constantly decreasing in the 21st Century (Du, 2005).

Figure 6: Three Main Industries in Indonesia:



(Data come from Wikipedia in 2017 & figure drawn by the author)

Political Culture & Ideology. Indonesia, the largest Muslim state in the world, is also one of the most geographically dispersed nations. And Indonesians have a diverse culture and set of beliefs: Islam, Protestantism, Roman Catholicism, Hinduism, Buddhism, and Confucianism are all recognized as the official religions. It consists of a group of archipelagos which range from the large islands of Sumatra and Java (in the west), through Sulawesi (in the center) to the territory of Irian Jaya (Western New Guinea), in addition to the territory of Kalimantan and the Molucca Islands (Zarrouki, K. & Analyst, M. 2016).

Although Indonesia is a Republic nation with Muslim as a majority in population, the women are generally considered to have a comparatively high social status by outside observers. Women have equal rights with men in politics since 1955 (Robinson, Bessell, 2002), although in practice, Indonesian gender ideology still emphasizes men as community leaders, decision makers, and mediators with the outside world, so women are the backbone of the home and family values and just 50 percent of Indonesian women are currently engaged in the labor force (Adzhani, 2015).

Government Structure (Centralization/Decentralization). The decentralization in Indonesia was implemented simultaneously throughout the entire country following the transition to democracy and the collapse of the Suharto regime. The previous centralized regime had been associated with high inequality in interregional allocation of funds, poor service delivery, and high levels of corruption (Bardhan & Mookherjee, 2006). As a result of the dispersed geography, the power from the Indonesian central government to Indonesia's 440 districts and municipalities is probably the most far-reaching decentralization of power seen in the modern world (Rieffel, 2007).

This Decentralization in Indonesia was both political and economic. Local governments in Indonesia provided political authority independent of upper level governments, regular elections with political parties, and devolution of responsibility over most local social services such as primary education, health, infrastructure and welfare. More than 30 percent of total government expenditure in Indonesia has been transferred to local governments and those transfers are largely formula-bound. Decentralization is greatly reducing the scope for political discretion at upper levels of government in Indonesia (Bardhan & Mookherjee, 2006).

Also, some researchers found the disadvantage of decentralization that the deregulation of the economy from central governments could not pass to the municipal governments because local governments often refuse to comply with the state's laws. Thus, decentralization could impede the full implementation of any new policies[6].

Economic Freedom and Political Freedom. In Indonesia, the economy has undergone rapid liberalization. Indonesia ranked 29th among 115 nations in 1995 in terms of economic freedom, down from its place in 1985 (ranked 15th) and in 1990 (ranked 13th) (Feng, Y., Hsiang, A.C. & Lee, J., 2002). The Indonesian market enjoys substantial economic freedom, though this freedom has decreased after the Asian Financial crisis in1997. What needs to be paid attention to is that in Indonesia, although the market is comparatively free and supposed to determine prices, government regulation has remained high. For example, governments regulate the price of rice by setting price ceilings or floors. Or the governments use of subsides to promote the agricultural sector and state-owned enterprises are often protected from market competition. “Indonesia has opened its domestic capital market without having established a set of competitive and efficient mechanisms first” (Feng, Y., Hsiang, A.C. & Lee, J., 2002).

Meanwhile, the substantial and comparatively high economic freedom is compromised by the lack of political freedom in the nation. Before the financial crisis, Golkar’s monopoly in Indonesian politics became an established fact in 1971. Indeed, in

[6] Cnbc.com

Indonesia, an archipelago, there are 17,000 islands and more than 300 ethnic groups. Rather than dealing with citizen issues with in an institutional framework, Indonesia leasers prefer to rule through ruthless political suppression accompanied by military brutality (Feng, Y., Hsiang, A.C. & Lee, J., 2002). However, after the financial crisis, there was a strong tension to build the New Order to establish a political system that is based on the rule of law rather than the rule of a person.

Feng (2001) indicates that political freedom causes economic freedom, while the noncausality from economic freedom to political freedom cannot be rejected. Moreover, these arguments have been confirmed in other researches. Riker and Weimer (1993) found a similar conclusion when they explore the exogeneity of political institutions. Economic freedom depends not only on economic policies, but also on a political system which consistent with economic freedom. Overall, political freedom is an important determinant of economic freedom, therefore Indonesia has a comparatively high level of economic freedom.

India----MFIs in a democratic country with a conventional culture and a high level of economic freedom

Microfinance in India. ***Status quo.*** The development of the microfinance industry in India has started since 1960s. In India, except for some NGOs (semiformal) and self-help groups (informal), almost all the other MFIs in India are formal institutions including domestic commercial banks (public sector banks, private sector banks, local area banks and regional rural banks), public trusts, non-profit companies, cooperatives and societies (Haq, Hoque and Pathan, 2008).

One important event that affected India’s MFIs significantly is the Andhra Pradesh (A.P.) Microfinance crisis in 2010. The capability of microfinance was touted and the explosive growth of microfinance in southern India caused over-lending and financial losses in MFIs. In order to meet the organizations’ growth target, loan officers often sold loans to clients who were already indebted to other microfinance institutions. The results of these aggressive lending even lead to the suicide of borrowers who carried heavy debt stress. This crisis hurt not only the MFIs in the Andhra Pradesh area but also the entirety of microfinance institutions in India. However, this country has been making efforts to recover losses and redevelop the financial system and judicial system after crisis.

The forms and shapes of MFIs in India are various and could be categorized into four types such as joint liability groups, self-help groups, the Grameen Bank Model, and rural cooperatives. The lending process of MFIs in India is completely different from that of the traditional financial sectors. Microfinance officers concern about the background of borrowers and decide who can get into the groups. Then the officers discuss the loan application and disbursal procedure with the members to make sure they understand the skills and requirements of microloan's application and operation. After that, the appointed officers need to follow up with the members of groups to make all the rules and regulations for the team and arrange the further training for members. Then various governmental sectors, NGOs, and banks give loans if the borrowers follow certain rules set by the MFIs.

Microfinance regulations and policies. The central bank regulates two types of MFIs in India, including bank and non-bank finance companies. As we illustrated previously, the types of MFIs are various in India, thus, a large number of MFIs were unregulated before the A.P. crisis. The Microfinance Institutions Development and Regulation Bill was introduced in 2012, which is a more clearly and detailed statutory framework to regulate MFIs in this industry. This act is considered successful in India. Furthermore, this country also launched a new poverty alleviation plan called the National Rural Livelihoods Mission in 2011, which aims to reach 70 million poor households before March 2018 (Zhang and Wong, 2014).

Innovations for microfinance. Innovations could happen in any link such as the institutions' management, financing, governance, client service and so on. The village federations of Self-Help Groups are an important microfinance innovation in India. As India has a large rural area and rural women are first organized in self-help groups (SHGs) of twelve to twenty members. Each group is supported by a local NGO in charge of training and regular monitoring. The practice of saving regularly and lending internally are the common points for all the SHGs. A joint women's committee formed by one to two representatives from each SHG to establish a SMS federation, which is encouraged to become legally chartered, to formally interface with the local NGOs. Most of the work of this SMS federation system is done at the village level, thus this system could help with saving time and the costs of banking; women who are chosen to serve in the village federation gain considerable prestige and are often elected to the local village governing sectors; Finally, the system is simple and easily replicated (Harries, 2002). Moreover, technology development could be applied in manage MFIs. The utilization of smart cards could help promote the computerization of transactions and simplify the process of public administration.

Basic Information (regime, population & economy): ***Regime.*** India is a parliamentary democratic republic, which means that the executive branch of government is held accountable to the legislative branch. Under this system of government, the President who is the head of State and the Prime Minister who is the executive branch are responsible for running the federal government. There are 29 states and 7 territories in India and the governments are divided into 3 branches: the legislative, the executive, and the judicial (Pariona, 2017). According to the research of Economist Intelligence

Unit's (EIU) Index of Democracy, the rank of overall score of democracy for India is 42 in the total of 165 countries, which means India is identified as a Flawed democracy.

India has a multi-party system with three levels of parties: national level, state level and district level. There are 6 major parties recognized as national political parties including the ruling Bharatiya Janata Party (BJP), which is considered as the right-wing party; the Indian National Congress, which is the main opposition party; the Bahujan Samaj Party (the Dalit Socialist party); the Communist Party of India (Marxist), which is the traditional left-wing party; the National Congress Party; and the Communist Party of India.

Population. India is the world's second most populated country with more than 1.35 billion residents and living in the world's seventh largest country (in terms of land area). According to data from the World Bank, the percentage of the rural population in India was 82.08% in 1960 and 66.40% in 2017. Furthermore, the total population of India has doubled in size in just 40 years with a current yearly growth rate of 1.11% and it is expected to unseat China as the world's most populated country (World Population Review). According to the report of Modified Mixed Reference Period (MMRP), which was proposed by the World Bank in 2015, there are 172 million people under the poverty

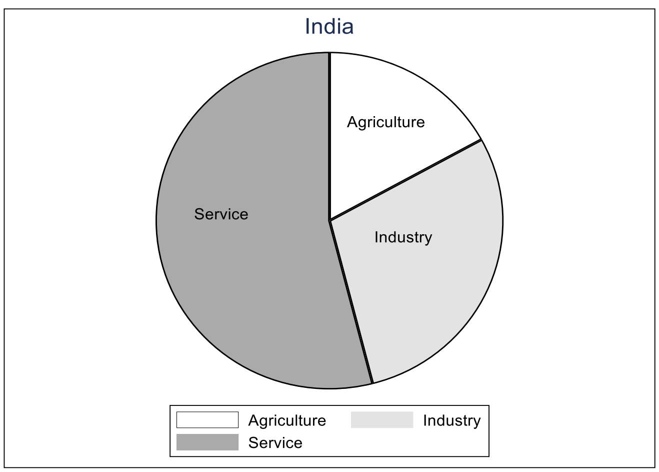
[7] https://data.worldbank.org/indicator/SP.RUR.TOTL.ZS

line in India and the poverty rate stood at 12.4% of the total population from 2011 to 2012 (India revised poverty line as $1.90) (Misra, 2015; Rediff, 2015).

Economy. According to the research of the World Bank, India is the world's sixth-largest economy, with a gross domestic product (GDP) of US$2.84 trillion and purchasing power parity (PPP) of $10.38 trillion in 2018. However, the country ranks 139th in per capita GDP (nominal) with $2,134 and 122nd in per capita GDP (PPP) with $7,783 as of 2018 (World Bank, 2018). Rural areas are the most active areas for the Indian economy that contains 15 million micro-enterprises, which constitutes 50% of the total number of industrial enterprises in India (Du, 2005). The agriculture sector employs 49% of the workforce and is estimated at 17.5% of GDP. After the 1991 economic liberalization, India achieved 6% to 7% average GDP growth annually (WEO,2017). Looking at the history of India's economy, between 1956 to 1974, India's GDP grew 3% and 4% per year with a closed and highly regulated economy; between 1975 to 1990, India's domestic private sector was given greater room for maneuver. The paradigm had a transformation to trade orientation beyond 1991. In 1991, a technocracy convinced India about the importance of globalization and private independence. India's private sectors were freed from significant state control during this period. The subsequent Indian private sector boom has been proved to be associated with high levels of economic growth later (Mukherji, 2009). And right now, India has become one of the fastest growing economies in the world.

In terms of the structure of the three main industries in India right now, agriculture occupies 16.8 percent of the GDP, the secondary sector (comprising of industry and construction) represents of 28.90 percent of the GDP, and the service industry occupies 54.30 percent of the GDP (see figure 7). Agriculture provides employment to 50% of the country's workforce (Madhusudhan, 2015)

Figure 7: Three Main Industries in India:



(Data come from Wikipedia in 2017 & figure drawn by the author)

Political Culture & Ideology: India became an independent country on 14th August 1947, which means the colonial experience of India and the period of British rule (1793-1947) was over and the powers of government was transferred by the last of the British Viceroys. As what was introduced previously, India is indeed democratic. Ten national elections have been held in India since independence. The culture of democracy in modern India has historic roots. The principles of free speech, assembly, and movement were established before independence. The values such as representation, election, and self-governance advocated by successive generations of a strong nationalist elite, who assumed institutional form as an authoritarian colonial raj took steps toward decolonization (Sisson, 1993.

Furthermore, India is truly a land of religious diversity. Though Hindus constitute over four-fifths of the country's population, Muslims, Christians, Sikhs, Buddhists and Jains exist in sizeable numbers (Dutt & Davgun, 1982). There are Two distinct subdivisions of Indian culture exist, separating North India and South India into clearly defined regions. Shielded by virtue of its peripheral, peninsular location from the ebb and flow of historical tides, the South was able to evolve a culture containing greater stability than that of the North (Nutt & Noble, 1982).

The patriarchal ideology plays an important role in India or many other Asian countries. However, women's status has improved a lot in the recent year of modern India. Programs like 'Sarva Shiksha Abhiyan' and 'Saakshar Bharat Mission for Female Literacy' has helped increase the literacy rates from less than 10 percent to more than 50% and dropout rates for girls have fallen by 16.5% between the year 2000 and 2005 (Banerjee, 2011). According to Banerjee's research, India has the world's largest number of professionally qualified women. Moreover, India has the largest population of working women in the world, which has more doctors, surgeons, scientists, and professors than the United States (Banerjee, 2011). However, some ideology related to women's "real domain" or objectification hasn't been changed much. For example, a lot of people still think marriage is women's ultimate destiny. The sex ratio of India also shows that Indian society is still prejudiced against women.

Government Structure (Centralization/Decentralization). India is a federal country with a high degree of heterogeneity. Inequality across regions and across levels of economic well-being has become evident. India has moved in the direction of decentralization since the first initiative actions to establish local government in 1957. Regional governments form an important intermediate tier between national and local governments. Furthermore, Indian local governments have devolved significantly less spending or allocational responsibilities: local governments have no jurisdiction over the administration of primary education and health. In most Indian regions, the devolution of administrative responsibility over most infrastructure and welfare programs has been de jure rather than de facto, with state bureaucracies continuing to retain their power over these programs (Bardhan & Mookherjee, 2006).

Economic Freedom (Supervision, Regulation & Globalization). According to the research of Indian economist Bibek Debroy, the economic reforms of economic freedom, including a reliance on the market and reduced government intervention, started in the late 1970s in India. There were two generations of economic reforms. First generation reforms include the external sector and refer to agenda items that are the province of the Central government such as product markets, while second generation reforms pertain more to the domestic economy and often concern agenda items falling within the purview of the states such as market for land and labor (Debroy, 2010). After the reforms, the 2018 data of reports from the Heritage Foundation shows that India ranked 127 in the index of economic freedom and 116 in the index of financial freedom of 177 countries in the whole world, which tells us that India has a comparatively very low level of economic freedom in a comparatively high level of democracy.

Here, the inequality of development in India need to be considered as well. India is a large and heterogeneous country, which is similar to China. In both countries some states are economically freer than others. There have been regional reports on economic freedom in recent years and the economic reform in India need to focus on the inter-state differences and pay more attention to areas with a comparatively lower freedom level (Debroy, 2010).

Conclusion

This chapter studied the political and cultural environment of microfinance institutions (MFIs) in three Asian countries: China, Indonesia, and India. The cross-national comparison has helped to understand the performance of MFIs in the three countries: we found that Indonesia has a relatively high sustainability of MFIs compared to China and India. India's sustainability of MFIs dropped dramatically after the microfinance crisis to -10.1% in 2011, and its average level of sustainability is still higher than the sustainability of MFIs in China. In terms of breadth of outreach, India is far ahead of Asian countries. China and Indonesia keep the similar lower level of breadth of outreach than India, but this number increased obviously after 2012. When we look at the depth of outreach, all these three countries have a relatively low level among all the Asian countries, especially China.

Political Environment. First of all, it is difficult to find a direct relationship between regime type and success of MFIs in these three cases and this may need a bigger sample cases study in further research. India and Indonesia are democratic countries while China is the only authoritarian country. India has the highest breadth of outreach in Asian countries in 2011 but Indonesia has the lowest breadth of outreach in these three cases. In terms of the financial sustainability, Indonesia has the best result comparing with India and China. However, India did not perform as well as Indonesia as a democratic country.

Furthermore, from the development history of these three cases from 2003 to 2014, I think that political stability plays a role for sustainability but not for the breadth of outreach. After the microfinance crisis, financial sustainability in India dropped to more than -10% in 2011 but its breadth of outreach remained the top one among all Asian countries during the period pre- and post-crisis. However, there are some researchers who think political stability does not affect results of MFIs. Warby (2007) even found that microfinance has the greatest poverty reduction effect under conditions of instability by using a large N analysis of Latin-American states from 1990- 2010 and a case study analysis.

Additionally, decentralization of political structures and a high level of commercialization of MFIs in Indonesia led to great financial results for Indonesia’s microfinance institutions. Furthermore, the competition from private institutions for state-owned MFIs helped to improve efficiency of management in MFIs and applications of new technologies in microfinance industry such as the biometric identification system in Indonesia. Meanwhile, as the microfinance sectors is run for profit, there is less motivation for MFIs in Indonesia to reach the poorest households.

Culture matters. This chapter analyzes the impact of culture on Microfinance in three countries and involved several factors such as gender, social relationship, and political culture. It is obvious that culture is one of the influential indicators for the success of MFIs in both theory and practice. For example, the mentality towards gender may affect the social status of women, which is important for their rights to accept education and enter society to work. Female clients are important for the outreach and depth of microfinance and according to the research, female borrowers have higher a level of repayment rate. Furthermore, culture also can influence the forms of MFIs. In Indonesia, diversity of religion leads to various types of MFIs and make this country into a worldwide laboratory for both Islamic MFIs and conventional MFIs.

Chapter Four

Microfinance Outreach and Sustainability: A Cross-National Quantitative Study

As seen in the literature review, few studies have been done concerning the performances of microfinance institutions from the political perspective. What I found about the research in this area is that most of the research focuses on some specific factors such as regulations, gender equality, or subsidy. The impact of governmental actions is complex, and it is hard to get the whole picture. Here, my research is going to explore political indicators in the extensive macro-level environment including regime type, governance capability, decentralization and the six dimensions of culture. Based on the political framework and the models of this empirical study, the central hypothesis be tested are as follows:

Hypothesis 1: A higher degree of democracy will be associated with positive outcomes for MFIs. This research assumes that in spite of the inner strength of microfinance institutions, the democratic political environment could still help the development of grassroots and can provide more room for various kinds of microfinance institutions to grow. This dissertation will use regime type as an important indicator, and this indicates four types: full democracies, flawed democracies, hybrid regimes and authoritarian regimes. These aspects are included in the Economist Intelligence Unit's

Index of Democracy. The measure of democracy is broken to the subgroups by regime type, as well as political rights and political culture[8].

Hypothesis 2: The governance quality indicators do not affect the performance of microfinance institutions. Governance quality reflects the ability of governments to protect citizen's rights through law making or implementing policies. In this research, governance quality is measured by indicators such as rule of law, regulatory quality, political stability, function of government, government effectiveness as well as Corruption Perceptions (the index developed by Transparency International).

Hypothesis 3: The MFIs' performance is positively affected by the degree of decentralization. Many scholars agree that decentralization can be a viable solution for enhancing efficiency and building institutional capacity to manage growth and diversification (Dempsey, Swire, 2006). Decentralization is measured by three variables including financial freedom, investment freedom, and tiers of government.

Hypothesis 4: The culture variables have an independent and statistically significant association with the performance of microfinance institutions. It is more

[8] The Economist Intelligence Unit's Index of Democracy is based on five categories: electoral process and pluralism; civil liberties; the functioning of government; political participation and political culture.

appropriate to see culture as intersecting with policy, social, and economic forces to produce specific outcomes in specific places and time periods.

Data and Variables

This dissertation uses data from the microfinance industry to test the four hypotheses stated above. More data has become available by a few research organizations such as MIX Market, EIU, the world bank and others. The database of political economics is of great importance in the operation of data inquiry and in the progress of research to explore more about the microfinance industry worldwide. The quantitative analysis here is operated at the institutional level and uses a panel database with information from close to 8957 microfinance institutions from 113 counties for the period 2003-2014. Appendix 1 presents all the variables' descriptions including dependent variables, control variables and independent variables. Then Appendix 2 (see below) presents the summary statistics of the variables studied in this dissertation. The values are the averages for all applicable years.

Dependent Variables.

As introduced in the literature review, most research ideally measures the performance of microfinance institutions by three components: outreach, sustainability and impact. This study is going to focus on outreach and sustainability as it is hard to measure the impact using a limited comparable data across countries. Furthermore, the

MFI faces unique challenges because it must achieve a double bottom line—provide financial services to the poor (outreach) and cover its costs (sustainability) (Hartarska, 2004)

The empirical analysis utilizes outreach data and sustainability data collected by the MIX Market information platform (www. Mixmarket.org). To date, MIX MARKET contains the best publicly available cross-country data of individual microfinance institutions' financial indicators (Hartarska, 2007). Data from MIX MARKET are self-reported by MFIs after going through a comprehensive review process. There is more data on microfinance that became available due to increasing MFIs appeared in this industry and participated to report data.

Outreach. Appendix 1 provides definitions of dependent variables and independent variables that are applied in this study. By definition, outreach, which considers the extent to reach the target population, is measured by the log of the number of active clients, which includes borrowers, depositors, and other clients who are currently have an outstanding loan balance with the MFI. Larger number of active clients illustrates the capability of MFIs to serve broader poor households, which also considers as "breadth of outreach". Different with the breadth of outreach, average total loans per borrower/ gross national income (GNI) per capita represents the extent of "depth of outreach." Larger values indicate that the MFI serves less poor borrowers. Both of above indicators are the standardized measure of MFIs performance as suggested by the guidelines from the Consultative Group to Assist the Poor (CGAP, 2003). The definitions and formula for each indicator are listed at the Appendix 1.

Sustainability. Sustainability is measured by accounting-based indicators. In general, sustainability accounting measures are considered more appropriate for long-term studies. It is hard for managers to manipulate statements for longer periods than for one year (Bhagat and Jefferis, 2002). This research uses return on assets (ROA) to measure sustainability, which shows how well the MFI can cover its costs through operating revenues. ROA is self-reported data and does not necessarily include the value of donations, however, subsidies and inflation that MFIs should be incorporating in this ratio normally (Hartarska, 2004).

Control variables.

Numerous control variables are used to account for the differences in MFIs in this dissertation. The differences in macro-economic conditions where MFI located are controlled by the size of the economy, which was measured by logarithm of (2010 constant US dollar) GDP. The differences in poverty level where MFIs located was captured by the (2010 constant US dollar) adjusted net national income. The difference in the global access for the MFI was measured by the economic globalization and political globalization. The difference in overall human resources on both buy and sell side was measured by the human development index. These exogenous factors were applied as the exogenous control variables in both studies on pollical and on cultural impact. Meanwhile, in the cultural impact study, a set of exogenous political factors were used as control for the addition political environment difference. The explanation of the data of control variables is as following:

First, MFI specified characters. These MFI-specific variables are measured by the natural logarithm of total assets, MFI age in years (3 categories), target market, regulation status, profit status, MFI legal status and regions. Those MFI-characteristic serve as controls to help identify the marginal impact of political and cultural variables. The raw data of MFI dummies are also from the global database which called MIX Market.

Second, macroeconomic variables. Researchers have recently analyzed the link between microeconomics and microfinance activity, which has shown significant connectivity between the operations of Micro Financial Institutions and Macroeconomic indicators (Esmerada Doci, 2017). And microfinance institutions operate in a wide variety of countries of different levels of economic status. The development indicators of macro-economic environment include logarithm of gross domestic product (GDP) (constant 2010 US$) and adjusted net national income (NNI) per capita (constant 2010 US$).

Third, three key political variables include political globalization, HDI and E government. More specifically, the data of political globalization come from the Swiss Institute of Technology in Zurich, with a measurement scale 0 to 100. The higher score means higher level of the number of the embassies and high commissions in a country, the number of international organizations to which the country is a member, the number of UN peace missions a country participated in, and the number of treaties signed between two or more states. Human development index (HDI) is available through the human development reports (2004 to 2014). The HDI is measured on a continuous scale of 0-1 and based on three dimensions measuring longevity and health, knowledge, and a decent standard of living[9]. HDI is created to emphasize that people and their capabilities should be used for assessing not only the development of a country and economic growth alone but also be the ultimate criteria to question national policy choices, asking how the two countries with similar level of GNI per capita can get different human development outcomes. The E-Government Development Index presents the level of E-Government Development of a country[10]. The database is available at the website of United Nations Public Administration Network.

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[9] http://hdr.undp.org/en/content/human-development-index-hdi

[10] The E-Government Development index incorporates the access characteristics, such as the infrastructure and educational levels, to reflect how a country is using information technologies to promote access and inclusion of its people. The EGDI is a composite measure of three important dimensions of e-government, namely: provision of online services, telecommunication connectivity and human capacity.
http://www.unpan.org/Library/MajorPublications/PublicEGovernanceSurvey/PublicEGovernanceSurveyintheNews/tabid/651/Default.aspx#popup

Key Independent Variables (Data of Political Environment and Culture)

According to the political economic theories' framework, this research is going to analysis the effect of the state from four components: the regime type and democracy, governance capability, decentralization and culture.

Regime Type. The regime type is definite by the Economist Intelligence Unit (EIU) in the report of the democracy index, which intends to measure the situation of state democracy in 167 countries. The overall score if democracy is a continuous score from 1 to 10 and the higher score means higher degree of democracy. This index was first published in 2006 and updated at 2008, 2010 and then publishes annually in the following years. In my dissertation, a panel data for the period of 2003 to 2014 in 113 countries is going to be used. Thus, I have adjusted the index for years that lack of data depends on when the country had a political regime change or major events that probably lead to the change. For example, if regime change happened in 2008, the data of 2006 index is going to be utilized for years 2004 to 2007 and the 2008 index is going to be used for years 2008 to 2010 and so on. According to the report of EIU, countries are categorized as one of four regime types: full democracies, flawed democracies, hybrid regimes and authoritarian regimes[11], which have been treated as 4 dummy variables in the fixed effect

[11] https://en.wikipedia.org/wiki/Democracy_Index

analysis. In this dissertation, the authoritarian regime had been defined as the base, hybrid regimes had been defined as regime type 1 and the rest of countries include flawed democracies and full democracies had been define as regime type 2. The regime type definite based on the overall score of democracy and the democracy index is based on 60 indicators. By studying the impact of four regime types, this dissertation looks more closely at indicators which can also measure the level of democratic development of a country. Thus, the democracy component is broken down into its subgroups: the political culture and political rights. Data of political rights ratings from the Freedom House evaluate three categories: electoral process, political pluralism and participation, and the functioning of government. The index ranges from 1 (strong rights) to 7 (weak rights)[12].

Governance Capability. In this dissertation, rule of law, regulatory quality, functioning of government, government effectiveness, and corruption perception-transparency international represent the capability of governance. The data of function of government is continued scores from 1 to 10 and come from the Economist Intelligence Unit (EIU) in the report of the democracy index. Higher value means better functioning of public institutions for political participation and democracy. Data of rule of law, government effectiveness, regulatory quality and political stability come from the dataset

[12] https://www.theglobaleconomy.com/indicators_list.php

of the World Bank's governance indicators. This measure uses continuous score and was originally designed on a scale of -2.5 to 2.5, with higher scores indicating better governance. Data of corruption perceptions-transparency come from the research of Transparency International with scores from 0 to 100 with 100 means less or no corruption. The values and data of transparency international are collected from the surveys and assessments of corruption, which operated by a variety of reputable institutions.

Decentralization. This dissertation is going to explore the impact of decentralization by testing for relationship to three variables: investment freedom index, financial freedom index and tiers of government. The database of investment freedom and financial freedom both come from the Heritage Foundation's Economic Freedom indicators[13]. This measure uses continuous scores and was originally designed on a scale of 0 to 100, with higher scores indicating a higher level of freedom. The data of tiers of government means the number of subnational tier governments, which cited from Daniel Treisman's "*Decentralization Dataset"* (2008).

Culture. This research uses the Hofstede national culture index (The Hofstede Center) [14] to analysis the connection between national cultural features and indicators of

[13] This conservative think tank's report rates countries on a 100-point scale in ten different areas: business freedom, trade freedom, fiscal freedom, government size, monetary freedom, investment freedom, financial freedom, property rights, freedom from corruption, and labor freedom.
[14] www.geert-hofstede.com

countries’ microfinance institutions through a random effect regression model. The six dimensions of national culture include power distance index (PDI), individualism versus collectivism (IDV), masculinity versus femininity (MAS), uncertainty avoidance index (UAI), long term orientation versus short term normative orientation (LTO) and indulgence versus restraint (IND). More specifically, first, in the Power Distance dimension, the degree of inequality among people which the population of a country considers as normal: from relatively equal (that is, small power distance) to extremely unequal (large power distance). All societies are unequal, but some are more unequal than others (Hofstede, 1993). Second, the Individualism dimension reflects the degree to which people in a country prefer to act as individuals rather than as members of groups. The opposite of individualism can be called Collectivism, so collectivism is low individualism. In collectivist societies a child learns to respect the group to which it belongs, usually the family, and to differentiate between in-group members and out-group members (that is, all other people) (Hofstede, 1993). Gorodnichenko and Roland (2010 and 2011) found that the individualism- collectivism cultural dimension has an important and robust causal effect on innovation and long run growth. Third, the Masculinity-Femininity dimension is a measurement of the degree to which tough values like assertiveness, performance, success and competition, which in nearly all societies are associated with the role of men, prevail over tender values like the quality of life, maintaining warm personal relationships, service, care for the weak, and solidarity, which in nearly all societies are more associated with women's roles (Hofstede, 1993). Women's roles differ from men's roles in all countries; but in tough societies, the differences are larger than in gentle ones. Fourth, the Uncertainty Avoidance dimension reflects the degree to which people in a country prefer structured over unstructured situations. Structured situations are those in which there are clear rules as to how one should behave. These rules can be written down, but they can also be unwritten and imposed by tradition (Hofstede, 1993). In countries which score high on uncertainty avoidance, people tend to show more nervous energy, while in countries which score low, people are more easy-going. A (national) society with strong uncertainty avoidance can be called rigid; one with weak uncertainty avoidance, flexible. In countries where uncertainty avoidance is strong a feeling prevails of "what is different, is dangerous." In weak uncertainty avoidance societies, the feeling would rather be "what is different, is curious." Fifth, the Long-term/Short-term Orientation dimension reflects cultural values directed toward the perspective of time. On the long-term side one finds values oriented towards the future, like thrift (saving) and persistence. On the short-term side one finds values rather oriented towards the past and present, like respect for tradition and fulfilling social obligations (Hofstede, 1993). Six, Indulgence stands for a society that allows relatively free gratification of basic and natural human drives related to enjoying life and having fun. Restraint stands for a society that suppresses gratification of needs and regulates it by means of strict social norms (Hofstede, 2010).

The base culture data for six dimensions of culture, containing information from 112 countries, are presented in Cultures and Organizations done by Professor Geert Hofstede, Gert Jan Hofstede, Michael Minkov and their research teams in 2010.

Empirical Model

This research is going to utilize newer data, which is regulation quality index measured by the World Bank's governance indicators from 2003 to 2014 from the institutional level with 8957 observations from 113 countries. Furthermore, this paper also uses the variable of MFIs characters which can help us explore the differences of performance between regulated MFIs and unregulated MFIs. The database of MFIs dummies is from MIX Market.

To analyze political and cultural impact on the MFI performance, which represented by sustainability, breadth of outreach and depth of outreach, this paper start with the following unobserved effects model,

$$Performance_{i,t} = c + P'_{i,t}\beta_P + MFI'_{i,t}\beta_{MFI} + M'_{i,t}\beta_M + \alpha_i + u_{i,t} \quad (1);$$

$$Performance_{i,t} = c + C'_{i,t}\beta_C + MFI'_{i,t}\beta_{MFI} + M'_{i,t}\beta_M + P'_{i,t}\beta_P + \alpha_i + u_{i,t} \quad (2),$$

where $Performance_{i,t}$, on the left-hand side of both equations, are measured by the sustainability, breadth of outreach and depth of outreach. Sustainability is measured by the $ROA_{i,t}$, the Return on Assets of the observed individual Micro Finance Institution in a given year. Breadth of outreach is measured by the $lnborrow_{i,t}$, which is the logarithm on the total active borrowers' numbers of the observed individual Micro Finance Institution in a given year. The $LBGNI_{i,t}$ is the measure of the depth of outreach, which stands for $\frac{\text{Average Loan per borrower}}{\text{GNI per capita}}$.

The empirical model (1) is used to analyze the impact of the political factors on the performance of MFI. The letter P_{it} is a vector composed of the specified political variables for MFI i at time t. The empirical model (2) is a model to analyze the culture effect on the MFI's performance. The symbol C_{it} is a vector consisting culture variables. The symbols β_P and β_C are vectors consisting of the corresponding parameters of political variables and culture variables, respectively.

In the right-hand side of both equations, the letter c is the model constant. The $MFI_{i,t}$ consists of a vector of the Micro Finance Institution specified variables. The β_{MFI} is a vector representing the coefficients of MFI specified variables. The letter M_{it} represents a vector of the Macro Economics variables. The β_M symbol is a vector consisting of two parameters of Macro Economics variables. The α_i is the individual unobserved effect of each MFI. The last term, u_{it}, is the error term, which varies over i and t. The model can be rewritten in the following form

$$y = X\beta + \varepsilon,$$

where $X = [\mathbf{1}_{nT} \quad \mathbf{P} \quad \mathbf{MFI} \quad \mathbf{M}]$ and $\beta = \begin{bmatrix} c \\ \beta_P \\ \beta_{MFI} \\ \beta_M \end{bmatrix}$ for equation (1); $X = [\mathbf{1}_{\mathbf{nT}} \quad \mathbf{C} \quad \mathbf{MFI} \quad \mathbf{M} \quad \mathbf{P}]$ and $\beta = \begin{bmatrix} c \\ \beta_C \\ \beta_{MFI} \\ \beta_M \\ \beta_P \end{bmatrix}$ for equation (2); $\varepsilon = \begin{bmatrix} \varepsilon_{1,1} \\ \vdots \\ \varepsilon_{i,t} \end{bmatrix} = (\mathbf{I}_{\boldsymbol{n}} \otimes \mathbf{1}_{T_i})\alpha + \mathbf{u}$, such that $\varepsilon_{i,t} = \alpha_i + u_{i,t}$. The letter T_i is the observed years of entities from the unbalanced data.

In the empirical study, if the unobserved effects α_i do not exist, a simple pooled OLS regression is suitable for the analysis. However, if one believes the individual MFI has its own unobserved characters which may or may not influence the MFI performances, the fix effects or random effects model is a more feasible tool. To test the unobserved effects α_i, the F statistics, $\frac{(R_{FE}^2 - R_{OLS}^2)/(n-1)}{(1-R_{FE}^2)/(\sum T_i - n - K)} \sim F_{n-1, \sum T_i - n - K}$, on the fix effect model and Breusch-Pagan Lagrange multiplier (1980) on the random effect model is formally used. The test result indicates the panel effect exists in both political impact and culture impact studies.

Political Impact Study. The political variables in this study are exogenous time-variant, which is feasible for both fixed effects and random effects models. As Jeffrey M. Wooldridge discussed in his ‘Advanced Panel Data Methods’, the fixed effects estimator is unbiased under a strict exogeneity assumption that the idiosyncratic error term $u_{i,t}$ should not be correlated with any of the explanatory variables across all time periods. The benefit of using FE model is that it explores the net relationship between the performance of MFI and political factors by removing the unobserved time-invariant effect α_i, which is unique to the individual, prior to estimation. Because of that, the fixed effect estimator allows for arbitrary correlation between α_i and the explanatory variables in any period. In the political impact study, the unobserved MFI endogenous characters such as MFI structure or managerial quality may correlated to the political explanatory variables such as regime, control of corruption or government effectiveness, etc. For example, it is common to observe that MFIs in a fully democratic regime show a relatively higher managerial quality than MFIs in an authoritarian regime. What's more, the mangers may be less incentivized in a country with more corruption issues. Certain regions such as Africa may have very different MFI structure than MFI in Asia. If any of the above situation persists, the fix effect estimator may be more reasonable for the inference.

Formally, the Hausman specific test can be used to check whether the unobserved effect is correlated to the explanatory variables. This test was proposed by Hausman in 1978. He considered a test statistic based on

$$\hat{q} = \hat{\beta}_{FE} - \hat{\beta}_{RE}.$$

In the context of maximum likelihood estimation under the equi-correlation RE framework. The null hypothesis is that $\hat{\beta}_{FE}$ and $\hat{\beta}_{RE}$ are consistent, but $\hat{\beta}_{RE}$ is efficient, so that

$$\hat{q} \xrightarrow{p} 0, \text{ and } \sqrt{n}(\hat{q}) \xrightarrow{p} N\left(0, n\widehat{avar}(\hat{q})\right).$$

The test statistic then becomes

$$H = \hat{q}\left(\widehat{avar}(\hat{\beta}_{FE}) - \widehat{avar}(\hat{\beta}_{RE})\right)^{-1}\hat{q},$$

where $H \sim \chi^2(K)$. As Imbens and Wooldridge (2007) discussed, the Hausman test is based on conventional variance matrix from both fix effects and random effects. The Hausman specific test indicates that the fix effects model is more suitable in the political impact over MFI performance study.

Mathematically, the fixed effects model is a constrained GLS model taken as a time demeaning transformation, defined as $\ddot{y} = Q_D y$, that $\ddot{y}_{i,t} = \mathrm{y}_{i,t} - \overline{y_i}$; $\ddot{X} = Q_D X$, that $\ddot{X}_{i,t} = \mathrm{X}_{i,t} - \overline{X_i}$; $\ddot{u} = Q_D u$, that $\ddot{u}_{i,t} = \mathrm{u}_{i,t} - \overline{u_i}$. The model can be rewritten as

$$Q_D y = Q_D X\beta + Q_D \varepsilon,$$

where $Q_D = \mathbf{I}_n \otimes (\mathbf{I}_{T_i} - T_i^{-1}\mathbf{1}_{T_i}\mathbf{1}'_{T_i})$.

The fixed effects estimator is

$$\hat{\beta}_{FE} = (X'Q_D X)^{-1}X'Q_D y;$$

$$\widehat{avar}(\hat{\beta}_{FE}) = \frac{y'Q_D y - y'Q_D X(X'Q_D X)^{-1}X'Q_D y}{\sum T_i - n - K}.$$

However, the fix effect model takes the time-demean transformation Q_D, in a form of $\mathrm{y}_{i,t} - \overline{y_i}$ on dependent variables and $\mathrm{X}_{i,t} - \overline{X_i}$ on explanatory variables, that any explanatory variable is constant across t, which means perfectly collinear within the entity, get swept away by the transformation. The MFI characters such as legal status, regulation status, profit status and regions are endogenous time-invariant variables. This paper excludes those time-invariant control variables from the fixed effect model, when conducting political impact study.

The panel model has two crucial assumptions for the panel models. One important assumption is that the autocorrelation, AKA serial correlation, should not be present, which means that $u_{i,t}$ follow a random walk across time. Mathematically, it means that, for all $t \neq s$, the following equation holds:

$$cov\left(u_{i,t}, u_{i,s} \,\middle|\, X_i, a_i\right) = 0.$$

Another important assumption of the panel models is that the variance of the differenced errors, conditional on all explanatory variables and unobserved effects is constant. That means for all t,

$$var\left(u_{i,t} \,\middle|\, X_i, a_i\right) = var\left(u_{i,t}\right) = \sigma_u^2.$$

In the empirical study, when the cluster effect, autocorrelation and heteroskedasticity, presents, i.e. some variables are correlated within the MFI cluster over the time, even the fixed effects or random effects model consistently estimate the coefficient, the serial correlation or the heteroskedasticity in the error term will still cause the result to be less efficient. As we know if the errors are positively correlated within cluster, then any additional observation will only provide the biased new information. Failure to control the error correlation will lead to a smaller standard error, which results in a larger statistic and over-rejection of true null hypotheses.

To test the autocorrelation, the Wooldridge's test (2002) is commonly used, because it requires relatively few assumptions, and the result is more robust. This method uses the residuals from a regression in first-differences,

$$y_{i,t} - y_{i,t-1} = \left(X_{i,t} - X_{i,t-1}\right)\beta_1 + (Z_i - Z_i)\beta_2 + (a_i - a_i) + u_{i,t} - u_{i,t-1};$$

$$\Delta y_{i,t} = \Delta X_{i,t}\beta_1 + \Delta u_{i,t}.$$

The null hypothesis is that if $cor\left(\Delta u_{i,t},\ \Delta u_{i,t-1}\right) = -0.5$, then $u_{i,t}$ is not serially correlated.

After applying the Wooldridge's test to the panel data, the results indicate a significant serial correlation present, which is logically sound, since the MFI performance variables and explanatory variables such as assets, GPD and political factors are normally changed gradually year by year.

The cluster-robust standard errors transformation, provided by Baltagi (2001) and Wooldridge (2002), can be applied to solve the serial correlation at the panel level. This method produces consistent estimates of the standard errors for both fixed effects and random effects model when autocorrelation present in the panel model. Meanwhile, this transformation is also robust to conditional heteroskedasticity. The cluster-robust estimator of asymptotic covariance on fix effects coefficients is

$$\widehat{avar}(\hat{\beta}_{FE}) = \left(\ddot{X}'\ddot{X}\right)^{-1}\left(\sum_{i=1}^{n}\ddot{X}_i'\hat{u}_i\hat{u}_i'\ddot{X}_i\right)\left(\ddot{X}'\ddot{X}\right)^{-1},$$

where $\hat{u} = \ddot{y} - \ddot{X}\hat{\beta}_{FE}$, $\ddot{y} = Q_D y$; $\ddot{X} = Q_D X$.

Culture Impact Study. In the cultural impact over MFI performance study, the culture explanatory variables, by definition, are time-invariant across the obtained period, so that the fixed effects model is not suitable to estimate the cultural influence over the MFI performances. Mathematically, the random effects estimator involves quasi-demeaning transformation on the data, i.e. $\mathrm{y}_{i,t} - \hat{\theta}_i\overline{y_i}$ and $\mathrm{W}_{i,t} - \hat{\theta}_i\overline{W_i}$, which overcomes the limitation of fixed effects estimator, allowing one to estimate the influence of the time-invariant variables, like the culture variables and some MFI specific time-invariant variables such as MFI legal status, regulation status, regions, etc.

The random effect estimator is GLS model taking quasi-demeaning transformation, define $W = [\mathbf{1}_{nT} \quad X]$, $\beta_{RE} = \begin{bmatrix}\alpha \\ \beta\end{bmatrix}$, $\varepsilon_i = \alpha_i\mathbf{1}_{T_i} + u_i$, then

$$E[\hat{\varepsilon}\hat{\varepsilon}']^{-1} = \widehat{\Omega}^{-1} = \frac{1}{(\hat{\sigma}_u^2 + T_i\hat{\sigma}_a^2)}\left(\mathbf{I}_n \otimes {T_i}^{-1}\mathbf{1}_{T_i}\mathbf{1}_{T_i}'\right) + \frac{1}{\hat{\sigma}_a^2}\left(\mathbf{I}_n \otimes (\mathbf{I}_{T_i} - {T_i}^{-1}\mathbf{1}_{T_i}\mathbf{1}_{T_i}')\right)$$

and

$$\widehat{\Omega}^{-1/2} = \frac{1}{\sqrt{(\hat{\sigma}_u^2 + T_i\hat{\sigma}_a^2)}}\left(\mathbf{I}_n \otimes {T_i}^{-1}\mathbf{1}_{T_i}\mathbf{1}_{T_i}'\right) + \frac{1}{\hat{\sigma}_\alpha}\left(\mathbf{I}_n \otimes (\mathbf{I}_{T_i} - {T_i}^{-1}\mathbf{1}_{T_i}\mathbf{1}_{T_i}')\right).$$

Estimate σ_u^2 from fix effect within estimator, let $Q_D = \mathbf{I}_n \otimes (\mathbf{I}_{T_i} - {T_i}^{-1}\mathbf{1}_{T_i}\mathbf{1}_{T_i}')$, then

$$\hat{\sigma}_u^2 = \frac{y\prime Q_D y - y\prime Q_D X(X'Q_D X)^{-1}X'Q_D y}{\sum T_i - n - K}.$$

Estimate σ_α^2 from between estimator, let $P = \mathbf{I}_n \otimes {T_i}^{-1}\mathbf{1}_{T_i}\mathbf{1}_{T_i}'$, then

$$\hat{\sigma}_\alpha^2 = \frac{y\prime Py - y\prime PW(W\prime PW)^{-1}W'Py}{n-1-K} - \frac{1}{T_i}\hat{\sigma}_u^2.$$

The GLS model can be rewritten as, $\ddot{y} = \ddot{W}\hat{\beta}_{RE} + \varepsilon$, where $\ddot{y} = \hat{\sigma}_\alpha \Omega^{-1/2}y$, such that $\ddot{\mathrm{y}}_{i,t} = \mathrm{y}_{i,t} - \hat{\theta}_i\overline{y_\imath}$; $\ddot{W} = \hat{\sigma}_\alpha \Omega^{-1/2}W$, such that $\ddot{\mathrm{W}}_{i,t} = \mathrm{W}_{i,t} - \hat{\theta}_i\overline{W_\imath}$, $\hat{\theta}_i = 1 - \sqrt{\hat{\sigma}_u^2/(\hat{\sigma}_u^2 + T_i\hat{\sigma}_\alpha^2)}$, then the random effects estimator is

$$\hat{\beta}_{RE} = \left(W'\widehat{\Omega}^{-1}W\right)^{-1}\left(W'\widehat{\Omega}^{-1}y\right) = \hat{F}X(X'Q_D X)^{-1}X'Q_D y + (\mathbf{I} - \hat{F})(W'PW)^{-1}W'Py;$$

$$\widehat{avar}\left(\hat{\beta}_{RE}\right) = \hat{\sigma}_u^2\hat{F}(X'Q_D X)^{-1},$$

where $\hat{F} = \left(X'Q_D X + (1-\hat{\theta}_i)^2 X'\left(P - \frac{1}{\sum T_i}\mathbf{1}_{\sum T_i}\mathbf{1}_{\sum T_i}'\right)X\right)^{-1} X'Q_D X.$

In the culture impact study, Wooldridge's test indicates that the autocorrelation presented at the panel level. Therefore, the cluster-robust transformation on error term is applied for the t statistics tests. The cluster-robust estimator of asymptotic covariance on random effects coefficients is

$$\widehat{avar}(\hat{\beta}_{RE}) = \left(\ddot{X}'\ddot{X}\right)^{-1}\left(\sum_{i=1}^{n}\ddot{X}_i'\hat{u}_i\hat{u}_i'\ddot{X}_i\right)\left(\ddot{X}'\ddot{X}\right)^{-1},$$

where $\hat{u} = \ddot{y} - \ddot{X}\hat{\beta}_{RE}$, $\ddot{y} = \hat{\sigma}_\alpha\Omega^{-1/2}y$; $\ddot{X} = \hat{\sigma}_\alpha\Omega^{-1/2}X$.

One important assumption of the RE estimator is that the unobserved effect α_i must be independent of the explanatory variables in all time periods. One crucial challenge of RE estimator is that one must specify the unobserved individual effect α_i which may influence the explanatory variables and catch the identified individual characters by the relevant control variables in the RE models to avoid biased estimation of coefficients of explanatory variables, i.e. omitted variable bias. The random effect estimator only requires that no perfect linear relationships exist among the explanatory variables. Therefore, to reduce the bias, a set of majority MFI endogenous variables and exogenous variables, which are considered as the major influence on the heterogeneity of MFI and do not present strong correlations to each other, are included as the control variables in the random effect estimator for culture study on the MFI performances.

Chapter Five

Discussion of Findings

Appendix 3 provides the results of Pearson's pairwise correlation coefficient, which indicated that multicollinearities that exist among some explanatory variables include government effectiveness, corruption perceptions, rule of law, regulatory quality, HDI and E-Government. Therefore, the stepwise selection over the rest of the explanatory variables was applied to the study to remove the multicollinearity issue. Furthermore, there are also co-relationships between the Regime Type variable and its subgroup variables (Political Culture and political rights variables). Thus, this paper developed four sub-models (1,2,3,4) by using stepwise selection to find the impacts of independent variables for the dependent variables including sustainability, breadth of outreach and depth of outreach in both fixed effect models and random effect models. Theoretically, all the four sub-models were using the similar sets of explanatory variables and should serve each other as the robustness test. Therefore, this paper will quote the most significant or highest coefficient value among four sub-models to explain the results for both political and culture study in the following results section.

Table 4 (see below) reports the generalized least squares estimation in the panel data of political variables, with missing values subject to step-wise deletion, and sustainability, breadth of outreach and depth of outreach as the dependent variables. This dissertation chose the fixed effects model to test political variables due to the nature of the time-variant study variables, which means these variables' output characteristics depend explicitly upon time and because of our robustness check (Hausman, 1978; test Prob<chi2=0.01). And the F-test (Prob<chi2=0.01) tells us that the fixed effects model on a panel data is more appropriate than the OLS regression model to test the impact of political variables on the MFIs' performance.

Regime Type and Democracy. As discussed in chapter two, there are four different regime types, including flawed democracies, full democracies, hybrid regime and authoritarian regime, categorized depending on the overall score of democracy. The Democracy component in this dissertation is broken down to its subgroups such as political rights and political culture.

As we can see in Table 4, this research tests Hypothesis 1 using the regime type and its subgroup variables including political rights and political culture. Findings indicated that only the breadth of outreach (measured by logarithm of the number of active clients), is positively associated with the regime types. This is consistent with Hypothesis 1: the higher level of democracy, the poorer borrowers are reached by MFIs, relative to a country with authoritarian regime. More specifically, holding all other factors fixed, MFIs in countries with flawed democracies and full democracies have on average 25.5 percentage points higher breadth of outreach than MFIs operating in countries with a hybrid regime and an authoritarian regime. Meanwhile, regime type itself does not have a statistically significant effect on both sustainability (measured by the ROA ratio) and depth of outreach (measured by average outstanding loans size /GDP per capita).

Table 4: Political Study

	Sustainability				Breadth of Outreach				Depth of Outreach			
	Return on Assets				ln(Borrow)				Average loan balance per borrower / GNI per capita			
VARIABLES	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
Constant	279.407***	218.484***	301.180***	229.520***	4.289	-13.670*	5.839	-14.333**	0.782	1.372	0.461	1.401
	(73.906)	(79.953)	(76.388)	(80.558)	(5.042)	(7.081)	(5.337)	(7.197)	(1.685)	(2.353)	(1.765)	(2.398)
<u>(Degree of Democracy)</u>												
Regime Type												
Authoritarian	0	0			0	0			0	0		
	(base)	(base)			(base)	(base)			(base)	(base)		
	0	0			0	0			0	0		
Hybrid Regime	-0.475	-0.102			0.084	0.131			-0.036	-0.026		
	(0.963)	(0.958)			(0.115)	(0.114)			(0.046)	(0.048)		
	-0.020	-0.004			0.019	0.030			-0.016	-0.012		
Democracies	-0.046	0.498			0.242*	0.255**			-0.003	0.011		
	(1.020)	(1.011)			(0.129)	(0.128)			(0.052)	(0.056)		
	-0.002	0.021			0.057	0.060			-0.002	0.005		
Political Culture			-0.611**	-0.667**			0.066**	0.075**			0.016	0.012
			(0.291)	(0.296)			(0.031)	(0.031)			(0.011)	(0.011)
			-0.051	-0.057			0.030	0.035			0.015	0.012
Political rights	-1.081***	-0.814**	-1.183***	-0.938**	-0.010	3.3e-04	-0.031	-0.032	0.014	0.012	0.023***	0.019**
	(0.351)	(0.360)	(0.373)	(0.367)	(0.031)	(0.031)	(0.030)	(0.030)	(0.010)	(0.009)	(0.008)	(0.008)
	-0.142	-0.107	-0.155	-0.123	-0.007	2.3e-04	-0.022	-0.022	0.021	0.019	0.034	0.029
<u>(Governance Capability)</u>												
Functioning of Government			-0.428	-0.308			-0.052	-0.058			0.019*	0.014
			(0.386)	(0.363)			(0.036)	(0.037)			(0.011)	(0.012)
			-0.063	-0.045			-0.043	-0.046			0.031	0.024
Regulatory Quality	-1.568		-1.273		0.156		0.188		-0.006		-0.029	
	(1.189)		(1.213)		(0.121)		(0.118)		(0.056)		(0.058)	
	-0.060		-0.049		0.034		0.041		-0.003		-0.013	

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 4: Political Study – continued

VARIABLES	Sustainability Return on Assets (1)	(2)	(3)	(4)	Breadth of Outreach ln(Borrow) (1)	(2)	(3)	(4)	Depth of Outreach Average loan balance per borrower / GNI per capita (1)	(2)	(3)	(4)
Political stability	-0.940	-0.468	-0.832	-0.459	0.056	0.063	0.029	0.026	-0.008	-0.001	-0.009	-0.002
	(0.700)	(0.746)	(0.695)	(0.735)	(0.066)	(0.066)	(0.064)	(0.065)	(0.023)	(0.021)	(0.023)	(0.022)
	-0.054	-0.027	-0.048	-0.027	0.017	0.020	0.009	0.008	-0.005	-0.001	-0.006	-0.001
Government Effectiveness		-3.956**		-3.595**		-0.102		-0.034		0.035		0.018
		(1.759)		(1.660)		(0.144)		(0.139)		(0.042)		(0.047)
		-0.137		-0.125		-0.020		-0.007		0.014		0.007
Corruption perceptions - Transparency International		0.096*		0.103**		-0.004		-0.007		0.003		0.003
		(0.051)		(0.051)		(0.005)		(0.005)		(0.002)		(0.002)
		0.059		0.063		-0.014		-0.024		0.021		0.021
(Degree of Decentralization):												
Investment Freedom Index	0.033**	0.036***	0.037***	0.041***	-0.001	-4.0e-04	-4.8e-04	-2.4e-04	-3.7e-04	-9.3e-05	-3.7e-04	-1.3e-04
	(0.014)	(0.014)	(0.014)	(0.013)	(0.001)	(0.001)	(0.002)	(0.002)	(0.001)	(0.001)	(0.001)	(0.001)
	0.044	0.050	0.050	0.057	-0.004	-0.003	-0.004	-0.002	-0.006	-0.002	-0.006	-0.002
Financial freedom	0.024	0.027	0.013	0.014	4.2e-04	-3.6e-05	0.003	0.002	-0.003***	-0.002***	-0.002**	-0.002**
	(0.024)	(0.025)	(0.024)	(0.025)	(0.002)	(0.002)	(0.002)	(0.002)	(0.001)	(0.001)	(0.001)	(0.001)
	0.027	0.031	0.014	0.016	0.003	-0.000	0.017	0.014	-0.033	-0.031	-0.027	-0.025
CONTROL VARIABLES:												
(MFIs characteristics)												
ln(Assets)	3.565***	3.793***	3.591***	3.796***	1.149***	1.160***	1.163***	1.173***	0.046***	0.045***	0.045***	0.044***
	(0.703)	(0.758)	(0.722)	(0.771)	(0.041)	(0.045)	(0.042)	(0.046)	(0.013)	(0.013)	(0.013)	(0.013)
	0.563	0.604	0.568	0.605	0.995	1.002	1.007	1.014	0.082	0.083	0.079	0.081
MFI Vintage												
New	0	0	0	0	0	0	0	0	0	0	0	0
	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)
	0	0	0	0	0	0	0	0	0	0	0	0
Young	5.445***	5.333***	5.397***	5.329***	-0.109	-0.140*	-0.114	-0.142*	0.001	0.029	0.004	0.031
	(1.007)	(1.044)	(0.993)	(1.039)	(0.073)	(0.074)	(0.074)	(0.074)	(0.036)	(0.036)	(0.036)	(0.036)
	0.178	0.175	0.177	0.175	-0.020	-0.025	-0.021	-0.025	2.3e-04	0.011	0.002	0.012

Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Table 4: Political Study - continued

	Sustainability				Breadth of Outreach				Depth of Outreach			
	Return on Assets				ln(Borrow)				Average loan balance per borrower / GNI per capita			
VARIABLES	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
Mature	4.629***	4.459***	4.580***	4.486***	-0.198**	-0.223**	-0.207**	-0.229**	-0.030	0.002	-0.024	0.006
	(1.099)	(1.135)	(1.084)	(1.127)	(0.096)	(0.098)	(0.097)	(0.098)	(0.036)	(0.035)	(0.037)	(0.036)
	0.175	0.170	0.173	0.171	-0.041	-0.046	-0.043	-0.047	-0.013	0.001	-0.010	0.003
Target Market												
Broad	0.140	0.241	0.103	0.192	0.062	0.065	0.060	0.065	0.132***	0.122***	0.131***	0.121***
	(0.547)	(0.561)	(0.545)	(0.560)	(0.053)	(0.053)	(0.052)	(0.052)	(0.013)	(0.011)	(0.013)	(0.011)
	0.006	0.010	0.004	0.008	0.015	0.015	0.014	0.015	0.063	0.061	0.062	0.060
High end	0.562	0.680	0.464	0.553	-0.088	-0.092	-0.107	-0.111	0.875***	0.879***	0.875***	0.878***
	(0.747)	(0.767)	(0.748)	(0.765)	(0.093)	(0.098)	(0.093)	(0.098)	(0.059)	(0.060)	(0.058)	(0.059)
	0.010	0.012	0.009	0.010	-0.009	-0.009	-0.011	-0.011	0.181	0.187	0.181	0.187
Low end	0	0	0	0	0	0	0	0	0	0	0	0
	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)
	0	0	0	0	0	0	0	0	0	0	0	0
Small business	0.122	-0.422	0.015	-0.528	-0.392**	-0.420**	-0.422**	-0.447**	2.505***	2.452***	2.504***	2.449***
	(1.069)	(0.989)	(1.072)	(0.987)	(0.178)	(0.179)	(0.179)	(0.182)	(0.169)	(0.173)	(0.169)	(0.173)
	0.002	-0.006	2.3e-04	-0.008	-0.032	-0.033	-0.035	-0.036	0.437	0.434	0.437	0.433
Portfolio at risk > 30 days	-0.039	-0.042	-0.041	-0.044	0.009***	0.011***	0.009***	0.011***	0.005***	0.005***	0.005***	0.005***
	(0.037)	(0.038)	(0.037)	(0.038)	(0.001)	(0.001)	(0.001)	(0.001)	(4.1e-04)	(3.8e-04)	(4.1e-04)	(3.8e-04)
	-0.005	-0.006	-0.006	-0.006	0.008	0.009	0.007	0.009	0.008	0.008	0.008	0.009
(Macro-Economic)												
log(GPD) 2010 US$	-13.116***	-10.067***	-13.749***	-10.150***	-0.325	0.582*	-0.397*	0.617*	-0.027	-0.053	-0.023	-0.061
	(3.326)	(3.718)	(3.401)	(3.747)	(0.221)	(0.336)	(0.231)	(0.341)	(0.073)	(0.111)	(0.075)	(0.111)
	-2.023	-1.550	-2.120	-1.563	-0.276	0.490	-0.337	0.519	-0.047	-0.095	-0.040	-0.110
Adjusted NNI per capita 2010 US$ (in $1000)	1.172	1.166	1.377*	1.311*	-0.028	-0.041	-0.009	-0.031	-0.032*	-0.035**	-0.036**	-0.035*
	(0.714)	(0.757)	(0.737)	(0.760)	(0.047)	(0.046)	(0.048)	(0.047)	(0.017)	(0.018)	(0.018)	(0.018)
	0.244	0.246	0.286	0.277	-0.032	-0.047	-0.010	-0.035	-0.075	-0.086	-0.084	-0.087

Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Table 4: Political Study - continued

	Sustainability				Breadth of Outreach				Depth of Outreach			
	Return on Assets				ln(Borrow)				Average loan balance per borrower / GNI per capita			
VARIABLES	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
(Political Control Variables)												
Economic Globalization	-0.157***	-0.139***	-0.174***	-0.157***	-0.004	-0.003	-0.003	-0.002	-0.003*	-0.003*	-0.003*	-0.003*
	(0.038)	(0.038)	(0.038)	(0.038)	(0.004)	(0.004)	(0.004)	(0.004)	(0.002)	(0.002)	(0.002)	(0.002)
	-0.156	-0.140	-0.173	-0.158	-0.022	-0.018	-0.015	-0.009	-0.036	-0.032	-0.034	-0.033
Political Globalization	-0.016	-0.003	-0.014	-0.004	0.004	0.006*	0.004	0.007*	0.001	0.001	4.6e-04	0.001
	(0.038)	(0.040)	(0.038)	(0.040)	(0.003)	(0.004)	(0.003)	(0.004)	(0.002)	(0.002)	(0.002)	(0.002)
	-0.018	-0.003	-0.016	-0.005	0.024	0.038	0.028	0.041	0.007	0.014	0.006	0.013
Human Development Index		-46.293		-50.456*		-7.673***		-8.269***		-0.365		-0.315
		(28.877)		(29.568)		(2.433)		(2.495)		(0.843)		(0.796)
		-0.415		-0.452		-0.368		-0.397		-0.038		-0.033
E-Government Index	-5.279		-5.542*		0.424		0.351		-0.127		-0.106	
	(3.369)		(3.344)		(0.338)		(0.343)		(0.145)		(0.149)	
	-0.053		-0.056		0.023		0.019		-0.014		-0.012	
Observations	6,644	6,444	6,644	6,444	5,999	5,825	5,999	5,825	6,625	6,426	6,625	6,426
R-squared	0.089	0.090	0.090	0.091	0.578	0.570	0.579	0.571	0.379	0.365	0.379	0.365
Number of mfi_id	1,553	1,513	1,553	1,513	1,392	1,360	1,392	1,360	1,550	1,511	1,550	1,511
F Test for Unobserved Effect	8.13***	7.77***	8.09***	7.80***	10.54***	10.69***	10.43***	10.47***	14.12***	13.4***	14.11***	13.38***
Wooldridge's Test	53.804***	54.305***	54.081***	54.555***	23.129***	20.227***	23.012***	20.019***	58.629***	54.985***	58.615***	55.019***
Modified Wald Test	1.4e+38***	5.6e+36***	1.1e+35***	7.1e+37***	1.9e+34***	3.5e+34***	1.2e+35***	1.2e+34***	1.0e+37***	1.1e+39***	1.2e+37***	4.6e+38***
Hausman Test	241.88***	236.95***	247.45***	237.15***	171.87***	174.41***	172.46***	187.12***	514.63***	479.04***	517.35***	480.83***

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Furthermore, if we look closer at the subgroups of democracy (political culture and political right), the results are consistent with the results of regime type when performance is measured by breadth of outreach. Political culture has a positive impact on breadth of outreach with a positive Beta of .075, which means an increase of one score of political culture index would help reach 7.8 percent more borrowers. When performance is measured by sustainability, political culture has a negative effect with a negative Beta of -.667, which means one unit of political culture index increased could cause the ROA reduces by 0.67 percent. Meanwhile, political rights have a negative effect on sustainability as well with a Beta of -1.183. Additionally, when performance is measured by depth of outreach, political rights have a positive Beta of 0.023, which says that a one score increase in political rights could increase the index of depth of outreach by 2.3 percentage points (equivalent to serving richer borrower). In summary, regime type could influence the breadth of MFIs directly. For example, a country with a hybrid regime tends to reach more borrowers than the country with an authoritarian regime. Furthermore, the impacts of the components of regimes are different. Political culture has a positive impact on breadth of outreach which is consistent with the impact of regime type however it has a negative impact on financial sustainability of MFIs. And higher level of political rights could bring lower financial results and reach fewer of the poorest borrowers.

According to the literature, in countries with higher level of political culture and political rights, MFIs have lower financial results possibly because most of the low-risk poor borrowers are already served by alternative financial institutions so MFIs serve risker borrowers and thus have poorer results. Additionally, in a democratic country, there may be a top-down society focus which creates policies and rules to protect minority rights. Democracies may overemphasize concern for citizens' rights in order to get political support instead of the rights of firms and especially financial institutions which traditionally have been viewed as exploitative of vulnerable populations. Furthermore, since breath of outreach implies increased service to the poor, this may cause an increase of disbursement of loans and MFIs may be forced to rely more on subsidies. Both of increasing input or relying on subsidies can hurt the financial sustainability of MFIs. Last but not least, a more democratic country may have policies to offer more access and less responsibilities for poor households to get a loan, which may increase the risk for MFIs. There seem to be a tradeoff between reaching poorer borrowers and maintaining good financial results in countries with good governance and rule of law.

Governance Capability*.* Hypothesis 2 was tested using 6 variables to indicate the impact of governance quality include corruption perception-transparency international, function of government, regulatory quality, political stability, rule of law, and government effectiveness. Results of the fixed effect model in Table 4 (see above) indicate that only the variable corruption perception-transparency international in all the governance capability variables is found has a significant positive effect on the performance of MFIs measured as sustainability. All other indicators have a negative impact or do not have statistically significant impact for outreach or sustainability of MFIs.

Specifically, "Corruption perception-transparency international" has a significant impact on ROA with a positive Beta of 0.103, which shows that for every one score change (increase) in the level of *corruption perception-transparency international,* there is an equivalent change (increase) of 0.10 percent in the level of sustainability of MFIs in a country. All other variables, including “rule of law”, “functioning of government”, and “government effectiveness” have negative impacts on the performance of MFIs. Specifically, rule of law has a negative Beta of -.294 on breadth of outreach and a positive Beta of .112 on depth of outreach, which tell us that a one score increase in the level of *rule of law* could cause a 25.47 percentage reduction of borrowers and increase the index of outreach by 11.2 percent (equivalent to serving wealthier borrowers). Also, functioning of government has a positive impact on the index of depth of outreach with a Beta of .019. Thus, MFIs in countries with stronger rule of law tend to reach not only fewer clients but also fewer of the poorest borrowers. When MFIs’ performance is measured as sustainability, the variable “government effectiveness” is significant with a negative Beta of -3.956, which means a 1 score increase of *government effectiveness* could cause a decrease of 3.96 percent of the sustainability of countries’ MFIs. Usually, countries with better governance capability are more developed counties. Based on these results it seems that MFIs find it harder to serve customers in wealthier countries.

The variable “corruption perception-transparency international” is the only one has positive impact in the indicators of governance capability. Corruption hinders economic growth by increasing costs, lowering productivity, discouraging investment, reducing confidence in public institutions, limiting the development of small and medium-sized enterprises, weakening systems of public financial management, and undermining investments in health and education (Lambsdorff, Johann, 2003). Thus, a more transparent government could decrease cost, enhance the equality of opportunities for investment or starting a business, and thus cause a higher level of sustainability of MFIs.

In summary, the results of governance capability variables are consistent with my expectation: governance capability does not have strong impact on the success of microfinance institutions and it seems that microfinance naturally needs less government support and a bottom-up approach fits more with demands of microfinance development.

Decentralization. As expected, findings show that the indicators of decentralization such as investment freedom index, financial freedom index and ties of government are statistically significant for the success of MFIs. The magnitudes of these coefficients are consistent with the hypothesis that MFIs' performance is positively related to the higher degree of decentralization. This is an important result because this finding could support my research questions that a bottom-up political perspective is better for the success of MFIs.

Hypothesis 3 is tested using three variables that indicate the level of decentralization, including investment freedom index, financial freedom index and tiers of government. Specifically, the investment freedom index has a positive impact on the sustainability of MFIs (Beta=.041), which means for a one unit increase in the level of *investment freedom,* there is an equivalent increase of .041 percent in sustainability of MFIs. The reason for this is probably that the higher level of investment freedom could increase economic opportunities for both the poor and the MFIs. Career training could reduce vulnerability while giving loans for starting a business could increase earnings and savings. Financial services also allow poor individuals to make the transformation from “every-day survival” to “planning for the future” (DiLeo, FitzHerbert, 2007). Knowing how to earn money could help increase the repay rate thus increase sustainability of MFIs.

At the same time, the findings also suggest that an increased level of financial freedom could help the MFI serve poorer clients. The Beta is negative of -.003, which means a 1 score increase in the level of *financial freedom* could cause the drop of .3 percent in the index of depth of outreach (means reach more poorest people). This result makes sense because a higher level of financial freedom normally goes with the better credit system which could provide the poorest households more access to financial institutions because the poorest households may have weaker credit backgrounds and lack access to the financial system.

The results of the estimation of tiers of government are presented in Table 5 (see below), which is the random effect model because the data of ties of government is time-invariance. Obviously, government structure with more ties (levels of local governments) affects sustainability positively (ROA would be improved by 2.658 percentage points for adding one level of ties). At the same time, “ties of government” could also help at the expense of depth, as local governments, which have more chances to reach households closely seem to be pushing for serving poorer borrowers. (Adding one score of ties of government would decrease the index of depth of outreach by 13.2 percentage points).

Table 5: Culture Study

	Sustainability				Breadth of Outreach				Depth of Outreach			
	Return on Assets				ln(Borrow)				Average loan balance per borrower / GNI per capita			
VARIABLES	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
Constant	-18.267	-39.787	-4.557	-29.611	-2.356	-3.321*	-2.910	-3.394*	3.105***	3.315***	3.005***	3.294***
	(23.633)	(30.272)	(20.876)	(24.921)	(1.926)	(1.887)	(1.964)	(1.990)	(1.061)	(1.125)	(1.012)	(1.094)
(Geert Hofstede's Six Dimensions)												
Power Distance Index	0.367***	0.308**	0.335***	0.312**	-0.023***	-0.018**	-0.022**	-0.016*	-0.002	-0.001	-0.002	-5.0e-04
	(0.118)	(0.122)	(0.130)	(0.142)	(0.008)	(0.008)	(0.009)	(0.008)	(0.002)	(0.002)	(0.002)	(0.002)
	0.302	0.257	0.275	0.260	-0.115	-0.092	-0.109	-0.082	-0.045	-0.014	-0.035	-0.009
Individualism	-0.156	-0.146	-0.145	-0.149	0.010	0.006	0.011	0.005	-0.002	-0.002	-0.002	-0.003*
	(0.130)	(0.126)	(0.131)	(0.122)	(0.008)	(0.008)	(0.008)	(0.007)	(0.002)	(0.002)	(0.002)	(0.002)
	-0.140	-0.133	-0.131	-0.136	0.056	0.035	0.061	0.029	-0.031	-0.051	-0.049	-0.065
Masculinity	0.259	0.230	0.196	0.159	0.003	0.010	0.005	0.010	-0.004	-0.003	-0.004	-0.003
	(0.258)	(0.253)	(0.242)	(0.240)	(0.010)	(0.010)	(0.010)	(0.009)	(0.003)	(0.003)	(0.003)	(0.003)
	0.196	0.176	0.148	0.121	0.013	0.046	0.024	0.046	-0.068	-0.053	-0.065	-0.047
Uncertainty Avoidance Index	-0.164	-0.181	-0.332**	-0.349**	-0.004	0.007	0.001	0.007	-0.009*	-0.009**	-0.010**	-0.010***
	(0.137)	(0.146)	(0.139)	(0.138)	(0.012)	(0.011)	(0.011)	(0.010)	(0.005)	(0.004)	(0.004)	(0.004)
	-0.241	-0.269	-0.486	-0.519	-0.032	0.062	0.012	0.066	-0.286	-0.285	-0.319	-0.315
Long-term Orientation	0.251***	0.168**	0.208**	0.095	0.002	0.007	0.004	0.008	0.004	0.006*	0.004	0.006**
	(0.088)	(0.082)	(0.089)	(0.088)	(0.008)	(0.008)	(0.008)	(0.008)	(0.003)	(0.003)	(0.003)	(0.003)
	0.368	0.248	0.304	0.140	0.019	0.065	0.037	0.072	0.142	0.191	0.134	0.197
Indulgence	-0.106	-0.060	-0.072	-0.053	0.012**	0.010	0.013**	0.011*	-0.001	-0.002	-0.001	-0.002
	(0.070)	(0.060)	(0.069)	(0.062)	(0.006)	(0.006)	(0.006)	(0.006)	(0.001)	(0.001)	(0.002)	(0.002)
	-0.210	-0.120	-0.143	-0.105	0.148	0.118	0.161	0.130	-0.039	-0.081	-0.050	-0.084
(Degree of Freedom)												
Tiers of Government	2.155*	2.658**	1.306	1.745	0.033	0.019	0.020	-0.009	-0.108	-0.118	-0.124*	-0.132*
	(1.190)	(1.159)	(1.266)	(1.202)	(0.106)	(0.107)	(0.107)	(0.108)	(0.071)	(0.074)	(0.069)	(0.073)
	0.126	0.157	0.076	0.103	0.012	0.007	0.007	-0.003	-0.139	-0.156	-0.160	-0.175

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 5: Culture Study – continued

	Sustainability				Breadth of Outreach				Depth of Outreach			
	Return on Assets				ln(Borrow)				Average loan balance per borrower / GNI per capita			
VARIABLES	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
CONTROL VARIABLES:												
(MFI Characteristics)												
ln(Assets)	2.471***	2.414***	2.468***	2.404***	1.049***	1.062***	1.058***	1.070***	0.028***	0.027***	0.027***	0.027***
	(0.487)	(0.536)	(0.476)	(0.527)	(0.025)	(0.025)	(0.026)	(0.026)	(0.007)	(0.006)	(0.007)	(0.007)
	0.341	0.337	0.341	0.336	0.899	0.910	0.906	0.917	0.085	0.085	0.084	0.083
MFI Vintage												
New	0	0	0	0	0	0	0	0	0	0	0	0
	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)
	0	0	0	0	0	0	0	0	0	0	0	0
Young	5.584***	5.243***	5.520***	5.283***	-0.060	-0.081	-0.074	-0.091	-0.030	-0.025	-0.030	-0.026
	(1.383)	(1.345)	(1.372)	(1.360)	(0.077)	(0.077)	(0.078)	(0.078)	(0.019)	(0.018)	(0.019)	(0.018)
	0.155	0.147	0.153	0.148	-0.010	-0.014	-0.013	-0.016	-0.018	-0.016	-0.019	-0.017
Mature	4.787***	4.364***	4.779***	4.493***	-0.239**	-0.242**	-0.253**	-0.253**	-0.035	-0.030	-0.036*	-0.031
	(1.298)	(1.259)	(1.289)	(1.271)	(0.095)	(0.096)	(0.098)	(0.098)	(0.021)	(0.020)	(0.022)	(0.021)
	0.155	0.143	0.155	0.147	-0.048	-0.048	-0.051	-0.051	-0.025	-0.022	-0.026	-0.023
Target Market												
Broad	0.404	0.459	0.333	0.432	-0.054	-0.044	-0.056	-0.047	0.181***	0.174***	0.185***	0.178***
	(0.636)	(0.652)	(0.624)	(0.645)	(0.069)	(0.070)	(0.069)	(0.071)	(0.012)	(0.012)	(0.012)	(0.012)
	0.014	0.016	0.012	0.015	-0.012	-0.010	-0.012	-0.010	0.140	0.138	0.143	0.141
High end	0.175	0.411	0.066	0.494	-0.162	-0.182	-0.203	-0.230	1.200***	1.215***	1.210***	1.225***
	(1.336)	(1.253)	(1.335)	(1.244)	(0.197)	(0.197)	(0.195)	(0.196)	(0.100)	(0.103)	(0.101)	(0.105)
	0.002	0.005	0.001	0.006	-0.012	-0.013	-0.015	-0.016	0.327	0.333	0.330	0.336

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 5: Culture Study – continued

	Sustainability				Breadth of Outreach				Depth of Outreach			
	Return on Assets				ln(Borrow)				Average loan balance per borrower / GNI per capita			
VARIABLES	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
Low end	0	0	0	0	0	0	0	0	0	0	0	0
	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)
	0	0	0	0	0	0	0	0	0	0	0	0
Small business	0.598	-0.298	0.311	-0.430	-0.007	-0.120	-0.039	-0.156	2.835***	2.815***	2.841***	2.823***
	(2.178)	(1.640)	(2.143)	(1.597)	(0.212)	(0.179)	(0.205)	(0.175)	(0.289)	(0.295)	(0.290)	(0.296)
	0.006	-0.003	0.003	-0.004	-4.1e-04	-0.007	-0.002	-0.009	0.575	0.570	0.577	0.572
Portfolio at risk > 30 days	-5.446*	-5.172	-5.443*	-5.121	-0.025	-0.041	-0.028	-0.053	-0.016*	-0.014*	-0.013	-0.012
	(3.278)	(3.154)	(3.253)	(3.119)	(0.110)	(0.113)	(0.108)	(0.111)	(0.009)	(0.008)	(0.008)	(0.007)
	-0.068	-0.065	-0.068	-0.064	-0.001	-0.002	-0.002	-0.003	-0.005	-0.004	-0.004	-0.003
Regulation Status	-2.493**	-2.653**	-2.594**	-2.750**	-0.239**	-0.259**	-0.236**	-0.263**	0.069***	0.065***	0.068***	0.065***
	(1.204)	(1.243)	(1.206)	(1.240)	(0.107)	(0.107)	(0.106)	(0.107)	(0.021)	(0.021)	(0.021)	(0.021)
	-0.088	-0.095	-0.091	-0.098	-0.053	-0.058	-0.052	-0.058	0.054	0.052	0.053	0.052
Profit Status	0.820	0.637	0.578	0.521	0.331**	0.361**	0.326**	0.351**	-0.049	-0.046	-0.050	-0.048
	(0.904)	(0.871)	(0.920)	(0.880)	(0.162)	(0.161)	(0.164)	(0.163)	(0.048)	(0.048)	(0.049)	(0.049)
	0.029	0.023	0.021	0.019	0.074	0.081	0.073	0.079	-0.039	-0.037	-0.040	-0.039
MFI Legal Status												
Bank	0	0	0	0	0	0	0	0	0	0	0	0
	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)
	0	0	0	0	0	0	0	0	0	0	0	0
Credit Union / Cooperative	4.729**	5.144**	4.775**	5.319**	0.159	0.200	0.161	0.190	-0.001	-0.022	4.1e-04	-0.021
	(2.352)	(2.579)	(2.331)	(2.586)	(0.295)	(0.298)	(0.295)	(0.298)	(0.080)	(0.079)	(0.080)	(0.080)
	0.128	0.140	0.129	0.145	0.026	0.032	0.026	0.030	-0.001	-0.013	2.5e-04	-0.013

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 5: Culture Study – continued

	Sustainability				Breadth of Outreach				Depth of Outreach			
	Return on Assets				ln(Borrow)				Average loan balance per borrower / GNI per capita			
VARIABLES	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
NBFI	1.257	1.422	1.548	1.758	0.564**	0.625**	0.549**	0.601**	0.031	0.019	0.035	0.023
	(2.105)	(2.196)	(2.075)	(2.212)	(0.241)	(0.245)	(0.240)	(0.243)	(0.068)	(0.068)	(0.067)	(0.067)
	0.043	0.049	0.053	0.061	0.122	0.136	0.119	0.131	0.023	0.015	0.026	0.018
NGO	-0.105	-0.165	-0.218	-0.208	0.860***	0.923***	0.880***	0.925***	-0.072	-0.092	-0.072	-0.092
	(2.383)	(2.433)	(2.379)	(2.429)	(0.307)	(0.310)	(0.307)	(0.310)	(0.083)	(0.081)	(0.082)	(0.081)
	-0.004	-0.006	-0.008	-0.007	0.187	0.201	0.191	0.202	-0.055	-0.072	-0.055	-0.072
Other	7.727	9.108	6.452	7.599	1.088	1.019	1.010	0.982	-0.151	-0.179	-0.162	-0.190
	(4.761)	(6.031)	(4.296)	(5.391)	(0.748)	(0.680)	(0.739)	(0.700)	(0.113)	(0.123)	(0.117)	(0.128)
	0.028	0.034	0.023	0.028	0.015	0.014	0.014	0.014	-0.013	-0.016	-0.014	-0.017
Rural Bank	3.576	3.722	4.780*	4.561*	-0.083	-0.065	-0.052	-0.046	0.139**	0.126*	0.141**	0.131**
	(2.609)	(2.623)	(2.600)	(2.610)	(0.301)	(0.306)	(0.304)	(0.306)	(0.066)	(0.066)	(0.065)	(0.067)
	0.069	0.073	0.092	0.089	-0.010	-0.008	-0.006	-0.005	0.059	0.055	0.060	0.057
MFI Regions												
Africa	0	0	0	0	0	0	0	0	0	0	0	0
	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)	(base)
	0	0	0	0	0	0	0	0	0	0	0	0
EAP	-4.303	-1.197	1.706	3.950	0.732*	0.355	0.669*	0.267	-0.324***	-0.409***	-0.329***	-0.408***
	(6.031)	(5.662)	(5.332)	(5.190)	(0.422)	(0.432)	(0.398)	(0.413)	(0.116)	(0.131)	(0.125)	(0.139)
	-0.113	-0.032	0.045	0.105	0.119	0.058	0.108	0.043	-0.189	-0.244	-0.192	-0.244
EECA	7.409	10.966	17.899**	22.420***	0.963	0.394	0.656	0.319	-0.043	-0.108	-0.020	-0.100
	(8.147)	(7.348)	(8.985)	(7.611)	(0.786)	(0.755)	(0.722)	(0.695)	(0.171)	(0.174)	(0.169)	(0.176)
	0.167	0.250	0.402	0.512	0.123	0.051	0.084	0.041	-0.021	-0.055	-0.010	-0.051

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 5: Culture Study – continued

	Sustainability				Breadth of Outreach				Depth of Outreach			
	Return on Assets				ln(Borrow)				Average loan balance per borrower / GNI per capita			
VARIABLES	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
LAC	14.241***	12.987**	23.217***	22.712***	0.165	-0.093	-0.114	-0.196	-0.090	-0.068	-0.060	-0.041
	(5.239)	(5.470)	(5.839)	(5.174)	(0.541)	(0.511)	(0.493)	(0.462)	(0.128)	(0.114)	(0.110)	(0.099)
	0.484	0.447	0.789	0.782	0.036	-0.020	-0.025	-0.042	-0.068	-0.052	-0.045	-0.031
MENA	20.578***	21.644***	22.313***	22.829***	1.039**	0.724	0.749	0.515	-0.393***	-0.415***	-0.375***	-0.389***
	(5.258)	(5.751)	(5.535)	(5.585)	(0.504)	(0.477)	(0.509)	(0.491)	(0.120)	(0.121)	(0.127)	(0.135)
	0.228	0.244	0.247	0.257	0.075	0.053	0.054	0.037	-0.097	-0.105	-0.092	-0.098
SA	-6.509	-2.898	0.458	2.760	1.229***	0.715*	1.224***	0.749**	-0.364***	-0.453***	-0.345***	-0.427***
	(5.908)	(6.227)	(5.369)	(5.664)	(0.411)	(0.401)	(0.386)	(0.381)	(0.109)	(0.120)	(0.121)	(0.129)
	-0.209	-0.094	0.015	0.090	0.252	0.147	0.251	0.154	-0.259	-0.330	-0.246	-0.311
(Macro-Economic)												
log(GPD) 2010 US$	-2.009***	-1.102	-2.017***	-1.115	0.019	0.014	0.025	0.021	-0.051*	-0.066**	-0.053*	-0.069**
	(0.772)	(0.884)	(0.764)	(0.876)	(0.083)	(0.084)	(0.083)	(0.084)	(0.027)	(0.029)	(0.027)	(0.028)
	-0.241	-0.133	-0.242	-0.134	0.014	0.010	0.018	0.016	-0.137	-0.176	-0.141	-0.185
Adjusted NNI per capita 2010 US$ (in $1000)	0.063	0.135	0.004	0.007	-0.055	-0.075*	-0.047	-0.070*	0.009	0.007	0.009	0.007
	(0.692)	(0.731)	(0.703)	(0.732)	(0.041)	(0.042)	(0.042)	(0.042)	(0.010)	(0.010)	(0.011)	(0.010)
	0.013	0.028	0.001	0.002	-0.068	-0.093	-0.058	-0.087	0.040	0.032	0.040	0.034
(Political Control Varibales)												
Economic Globalization	-0.270***	-0.206***	-0.274***	-0.204***	-0.009*	-0.006	-0.009*	-0.005	-0.004**	-0.004**	-0.004**	-0.004**
	(0.062)	(0.061)	(0.062)	(0.059)	(0.005)	(0.005)	(0.005)	(0.005)	(0.001)	(0.002)	(0.002)	(0.002)
	-0.230	-0.177	-0.233	-0.175	-0.050	-0.031	-0.048	-0.027	-0.067	-0.075	-0.067	-0.078
Political Globalization	-0.035	-0.057	0.004	-0.017	0.003	0.004	0.004	0.006	-0.002	-3.8e-04	-4.3e-04	0.001
	(0.069)	(0.065)	(0.066)	(0.071)	(0.006)	(0.006)	(0.006)	(0.007)	(0.002)	(0.002)	(0.002)	(0.002)
	-0.020	-0.033	0.002	-0.010	0.009	0.013	0.015	0.023	-0.020	-0.005	-0.005	0.009

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 5: Culture Study – continued

	Sustainability Return on Assets				Breadth of Outreach ln(Borrow)				Depth of Outreach Average loan balance per borrower / GNI per capita			
VARIABLES	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
Regime Type												
Authoritarian	0	0			0	0			0	0		
	(base)	(base)			(base)	(base)			(base)	(base)		
	0	0			0	0			0	0		
Hybrid Regime	-0.767	-1.041			0.209*	0.226*			-0.075	-0.071		
	(1.040)	(1.029)			(0.124)	(0.127)			(0.058)	(0.059)		
	-0.022	-0.031			0.037	0.040			-0.048	-0.047		
Democracies	4.586***	4.436**			0.181	0.243			-0.068	-0.066		
	(1.691)	(1.744)			(0.192)	(0.194)			(0.060)	(0.063)		
	0.149	0.145			0.036	0.048			-0.049	-0.048		
Political Culture			0.505	0.790*			0.035	0.045			0.014	0.010
			(0.477)	(0.462)			(0.040)	(0.040)			(0.014)	(0.012)
			0.033	0.052			0.014	0.018			0.020	0.014
Functioning of Government			-0.415	0.037			-0.047	-0.053			-0.002	-0.005
			(0.451)	(0.425)			(0.042)	(0.038)			(0.013)	(0.012)
			-0.052	0.005			-0.036	-0.040			-0.005	-0.015
Political rights	-1.089**	-0.634	-1.171**	-0.548	-0.017	-0.019	-0.056	-0.073*	-0.002	-0.008	0.011	0.002
	(0.471)	(0.446)	(0.526)	(0.507)	(0.035)	(0.039)	(0.034)	(0.039)	(0.010)	(0.011)	(0.008)	(0.009)
	-0.110	-0.064	-0.118	-0.055	-0.011	-0.011	-0.034	-0.044	-0.004	-0.019	0.025	0.004
Rule of Law	-1.246		-1.518		-0.530***		-0.469***		-0.009		-0.002	
	(3.571)		(3.965)		(0.158)		(0.159)		(0.045)		(0.046)	
	-0.033		-0.040		-0.088		-0.078		-0.005		-0.001	

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 5: Culture Study – continued

	Sustainability				Breadth of Outreach				Depth of Outreach			
	Return on Assets				ln(Borrow)				Average loan balance per borrower / GNI per capita			
VARIABLES	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
Regulatory Quality	-1.259		-0.209		0.334**		0.423***		0.068**		0.060	
	(1.956)		(2.088)		(0.150)		(0.158)		(0.035)		(0.045)	
	-0.041		-0.007		0.067		0.085		0.049		0.043	
Political stability	-0.916	-0.342	-0.465	-0.011	0.196**	0.151*	0.150**	0.099	-0.016	-0.028	-0.005	-0.017
	(0.956)	(1.009)	(0.991)	(1.062)	(0.079)	(0.084)	(0.071)	(0.076)	(0.028)	(0.032)	(0.029)	(0.034)
	-0.044	-0.017	-0.023	-0.001	0.059	0.045	0.045	0.030	-0.017	-0.031	-0.005	-0.018
Government Effectiveness		-5.568*		-5.283		0.066		0.200		0.078*		0.084*
		(3.318)		(3.302)		(0.155)		(0.163)		(0.041)		(0.051)
		-0.143		-0.136		0.010		0.031		0.045		0.048
Corruption perceptions - Transparency International		-0.027		-0.059		-0.008		-0.010		0.001		0.001
		(0.116)		(0.121)		(0.007)		(0.007)		(0.002)		(0.002)
		-0.014		-0.030		-0.024		-0.032		0.010		0.015
Investment Freedom Index	0.025	0.044**	0.019	0.033*	-0.004**	-0.004**	-0.004**	-0.004**	-2.4e-05	-2.8e-04	-1.6e-04	-4.0e-04
	(0.019)	(0.020)	(0.018)	(0.020)	(0.002)	(0.002)	(0.002)	(0.002)	(4.4e-04)	(3.7e-04)	(4.1e-04)	(3.7e-04)
	0.026	0.047	0.020	0.036	-0.028	-0.028	-0.029	-0.029	-0.001	-0.007	-0.004	-0.010
Financial freedom	-0.038	-0.027	-0.018	0.008	0.001	0.002	0.001	0.002	-0.001*	-0.001	-0.001	-0.001
	(0.041)	(0.039)	(0.041)	(0.041)	(0.003)	(0.003)	(0.003)	(0.003)	(0.001)	(0.001)	(0.001)	(0.001)
	-0.039	-0.028	-0.018	0.008	0.007	0.011	0.006	0.012	-0.027	-0.025	-0.021	-0.023
Observations	3,549	3,520	3,549	3,520	3,188	3,165	3,188	3,165	3,536	3,507	3,536	3,507
Number of mfi_id	862	845	862	845	780	767	780	767	861	844	861	844
Breusch & Pagan LM Test	1098.25***	1143.05***	1091.49***	1141.24***	1958.99***	1971.93***	1967.05***	1978.81***	631.93***	616.94***	618.55***	608.01***
Wooldridge's Test	26.455***	26.035***	26.401***	25.979***	6.904***	7.073***	6.738***	6.830***	49.828***	54.047***	49.085***	52.843***

Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Culture. Hypothesis 4 is about the impact of culture indicators and Hofstede's six primary dimensions of culture, which have been tested in Table 5 by using a Random Effect Model. The results in Table 5 indicate that there is a significant relationship between culture and the performance of MFIs, so cultural factors should be taken into consideration when we explore the environment for MFIs' success.

First, according to the results in table 5, a higher level of "power distance index" has a positive impact for sustainability and a negative impact for breadth of outreach. More specifically, the sustainability (ROA) would be improved by 0.367 percentage points for a unit change (increase) in "power distance index". The impact is not very strong but does exist. Meanwhile, a one unit increase in "power distance index" would decrease the index of breadth of outreach by 2.3 percentage points. "Power-Distance" is a term that describes how people in a society view the relationship between superior and subordinate and the public acceptance of authority and inequality of power (Hofstede 1984, 1991). Thus, MFIs, in society with higher power distance MFIs are more financially stable but reach fewer borrowers than in societies with smaller power distance.

Centralized decision structure, authority and the use of formal rules are often the characteristics of organizations in countries with a high degree of power distance index (Erumban and Jong, 2006; Kalu, 2019).

Thus, the results are telling us that a centralized society tends to have better sustainability of MFIs and reach fewer borrowers. This is a supplement for the previous conclusion, which is that a centralized political structure could not benefit MFIs. When we see the benefits of a decentralized society for MFIs, we should also know there are still advantages in a centralized society for MFIs. For example, a centralized political structure may benefit the sustainability by adding pressure for subordinates to secure to get repayment on time. The citizens in centralized society expect to be told what to do and may be more easily controlled by institutions. Furthermore, a centralized decision structure could reduce the complex decision-making process which help save expeditions to a certain extent. However, the corruption could be a weakness of centralized society, and the demands for financial services by the poor are harder meet which causes the lower level of breadth of outreach.

Second, “Individualism”, is the variable that reflects the degree to which people in a country prefer to act as individuals rather than as members of groups (Hofstede 1984, 1991). It has a small impact on the depth of outreach and does not have any influence on sustainability and breadth of outreach. Specifically, adding one-unit level of individualism would decrease the index of depth of outreach by 0.3 percentage points, which means higher levels of Individualism help reach poorer borrowers.

Third, “masculinity” is a measurement of the degree to which “tough” values like assertiveness, performance, success and competition, (values which in many societies are associated with the role of men) prevail (Hofstede 1984, 1991). Contrary to the expectation, “masculinity” does not have any impact for both sustainability and outreach of MFIs. Several studies focused on gender issues have argued that female borrowers tend to have better repayment, which could increase suitability. This dissertation’s research reveals that on the national level, the degree of inequality and the level of political rights may have a much greater effects for the performance of MFIs than the effects of “masculinity” factor, especially for the total number of borrowers.

Fourth, “uncertainty avoidance” reflects the degree to which people in a country prefer structured over unstructured situations (Hofstede 1984, 1991). A higher level of “uncertainty avoidance” means that people in this kind of society are more risk averse. According to Table 5, this cultural dimension has worse sustainability and better capability to reach poorer people (negative impact on both ROA and the depth of outreach). The sustainability (ROA) would be decreased by .349 percentage points for a one unit increase in degree of “uncertainty avoidance”. And a one unit increase in degree of “uncertainty avoidance” would decrease the depth of outreach by one percentage point (the higher depth of outreach means it reaches wealthier people). The results above have reflected the impact of culture in practice. “Uncertainty Avoidance” measures the level of tolerance for uncertainty in the future and ambiguity within society (Murdock, 2009). There is an argument related to “uncertainty avoidance” which states that this kind of risk averseness brings with it anxiety (Kalu, 2018). This anxiety really can affect the policy making because there are more people who think it is necessary to have strict rules or regulations and supervisions, instead of the free market, to control and secure the future. We have found that regulation and good governance do not have positive impact on sustainability which is consistent with the results of “uncertainty avoidance”.

Fifth, “long-term orientation”, reflects cultural values directed toward the perspective of time. On the long-term side one finds values oriented towards the future, like thrift (saving) and persistence. On the short-term side one finds values rather oriented towards the past and present, like respect for tradition and fulfilling social obligations (Hofstede 1984, 1991). On the long-term side one takes a more pragmatic approach, while on the short-term side is more normative (Kalu,2018). Findings indicate that “long-term orientation” affects sustainability positively (ROA would be improved by .251 percentage points for an increase in one unit of “long-term orientation”) and affects the depth of outreach positively (an increase in one unit of *long-term orientation* would increase the index of depth of outreach by .6 percentage points). Thus, a pragmatic perspective could benefit the sustainability of MFIs and cause them to serve fewer of the poorest borrowers. On the contrary, a more normative perspective tends to result in MFIs reaching more poor people.

Sixth, higher score of “Indulgence” reflects people have a willingness of enjoying life and having fun, defined at the extent people try to control their desires and impulses. The opposition of “Indulgence” is “Restraint” (Kalu, 2018). It is interesting to notice that societies with a high score in “Indulgence” has a significant positive impact on the breadth of outreach for MFIs (an increase in one unit of “Indulgence” could help reach 1.3 percent more borrowers). The results indicate that societies with a higher degree of “Indulgence”, which means more people prefer to have more leisure time and spend money as they wish, tend to reach a larger number of microfinance borrowers. It may also suggest that at least some of the loans taken are not for productive purposes but possibly for larger life events such as wedding etc.

Control Variables. This research involved microfinance characters variables, macroeconomic variables and some political alternative variables such as E government, economic globalization, political globalization, and human development index (HDI) as the control variables. The control variables are not my focus because they may not be the main part of the political environment or they could be presented through other political indicators. Among all the macroeconomic and political control variables, the strongest significance comes from economic globalization, GDP and HDI. Specifically, findings indicate that the higher level of GDP and economic globalization have a negative impact on sustainability of MFIs. GDP especially has a strong effect on sustainability, which means a one unit increase of GDP could lead to the decrease of sustainability of 13.749

percent points. And HDI has a significant impact and strong effect on the breadth of outreach (a one unit increase of HDI leads to around 8 time decrease on breadth of outreach). The results indicate that perhaps the countries with higher level of HDI and GDP have less demand for microfinance to complement to the traditional financial system. Furthermore, the economic globalization also has significant negative impact on sustainability, which indicate that maybe a higher level of economic globalization leads to more alternative channels for investors which makes it harder to have enough investors and donors for microfinance funds. Furthermore, there may be other reasons that countries with higher level economic globalization normally have higher level of economic development so there would be less demand for microfinance in those developed countries. This finding may be seen in the real world since developing countries have greater demands for microfinance and better performance of MFIs than developed countries.

Chapter Six

Conclusions and Recommendations

Looking at the developing processes of microfinance institutions in different countries, this dissertation states that although microfinance is not a panacea or a magic bullet that can single-handedly wipe out poverty, evidence on this innovative method reflects a positive story and the chance to make a great impact on poverty-stricken areas. This dissertation concludes that institutional context is important for understanding the operational process, barriers and internal mechanisms of this industry. As microfinance institutions (MFIs) continue to change, grow, and mature, studies will continue to explore more about its potential ability and demands to help the poor. Both qualitative and quantitative analysis applied in this dissertation have achieved a clearer picture of the microfinance industry from the political science perspective and explores what kind of political and cultural environment MFIs can reach the biggest success.

In terms of the empirical study, some of the results are consistent with the hypotheses of this dissertation. Also, some of the results are unexpected and even challenged my previous assumptions. However, all of the objective quantitative conclusions have answered the research questions of this dissertation and are meaningful for researchers to understand the dynamic relationship between political environment, culture and MFIs. Meanwhile, the cases studies of this dissertation help to see how MFIs operate and grow in three developing Asian countries and provides the detailed information on how MFIs succeed or fail in practice.

Macro-Economic Environment

According to the results of the control variables in the empirical study, it seems that it is harder for the countries with higher levels of HDI and GDP to serve poor households through MFIs and there is less demand for microfinance in those developed countries. Furthermore, it is harder for MFIs in countries with higher levels of economic globalization to reach financial sustainability. As illustrated previously, people in developed countries normally have more alternative channels to get loans and make investments, which makes it harder to have investors and donors for the microfinance funds. Furthermore, because most of the low-risk poor borrowers are already served by alternative financial institutions, MFIs serve riskier borrowers and thus have worse results in the developed countries.

As illustrated in the cases studies, both China and India have large numbers of poor people, which leads to the extension of both scale and demand in microfinance and a rapid expansion of MFIs. Furthermore, microfinance uses small-scale loans which are more popular in agricultural areas. This intrinsic attribute fits better for the demand of developing agricultural countries such as China and India.

Regime and Democracy

The quantitative analysis of this dissertation found that regime type and democracy level have a positive impact on the breadth of outreach, which means the regime type with a higher level of democracy helps to reach more borrowers. It is not possible to know the results of sustainability and depth of outreach if we just look at the regime types themself such as full democracies, flawed democracies, hybrid regimes and authoritarian regimes.

Furthermore, the subgroups of democracy indicate that higher level of democracy (political culture and political rights) could help to reach more clients, which is consistent with the results relating to regime types. Additionally, more findings indicate that the higher level of democracy could lead to worse financial sustainability and reach fewer poor households. The impact is not very strong but does exist. Considering all the findings together, this dissertation concludes that the impact of democracy could be caused by several reasons: Sometimes democracies are concerned with citizens' rights in order to get political support instead of supporting financial markets development and sustainable MFIs. The policies they enforced may retard microfinance development and the sustainability of MFIs. Furthermore, in countries with higher levels of democratic political culture and political rights, most of the low-risk poor borrowers are already served by alternative financial institutions, so MFIs serve risker borrowers and thus have poorer results. Additionally, from the example of India, we can see that the aggressive lending and extension of outreach in democratic countries could cause the increase of disbursement of loans, and MFIs may be forced to rely more on subsidies and even hurt benefits of both MFIs and borrowers.

Moreover, from the above findings on democracy, there seems to be a tradeoff between reaching poorer borrowers and maintaining financial sustainability. According to the current research, there are other authors who hold the same view. Schreiner (2002) thinks that because the poorest borrowers tend to get smaller but frequent loans thus it is relatively costlier to serve the poorest. However, Quayes (2012) analyzed 702 MFIs from 83 countries and found that there is also no trade-off between financial sustainability and depth of outreach. Overall, in terms of the relationship between sustainability and outreach, there needs to be further research in the future that considers both short-term and long-term influences.

Decentralization

The second important concern of this study is issue of the efficacy of top-down or bottom-up approaches. Good and strong governance indicates a top-down perspective and centralized political structure, while a higher level of decentralization supports the bottom-down perspective. The assumption of this dissertation is that a bottom-up alternative with individual participation in the market as the basis for freedom may better help the development of MFIs. The results of decentralization indicators, which include investment freedom index, financial freedom index, and ties of government, have verified this assumption to a certain extent. Findings indicate that a higher level of investment freedom leads to a higher level of sustainability, while more financial freedom and ties of government help to reach poorer people and extend the depth of outreach. Thus, we could see that a less regulated market could provide more economic opportunities for the poor households and motivate the inner power of MFIs and the potentials of people to develop and perform better. At the same time, a more decentralized political structure with more tiers of local governments could be closer to the customers, which also helps to reach more borrowers and serve poorer households. This dissertation used Indonesia as a representative of countries with a high level of decentralization. The power of Indonesian central government has been dispersed to 440 districts is considered as the most far-reaching decentralization of power in the world (Rieffel, 2007). As a result, MFIs in Indonesia tend to be more independent from governmental subsidies and achieve greater financial sustainability than China and India. Competitions between MFIs could help to improve the efficiency of management and the applications of new technology in microfinance industry in Indonesia. However, the commercialized MFIs in this country run for profit thus have less motivation to reach more poorest households.

Governance Capability

Meanwhile, this dissertation also studies the impact of good governance through the empirical study on six variables including corruption-perception, function of government, regulatory quality, political stability, rule of law, and government effectiveness. Only "corruption-perception" has a positive impact on the success of MFIs. "Rule of law" has a negative impact on both breadth and depth of outreach while "government effectiveness" and "function of government" have a positive impact on sustainability of MFIs (meaning that it reaches fewer poor clients). The findings are consistent with the previous expectations of this dissertation. It seems that microfinance naturally needs less government support and should not rely on a powerful top-down model of society.

Furthermore, according to the quantitative analysis, political stability has no impact on either sustainability and outreach of MFIs. However, through the detailed case studies in China, India and Indonesia, this dissertation found that political stability plays a role in the results of sustainability in three countries but not for breadth of outreach. After the microfinance crisis, financial sustainability in India dropped to more than -10% in 2011 but its breadth of outreach remains the top one among all Asian countries during the period pre- and post-crisis. However, some research that suggests that political stability does not affect the results of MFIs. As stated in the previous chapter, Warby (2007) even found that microfinance has the greatest poverty reduction effect under conditions of instability. This dissertation believes that the level of political stability and the regulation and actions taken pre and post conflicts could play a role together to impact the outcome of MFIs.

Culture

Geert Hofstede's six culture dimensions have been used to analyze the impact of culture on microfinance institutions sustainability and outreach. This is a strong and valuable complement for the above political analysis. First of all, this dissertation confirmed the existence of a link between societal culture and performance of MFIs. There are five dimensions of culture all related to performance of MFIs. Within these links, results are consistent with the conclusions on the role of political variables. For example, in countries with higher levels of "Individualism," which means societies have higher levels of democratic values, MFIs tends to reach more clients. "Uncertainty avoidance" may be able to explain why a society, having more rules and supervisions to secure the future, tends to have lower sustainability of MFIs.

Some of the unexpected results were related to "power distance index". A society with a higher level of power distance is usually a society with a centralized government structure. The findings indicate that higher levels of "power distance index" (centralized society) tends to have better sustainability but reach fewer borrowers. This is a supplement for the previous conclusion, which is that a centralized political structure could not benefit MFIs. When we see the benefits of decentralized society for MFIs, we should also know that for MFIs targeting the poor it may be easier to operate in centralized society, either because potential clients have fewer alternatives, the incentives to repay are better or because in alternative scenarios, the good clients are served by more traditional financial service providers.

General Conclusion

With regard to the general ideological issue addressed in the first chapter, that of top-down vs. bottom-up approaches, this study does indicate strong evidence for a more bottom-up approach. MFIs tend to function better in a situation where initiative lies more with local actors than with highly centralized institutions. Thus a more communitarian approach, as opposed to either excessive individualism or collectivism, appears to be a more promising strategy for lifting people out of poverty.

Overall, all the above analyses aim to illustrate the whole picture for the MFIs' political environment. We do know that it is hard to change a country's regime, traditions, or culture. Attitudes toward money, financial institutions and debt in general also vary and are important for the success of MFIs. However, these political environment analyses can provide rational actors clearer ideas on what constitutes an enabling environment for MFIs toward which governments can craft their policies and develop supportive processes. A society could not change immediately, but every society can change incrementally.

Limitations and Further Study

As a political economic research focus on microfinance, there are other political explanations that have not been maintained here such as gender equality, income equality or education level. Those factors may also be related to outcomes of MFIs. According to some research, females have a comparatively high repayment rate and as we found through the case study of India, efforts to maintain the number of female borrowers make India the top one among Asian countries at the breadth of outreach even during the microfinance crisis.

Furthermore, this dissertation has tested the impact of degree of economic freedom. However, it does not further explore the impacts of detailed economic or financial policies, which could be more meaningful for providing the clear instructions for government sectors and policy makers in future.

The limits of my knowledge in economics and limit of data are the other insufficient points of this dissertation. Even there are more and more data coming out in recent years, it is still hard to find data for many variables.

Further Consideration

This dissertation has provided a starting point to draw a line between state sectors and individual actors. More new data and advanced statistical techniques could be used in future research to explore more ideas to solve poverty problems. For example, research could focus on more specific policies in different countries or focus on creating more accesses for the poor for financial services or education. Microfinance may not be the perfect solution to all problems but it could be a useful instrument for reducing the gap between the poor and the middle class.

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Appendix 1

Variables Description

VARIABLES	DESCRIPTION
Dependent Variables:	
Return on Assets	Net income divided by total assets, which shows how well the MFI uses its total assets to generate returns.
ln(Borrow)	Logarithm of the number of active borrowers or borrowers and savers the MFI serves; active borrowers mean borrowers who currently have an outstanding loan balance with the MFI or are responsible for repaying any portion of the gross loan portfolio
Average loan balance per borrower / GNI per capita	(Average total loans/total number of borrowers)/GNI per capita in $US. Higher values mean that the MFI serves richer borrowers
MFI Variables:	
ln(Assets)	Logarithm of the total assets of the MFI. Total assets include all assets net of contra asset accounts such as the loan loss reserve and accumulated depreciation.
MFI Vintage	Number of years since inception, including new, young and mature. New is the base
MFI Legal Status	A dummy variable that categorized by the legal structure. Bank: The MFI is a bank and zero otherwise; Credit Union / Cooperative: The MFI is a Credit Union/cooperative and zero otherwise; NBFI: The MFI is a NBFI and zero otherwise NGO: The MFI is a NGO and zero otherwise Rural Bank: The MFI is a rural bank and zero otherwise Other: Otherwise

Regulation Status	A dummy that equals one if the MFI is regulated/supervised by a government regulatory agency (Not regulated = 0 Regulated=1)
Profit Status	The indicator presents that whether the organization is one which is run with the aim of making a profit. (Non-profit=0 For-profit=1)
MFI Regions	A dummy variable that categorized by regions
Target Market	The market MFIs choose to focus on, including four categories: broad, high end, low end and small business. Low end is the base.
Macro Economics Variables:	
log(GDP)	Logarithm of gross domestic product
Average loan balance per borrower / GNI per capita	Adjusted net national income per capita (constant 2010 US$, in $1000)
Political Variables:	
(Degree of Democracy)	
Regime Type	Regime dummy variables categorized according to the democracy index. Authoritarian regimes are the base=0; Hybrid regimes=1 ; flawed democracies and full democracies = 2
Political Rights	Evaluate three categories: electoral process, political pluralism and participation, and the functioning of government. 1 (strong rights) to 7 (weak rights)
Political Culture	A supportive democratic culture which is one of the categories of democracy index measured by Economist Intelligence Unit. 0 to 10 (higher score means higher degree of democracy)

<u>(Governance Capability)</u> Functioning of Government	Higher data means better functioning of public institutions for political participation and democracy 1 to 10 (higher value means better functioning of public institutions for political participation and democracy)
Rule of Law	Captures perceptions of the extent to which agents have confidence in and abide by the rules of society, the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. -2.5 to 2.5 (higher scores indicating better governance)
Government Effectiveness	Captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies -2.5 to 2.5 (higher scores indicating better governance)
Regulatory Quality	Captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. (higher scores indicating better governance) -2.5 to 2.5 (higher scores indicating better governance)
Political Stability	Measures perceptions of the likelihood of political instability and/or politically- motivated violence, including terrorism. -2.5 to 2.5 (higher scores indicating better governance)
Corruption Perceptions-Transparency International	The indicator values are determined by using information from surveys and assessments of corruption, collected by a variety of reputable institutions.0-100 (100 means less or no corruption)
<u>(Degree of Freedom)</u> Investment Freedom Index	The extent of freedom for individuals and firms to move their resources into and out of specific activities, both internally and across the country's borders, without restriction. 0 to 100 (higher scores indicating a higher level of freedom)

Financial Freedom	An accessible and efficiently functioning formal financial system ensures the availability of diversified savings, credit, payment, and investment services to individuals and businesses. 0 to 100 (higher scores indicating a higher level of freedom)
Tiers of Government	The number of subnational tier government

Culture Variables:

Power Distance Index	The extent to which the less powerful members of organizations and institutions (like the family) accept and expect that power is distributed unequally.
Individualism	The extent to which people feel independent, as opposed to being interdependent as members of larger wholes.
Masculinity	The extent to which the use of force in endorsed socially. In a masculine society, men are supposed to be tough. In a masculine society, men are supposed to be tough
Uncertainty Avoidance Index	Uncertainty avoidance deals with a society's tolerance for uncertainty and ambiguity.
Long-term Orientation	Long-term orientation deals with change. In a long-time-oriented culture, the basic notion about the world is that it is in flux and preparing for the future is always needed.
Indulgence	Indulgence is about the good things in life. In an indulgent culture it is good to be free. Doing what your impulses want you to do, is good. Friends are important, and life makes sense. In a restrained culture, the feeling is that life is hard, and duty, not freedom, is the normal state of being.

Political Control Variables:

Economic Globalization	Economic globalization has two dimensions: actual economic flows and restrictions to trade and capital. The sub-index on actual economic flows includes data on trade, FDI, and portfolio investment. The sub-indexes on restrictions consider the hidden import barriers, mean tariff rates, taxes on international trade (as a share of current revenue), and an index of capital controls.
Political Globalization	The degree of political globalization is determined by the number of embassies and high commissions in a country, the number of international organizations to which the country is a member, the number of UN peace missions a country participated in, and the number of treaties signed between two or more states.
Human Development Index (HDI)	A summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and have a decent standard of living.
E-Government Index	The use of electronic communications devices, computers and the Internet to provide public services to citizens and other persons in a country or region.

Appendix 2

Variables Summary

VARIABLES	(1) N	(2) %	(3) sd	(4) mean	(5) min	(6) max
Dependent Variables:						
Return on Assets 100%	8,767		13.08	0.78	-345.3	79.86
ln(Borrow)	7,734		2.2	14.76	0.69	21.72
Average loan balance per borrower / GNI per capita	8,116		3.18	0.71	8e-03	224.5
Political Variables:						
Regime Type	8,762		0.76	1.25	0	2
Authoritarian	1,740	19.86				
Hybrid Regime	3,122	35.63				
Democracies	3,900	44.51				
Political Culture	8,762		1.01	4.83	1.88	8.75
Functioning of Government	8,762		1.95	4.86	0	8.93
Political rights	8,773		1.66	3.65	1	7
Rule of Law	8,791		0.44	-0.6	-1.9	1.37
Government Effectiveness	8,789		0.44	-0.42	-2.07	1.28
Regulatory Quality	8,789		0.5	-0.32	-2.24	1.52
Political stability	8,781		0.7	-0.78	-2.81	1.2
Corruption perceptions - Transparency International	8,357		7.54	29.89	8	74
Investment Freedom Index	8,588		16.31	45.51	5	90
Financial freedom	8,628		13.77	47.38	10	90
E-Government Index	8,787		0.13	0.41	0	0.73
Culture Variables:						
Power Distance Index	5,421		12.26	74.93	35	100
Individualism	5,421		12.94	25.97	6	60
Masculinity	5,421		11.16	51.14	21	73
Uncertainty Avoidance Index	5,421		20.45	65.24	13	98
Long-term Orientation	6,312		21.86	38.4	3.53	87.41
Indulgence	6,319		24.54	43.46	0	100
Tiers of Government	8,406		0.83	4.11	2	6
MFI Variables:						

ln(Assets)	8,795		1.97	15.92	4.29	24.47
MFI Vintage	8,413		0.68	1.58	0	2
new	912	10.84				
young	1,677	19.93				
mature	5,824	69.23				
Target Market	8,211		1.04	2.05	1	4
Broad	3,860	47.01				
High end	427	5.2				
Low end	3,555	43.3				
Small Business	369	4.49				
Portfolio at risk > 30 days	7,843		1.5	0.08	0	132.3
Regulation Status	8,795		0.48	0.63	0	1
Not regulated	3,286	37.36				
Regulated	5,509	62.64				
Profit Status	8,548		0.5	0.43	0	1
Non-profit	4,896	57.28				
For Profit	3,652	42.72				
MFI Legal Status	8,745		1.19	3.16	1	6
Bank	926	10.59				
Credit Union / Cooperative	1,316	15.05				
NBFI	2,959	33.84				
NGO	2,983	34.11				
Other	108	1.23				
Rural Bank	453	5.18				
MFI Regions	8,795		1.6	2.45	0	5
Africa	1,456	16.55				
EAP	1,112	12.64				
EECA	1,525	17.34				
LAC	2,894	32.91				
MENA	364	4.14				
SA	1,444	16.42				
Macro Economics Variables:						
log(GPD) 2010 US$	8,771		1.91	25.05	19.73	29.75
Adjusted NNI per capita 2010 (in $1000)	8,237		2.397	2.72	-1.88	13.80
Other Variables:						
Economic Globalization	8,357		11.79	53.01	19.53	85.5
Political Globalization	8,751		14.53	73.44	23.36	94.92
Human Development Index	8,768		0.11	0.63	0.29	0.85

Appendix 3

Pearson's Pairwise Correlation of Political Variables and Culture Variables

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22
1	1																					
2	-0.37*	1																				
3	-0.45*	-0.67*	1																			
4	-0.01	-0.1*	0.1*	1																		
5	-0.55*	-0.18*	0.61*	0.23*	1																	
6	0.69*	0.12*	-0.67*	-0.12*	-0.65*	1																
7	-0.27*	-0.3*	0.51*	0.14*	0.58*	-0.42*	1															
8	-0.13*	-0.23*	0.32*	0.26*	0.41*	-0.45*	0.69*	1														
9	-0.22*	-0.24*	0.41*	0.33*	0.56*	-0.47*	0.78*	0.76*	1													
10	-0.33*	-0.22*	0.48*	0.13*	0.4*	-0.43*	0.74*	0.69*	0.65*	1												
11	-0.01	0.01	0	0.27*	0.1*	-0.16*	0.24*	0.39*	0.33*	0.32*	1											
12	-0.21*	-0.04*	0.21*	0.09*	0.15*	-0.31*	0.26*	0.42*	0.3*	0.64*	0.28*	1										
13	-0.33*	-0.02	0.28*	-0.17*	0.13*	-0.32*	0.25*	0.35*	0.15*	0.6*	0.28*	0.58*	1									
14	-0.19*	-0.25*	0.39*	-0.15*	0.24*	-0.22*	0.58*	0.38*	0.27*	0.55*	0.21*	0.15*	0.34*	1								
15	-0.03*	-0.07*	0.09*	-0.5*	-0.12*	0.24*	-0.01	-0.41*	-0.23*	-0.19*	-0.21*	-0.44*	-0.16*	0.05*	1							
16	-0.02	-0.28*	0.27*	0.09*	0.26*	-0.05*	0.38*	0.06*	0.5*	0.06*	-0.05*	-0.12*	-0.24*	0.02	0.18*	1						
17	-0.05*	-0.18*	0.2*	-0.34*	0.17*	-0.02	0.17*	-0.2*	-0.07*	-0.19*	-0.37*	-0.25*	-0.07*	0.15*	0.35*	0.15*	1					
18	-0.27*	0.14*	0.05*	-0.16*	-0.14*	-0.17*	-0.01	0.21*	-0.19*	0.41*	0.22*	0.5*	0.52*	0.41*	-0.17*	-0.31*	-0.37*	1				
19	0	0.2*	-0.18*	-0.09*	0.02	0.29*	0.03*	-0.19*	-0.05*	-0.13*	-0.01	-0.39*	-0.29*	0.21*	0.25*	0.25*	-0.19*	-0.16*	1			
20	-0.16*	-0.2*	0.31*	0.08*	0.12*	-0.33*	0.16*	0.27*	-0.01	0.31*	0.23*	0.33*	0.44*	0.14*	-0.03*	-0.25*	0.26*	0.29*	-0.61*	1		
21	-0.01	0.13*	-0.11*	0.16*	0.06*	-0.04*	-0.07*	-0.09*	0.09*	-0.24*	-0.2*	-0.22*	-0.28*	-0.39*	0.08*	0.12*	-0.16*	-0.57*	0.12*	-0.29*	1	
22	-0.18*	-0.14*	0.28*	-0.14*	0.12*	-0.17*	0.49*	0.31*	0.21*	0.47*	0.26*	0.12*	0.3*	0.89*	0.04*	-0.03	0.07*	0.5*	0.33*	0.02	-0.44*	1

* Correlation significant at 5% level

Variables Legend:

1. Authoritarian
2. Hybrid Regime
3. Democracies
4. Political Culture
5. Functioning of Government
6. Political rights
7. Government Effectiveness
8. Corruption perceptions - Transparency International
9. Rule of Law
10. Regulatory Quality
11. Political stability
12. Investment Freedom Index
13. Financial freedom
14. E-Government Index
15. Power Distance Index
16. Individualism
17. Masculinity
18. Uncertainty Avoidance Index
19. Long-term Orientation
20. Indulgence
21. Tiers of Government
22. Human Development Index