

Article

Scaling Social Enterprises through Product Diversification

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Abstract: Scaling has remained a challenge for social enterprises, which strive to balance social impact with financial performance to facilitate sustainable development. Product diversification, a common scaling strategy in commercial enterprises, has been recently proposed as a strategy to scale social enterprises while keeping their dual goals in balance. We empirically investigate this using a combination of qualitative and quantitative analyses of microfinance institutions in India. Our inductive analysis reveals that product diversification in social enterprises varies along two dimensions—relatedness and locus of impact—to give four distinct diversification strategies. Each of these strategies impacts the social and financial goals of the organization differently. To scale successfully, social enterprises need to deploy a deliberate and dynamic mix of product diversification strategies. The paper makes an important contribution to the field of social entrepreneurship by exploring how diversification strategy can help social enterprises scale. It also provides important insights to social entrepreneurs on how they should deploy a mix of diversification strategies to maintain a balance between their social and financial goals.

Keywords: scaling; social enterprises; microfinance; product diversification strategies



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1. Introduction

The scaling of social enterprises offers the potential of unleashing market forces to address social problems in a substantial and sustainable manner [1,2]. Though highly desirable, scale has remained elusive for social enterprises [3]. For every poster child such as Grameen Bank, there exist many social enterprises that stagnate and remain limited in their impact. A core challenge for scaling social enterprises stems from the fact that they need to simultaneously manage two goals—social impact and financial performance—that ensure sustainable development. Social impact is the *raison d'être* for social enterprises, but they also need to generate financial returns to be self-sufficient and invest towards enhancing their social impact. Pursuit of these dual goals is a difficult balancing act [4–7]. A thrust on financial outcomes can compromise social goals, causing a mission drift [8]. At the same time, leaning towards social goals poses a challenge to the viability of the social enterprise.

Take the example of microfinance institutions (MFI) that provide credit to people at the base of the income pyramid (BoP) who are not served by formal banking institutions. The role of MFIs in fostering sustainable development in local regions has been studied by sustainability researchers [9,10]. MFIs address an important social need, i.e., access to credit [11], but also aim to run a financially profitable operation that can cover their operating expense and fuel growth. They can increase their profitability if they cherry-pick credit-worthy customers and/or hike up interest rates, but it would compromise their social mission [12]. At the same time, if they lend to customers in abject poverty, set rock-bottom interest rates or allow credit to be used for a broad spectrum of uses, they might

quickly become financially unviable [13]. This core tension between social and financial goals often impedes the scaling of social enterprises [14]. The challenge is evident in the words of Suresh Krishna, co-founder of Credit Access Grameen Ltd., which is today one of the largest MFIs in India.

“Margins are thin, which means you need to run the treadmill much faster. The moment you start chasing money then you have to compromise on a lot of things. That drives mission drift. That is the main challenge.”

This hurdle to scaling social enterprises has become apparent as organizations have tried and struggled to replicate their operating model in multiple regions [2,3]. The idiosyncratic socioeconomic and regulatory conditions that prevail in new locations pose a challenge to scaling the enterprise while maintaining the two goals in balance. In other words, scaling using a replication strategy has proved to be challenging for sustainable development. Recently, product diversification, a time-tested scaling strategy in commercial enterprises, has been proposed as an alternative strategy to scaling a social enterprise [15]. In contrast to replication strategies, which take a supply-side perspective, diversification takes a demand-side perspective by responding to the needs of the customers with new products. By addressing a range of customer needs that generate new revenue streams, it can be an attractive strategy for scaling social enterprises, sidestepping the dialectic pulls of meeting social goals and enhancing financial performance. While the theoretical proposition of such a strategy is appealing, we know very little about if and how product diversification is being put to practice in social enterprises. We aim to take a first step towards addressing this gap by empirically exploring the following questions: How do social enterprises engage in product diversification? What are the product types they diversify into and the factors that influence the decision? How does it impact sustainable development; i.e., what is the tradeoff between social impact and financial performance in scaling through product diversification?

Through qualitative analyses of ten MFIs in India, we isolate two dimensions of product diversification—relatedness with the core offering of the organization and the locus of impact on society. Based on these dimensions, we develop a typology of product diversification. We find that social enterprises need to deploy a carefully planned diversification strategy, striking a balance between the different product types. Pursuing one to the exclusion of others could tradeoff social outcomes for financial outcomes or vice versa. Overall, the study empirically validates product diversification as a scaling strategy in social enterprises and broadens the scope of scholarly inquiry. It also provides important guidance for social entrepreneurs on deploying this strategy.

The rest of the article is organized as follows. We will first briefly describe the method we adopted to explore our research questions. We will then present the backdrop to our study by elaborating and comparing the different scaling strategies in social enterprises, weaving our insights from the field with prior literature. We will then dive deeper into diversification strategy and present our typology of product diversification. We will conclude with a discussion of how social enterprises may leverage product diversification strategy and the key drivers and constraints of using these.

2. Methods

We adopted a mix of quantitative and qualitative methods for our research inquiry. We partnered with Sa-Dhan, a self-regulatory body for the microfinance sector in India that is recognized by the Reserve Bank of India. Sa-Dhan’s mission is to monitor the microfinance sector and ensure regulatory compliance with the Reserve Bank of India guidelines. Sa-Dhan sends out annual surveys to its MFI members that among other things capture the various products and services offered by the MFIs. We built our dataset from this annual survey data. It comprises details of MFIs that operated in India between 2013 and 2019. Our data cover 95 percent of MFIs that operated during the period of study. We verified the accuracy of data from independent sources wherever possible. Using the annual survey data, we were able to measure the level and nature of diversification.

The large dataset on MFIs only provided an empirical validation (or rejection) for the presence of a product diversification strategy but did not answer the exploratory questions such as why and how MFIs embarked on this strategy. Given the lack of detailed research on this topic and the “how” and “why” types of questions we sought to answer, it was appropriate to ground our understanding in qualitative data [16]. To that end, we constructed a sample of ten MFIs for in-depth qualitative data collection. Since our interest was to understand the diversification journey, we only considered diversified MFIs for our interviews. It is well established that variation in the sample is needed for reliable and generalizable findings [17]. Therefore, we chose MFIs that varied on the following dimensions: their legal form (for-profit and non-profit MFIs), which prior research has revealed as being an import driver of strategy [18]; loan portfolio size, which indicates the financial strength; and extent of geographical diversification, which indicates the size of operations. Our sample is representative of the MFI population consisting of old and new MFIs with significant size variance ranging from the largest to the smallest, as well as those that are both niche and diversified in terms of their areas of operation. About 56 percent of the MFIs in the total population of 155 MFIs were for-profit entities (non-banking financial companies and small finance banks), and the rest were non-profit entities (registered as Trusts, Societies and Section 8 companies). In our interview sample, about 70 percent of the MFIs are for-profit, while the rest are registered as non-profit firms. Table 1 breaks down the MFIs we interviewed based on these characteristics.

Table 1. Summary of MFIs Interviewed.

S. No.	MFI Name	Legal Form	Founding Year	No. of States	Loan Portfolio in Indian Rupees ₹ (10 million) FY 2019
1	MFI-A	Non-profit	2002	5	1406.23
2	MFI-B	For-profit	2009	4	567
3	MFI-C	For-profit	1999	5	6679.8
4	MFI-D	Non-profit	2009	3	9.18
5	MFI-E	For-profit	2008	16	2475
6	MFI-F	Non-profit	2007	4	189.69
7	MFI-G	For-profit	1990	22	6374
8	MFI-H	For-profit	2016	22	621.7
9	MFI-I	For-profit	2004	24	9353
10	MFI-J	For-profit	2009	11	4139

We conducted detailed semi-structured interviews with MFI principals to understand their approach towards diversification. The questions were directed at understanding their scaling strategies and eliciting their product diversification journey starting from a basic loan product. We probed them to understand the rationale behind diversifying into different types of products, the challenges encountered and the approach they adopted to balance their financial and social goals through this process. On average, each interview lasted 45–60 min. We recorded the interviews with permission and transcribed them to facilitate our analyses.

As a starting point for our analysis, we wrote detailed cases on each of the MFIs, capturing their diversification journey. Following the repeated case approach for qualitative analyses [17], we looked for similar themes of diversification across the cases we interviewed. Cross-case comparison allowed us to inductively derive two dimensions of diversification. We iterated between the data gathered through the semi-structured interviews and theory to label the two dimensions of diversification. Having isolated the two dimensions, we arrived at the typology of diversification strategies and examples of the types of products that would fall under each strategy. Based on this typology, we reclassified the diversification activities of 155 MFIs in our quantitative sample to map

out the distribution of diversification and its impact on the social and financial goals of the MFIs.

3. An Overview of Scaling Strategies

There are multiple pathways to scale. Broadly, social enterprises may deploy one or more of the following three strategies to scale their impact, namely Scaling Up, Scaling Deep and Diversification [19–22]. Each of these strategies involves a distinct approach and a unique set of organizational challenges and holds the potential to unlock the social and financial value in different ways. These are summarized in Table 2.

Table 2. Scaling strategies of social enterprises.

Scaling Strategy	Organizational Challenge	Source of Social Value	Source of Financial Value	Articles on the Topic
Scaling Up	Localizing the business model	Number of beneficiaries impacted	Volume of transactions from increased customer base or franchise/license fee	Bradach (2003) Dees et al. (2004)
Scaling Deep	Co-opting partners to shape institutions	Stronger ecosystem leading to systemic improvement	Greater efficiency due to reduced friction in transactions	Grant and Crutchfield (2007); Bloom and Dees (2007)
Diversification	Synergy between business models	Deeper engagement with beneficiaries to address multiple pain points	Volume of transactions from expanded product portfolio	Fosfuri et al. (2016)

3.1. Scaling up Strategy

Scaling Up is a strategy where an organization takes a tried and validated operating model to multiple locations with the aim of reaching more beneficiaries [23–25]. This is also called a “replication strategy” and has received the most attention from practitioners and academic scholars. The key challenge to this strategy is to articulate the organization’s theory of change and identify the core set of activities or the “minimum critical specification” [26] that underpin their theory of change [2]. Following that, the organizational challenge is to create a model that can be tailored to cater to the idiosyncratic requirements of each location. These quotes are instructive on the localization requirements and challenges faced during scaling through replication:

“It is a cookie cutter, replication model. Expanding within a state is reasonably straightforward. However, when we get into a new state, we have to hire people with the local language familiarity. Scale up was slow in the initial stages but once we got a foothold, it went faster.” —CEO of MFI-E

“There are regional nuances to factor when you replicate. The per capita income is different. If you go to Bihar, the per capita income is low, and you start with very small loans, whereas in Punjab the loan size is much bigger. In Gujarat, entrepreneurship is in-built into people as compared to other parts of the country. If you go the North-east and South, it’s a matriarchal society as compared to Haryana, where the men are the decision makers.” —CEO of MFI-G

Another example of the challenges faced by replication strategy is evident from the experience of MFI-I. This organization was founded in 2004, taking inspiration from the Grameen Bank model to provide microfinance for the urban poor. Here is what CEO of MFI-I says on the choice of its market segment:

“What we identified at that time was that the urban poor in India was a significant population, may not be as large as the rural poor, but a significant number, and one of the fastest growing segment of population in India, and frankly no microfinance institution has been directed towards urban poor even Grameen was focused on the rural poor.”

However, MFI-I soon realized that Grameen's business model that worked well with the rural poor did not seamlessly translate to the urban poor that MFI-I sought to target. The biggest challenge was taking the business model and localizing it to meet the requirements of a different target market. MFI-I had to substantially tweak and change the way it applied the Grameen Bank model that primarily served the rural areas. However, their model was still built to leverage 'social capital as collateral', which was the basic concept behind Grameen Bank's model of business, so they focused on urban slums, which share many characteristics with a village community. However, they had to rethink several aspects of the model (e.g., marketing, risk management) for this new segment, experiment and perfect them over time.

The above examples bring out the challenges involved in scaling up, be it to new geographical locations or to new market segments. An organization may choose to scale up by franchising or licensing its model or by organically growing the organization in multiple locations [27]. Either way, if executed successfully, the scaling-up strategy unlocks social value by positively impacting the lives of a large number of beneficiaries [19,25]. It also drives financial growth for the organization by an increase in the volume of transactions or by way of franchise/license fees. Several notable social enterprises such as Habitat for Humanity and Teach for America have adopted a franchising approach, while Grameen Bank is an example of a social enterprise that has scaled up organically [3]. In the case of MFI-I, they decided to initially work with other organizations and then settled on scaling organically eventually covering more than 24 states in India.

3.2. *Scaling Deep Strategy*

Scaling deep is a strategy where the organization improves the environment in which it operates [28], be it the institutional framework or the community processes, in order to enhance the impact on its beneficiaries. In contrast to the scaling-up strategy, scaling deep does not entail increasing the geographical footprint but is concerned about improving the quality of impact in a location. As Bloom and Dees articulate in their winter 2008 issue of *Stanford Social Innovation Review*, scaling deep involves "not just understanding the environment but also shaping that environment to support organizational goals".

To scale deep, social enterprises first need to map out the various players in the ecosystem, the relationships between those players, and the prevalent environmental conditions that guide interactions and exchange between them. With this understanding of the overall system, social enterprises attempt to change the environmental conditions and/or introduce innovative practices that move the system towards a new state [29]. For example, this might include the promotion of collective action within the community, more inclusive participation of all the members within the community, facilitating access to inputs and markets and reducing information asymmetries [30]. This requires building relations with multiple stakeholders in the ecosystems who can work together create a force multiplier effect. MFI-J was started in 2009 by a former banker with the intention of bringing about holistic change. Though the organization chose to function as a for-profit entity, it realized that it needed a holistic approach to bring substantial change. The institutional voids endemic to rural under-banked communities [31,32] where MFI-J focused meant that meeting financial ratios depended on improving the education and health of their borrowers if they were to really bring about a change.

"When we thought of MFI, it was more of community-based approach, you need to go hinterland, understand the people, go to the excluded population. Then I thought it was very important to understand the local language, culture and the environment. This institution (another subsidiary) was made for the purpose of focusing on health and education space and to the extent we can do it for our target market. We may not be able to cover all our customers or members . . . in fact, that was a huge task. We have got partners like IFC (another NGO) who were our partners during that time."

Scaling deep is a long-term strategy but one that creates a systemic impact as opposed to an individual-level impact. The financial impact of this strategy may not be evident in the short run and would result from improved efficiency in transactions over the long run. For example, higher capability, lower information asymmetries and reduced corruption could help customers make better choices, which in turn could reduce risks, enhance profitability and ultimately improve the portfolio quality of the MFI [30]. The organizational challenge in scaling deep is to develop a business model that can create value while being socially fruitful. As social enterprises get deeply embedded in building a conducive ecosystem, they face the challenge of developing business models that can translate across geographic and demographic boundaries.

3.3. Diversification Strategy

Product diversification or simply diversification refers to a scaling strategy where an organization broadens the range of products and services it offers [33]. Diversification has been a common scaling strategy among commercial enterprises for decades, if not centuries. However, it is a relatively recent phenomenon in the context of social enterprises and one that has not received sufficient attention. As discussed earlier, the fundamental constraint to scaling social enterprises comes from their commitment to maintaining a balance between their dual goals, where the risk of increasing financial performance can come at the cost of social impact and vice versa [34]. Diversification promises to allow social enterprises to sidestep this dialectic pull by deeply engaging with their beneficiaries to address a range of problems and needs [15].

Product diversification leverages the organization's familiarity with the target community and builds on an existing operating infrastructure. Alongside solving a wide array of problems that plague marginalized beneficiaries and their households, diversification also generates revenue for the organization through the sale of additional products or services. Typically, social enterprises often diversify in areas where existing markets for allied services are weak or non-existent.

Take the example of MFI-B, which was started in the year 2009 by a founder with prior experience working in an NGO. He realized that often loans granted for income-generating activities ended up being used for other exigencies, consequently affecting the ability of borrowers to repay. Therefore, along with microcredit, they also diversified into offering allied products such as insurance, which facilitates their core business—getting more loans applied towards income generation. As an example, MFI-B gives out microfinance to individuals who buy a cow and use the dairy products to set up their small enterprise to repay the loans over time. However, there is always the risk of individuals not utilizing the best practices for rearing, leading to livestock distress. To overcome this challenge, MFI-B diversified into livestock insurance for their borrowers. In our interviews, the founder shared the reasoning behind diversification into insurance.

“What happens is today one of the good income sources for rural customers is milk because the price is almost constant . . . there is a local breed and there is a crossbreed. If you give the choice, they will go for a local breed because it is much sturdy, and the risk of dying is not that much. Crossbreed gives more yields but there is a risk. We introduced insurance for these cows and also helped them to actually select the right cow. It is a very simple thing, but it is so important. That worked out very well.”

MFI-B's diversification into livestock insurance not only extended its social impact but also generated new revenue streams and better repayment rates. This example shows the potential of diversification as a scaling strategy that can maintain the balance between social and financial goals, leading to sustainable development. However, diversification encompasses a range of products, and it is not immediately clear if they all lead to such balanced growth. An important consideration in this context is the question of not just what to do but also what not to do [35]. Below, we explore the different product diversification

strategies and if/when they enable scaling the organization while keeping both social and financial goals intact.

4. Findings

4.1. The Two Dimensions of Product Diversification

Our analysis of 155 MFIs that operated between 2013 and 2019 in India revealed that 69% of them engaged in product diversification. This means that they go beyond microcredit to offer other products and services to their customers. A veteran of the microfinance industry confirmed this: “In the last 20 years, Microfinance has seen a journey from microloans to housing loans and many other products”. Our interviews revealed a variety of products that MFIs offer. On analyzing the attributes of these products, we were able to map them along two dimensions: relatedness to the core product and locus of impact (Figure 1).

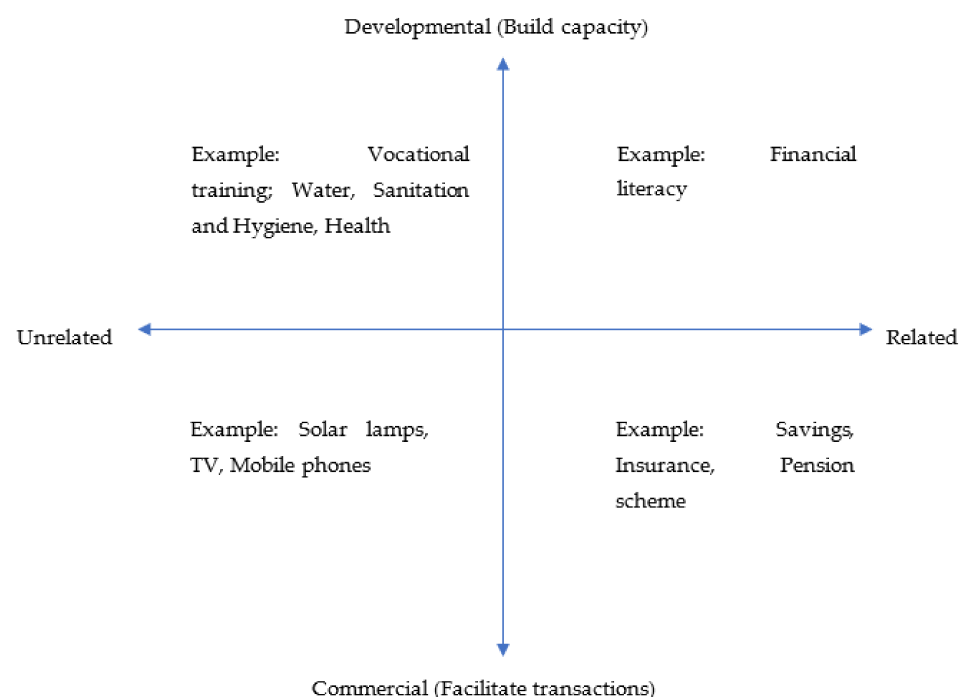


Figure 1. A typology of product diversification strategies.

4.1.1. Relatedness

The first is a dimension that captures the extent to which a new product or service is related to the core offering of the organization. We refer to this dimension as “relatedness” and it is represented by the x -axis in Figure 1, with related diversification on one end of the axis and unrelated diversification on the other end. Related diversification refers to products within the same industry group and unrelated diversification refers to products across different industry groups [36]. This dimension has been extensively explored in the context of commercial enterprises within strategic management research [37].

Extending this to social enterprises, the axis represents a continuum that has diversified offerings that are highly related to the core sector of the social enterprise on the right end of the axis and become less related towards the left side. In the context of MFI, on the right end of this axis are products and services that are in the same or allied sectors (e.g., financial services) and build on the core competence of the organization. Offering financial literacy, facilitating savings and remittances and providing business insurance are some products and services that are related to the core function of banking and microfinance. Synergies from related products and services arise from exploiting common capabilities built on existing pools of resources and technology [37].

On the other end is unrelated diversification into products and services that are outside the organization's primary industry group. In the case of MFIs, these would be products outside the banking and financial services sector. From strategic management research, we know that the resources and capabilities of an organization are dynamic and constantly evolving [38]. Changes to the organization's bundle of resources can prompt it to diversify into unrelated product markets [39]. This can happen as a consequence of learning from the market and from other entities in the ecosystem that may expose the organization to novel resources and experiences [40]. As the knowledge base expands, so does the ability of the organization to absorb new knowledge [41,42], setting up a cycle of expanding capabilities and new product markets [39,40]. This can be extended to the context of social enterprises, which upon gaining knowledge of the environment in which they operate and interacting with other actors in the ecosystem, often diversify into unrelated products and services. Offering products such as renewable energy lamps, water, sanitation, and education is not related to the core business of microfinance, but MFIs often diversify into these sectors as they grasp the realities of their operating environment. Unlike related diversification, these products have little synergy with the core offering of the MFI and will need substantial investments.

4.1.2. Locus of Impact

The second dimension that emerged from our analysis is unique to social enterprises and captures the arena where the new product or service makes an impact. We refer to this dimension as "locus of impact", and it is captured by the y -axis in Figure 1, with developmental diversification on the upper end of the axis and commercial diversification on the lower end. Developmental diversification refers to products and services that build capacity and resilience in the target communities, while commercial diversification refers to products and services that facilitate new market transactions.

Social enterprises operate in environments that are under-developed and fraught with different types of institutional voids [43]. In such contexts where voids are endemic, markets are either non-existent or operate below a threshold that makes sustainable operations impossible [30–32,44–46]. To counter such a scenario, social enterprises have to build capacity in target communities to empower them and prepare the ground for market mechanisms to operate [32,44]. In the context of MFIs, capacity-building products and services such as enabling financial literacy, and providing vocational assistance and skill development, health and sanitation all constitute diversification activities that address the ability of the communities to participate in markets. These fall under developmental diversification.

Sometimes, markets may exist but the frictions in the use of market mechanisms render them weak and inefficient. In this scenario, social enterprises can diversify into products and services that fill the voids that inhibit the smooth functioning of markets and facilitate transactions. While there may be a demand for savings facilitation, micro-pension, micro-insurance, mobile phones and renewable energy products such as solar cookers and lamps, the markets operate with considerable frictions. The low population density and/or poor infrastructure that is riddled with voids render markets inefficient and even unusable. To meet such demands, MFIs may diversify into these products that meet the immediate needs of the customers and drive more transactions for the organization. Such products and services create new revenue streams for the MFIs and fall under commercial diversification.

4.2. Product Diversification Strategies

The two dimensions—relatedness and locus of impact—give us four quadrants, each representing a distinct diversification strategy. Figure 1 gives examples of the diversified products and services in each of the four quadrants. The success and trajectory of diversification depends on the contingent benefits of such diversification on the ability of the MFI to scale—their financial as well as social impact. Figure 2 shows the distribution of diversification for the MFIs in our sample along the two dimensions of relatedness and

locus of impact. The distances on the axes indicate the scale of diversification in each of the four quadrants.

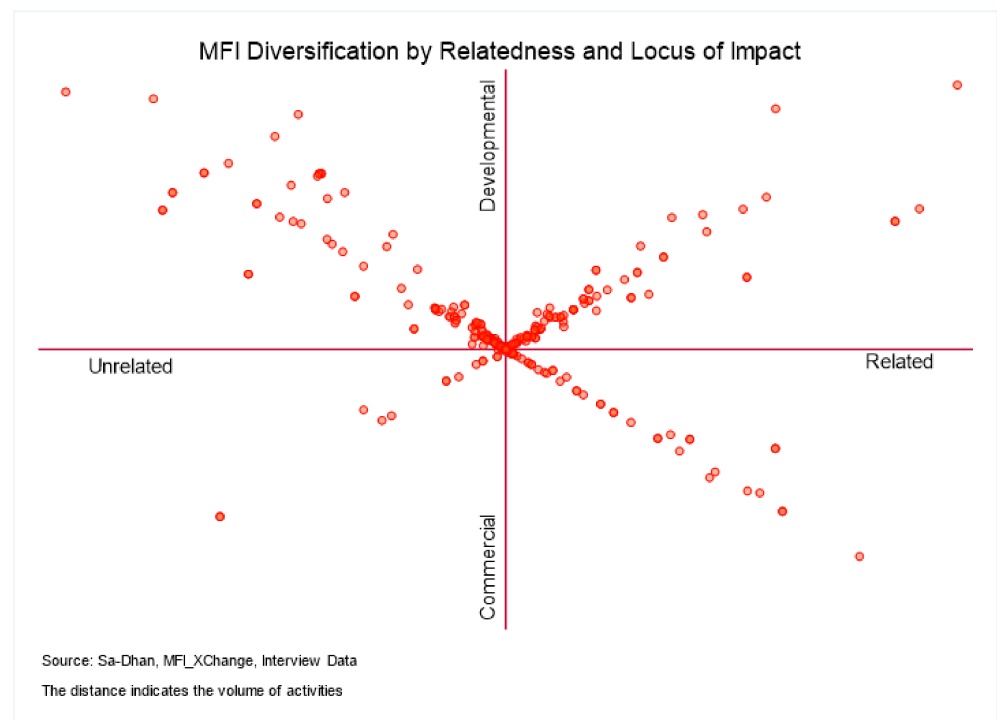


Figure 2. Distribution of MFI diversification.

4.2.1. Related Developmental Diversification

The top-right quadrant of Figure 1 captures products that are related to the core sector of the social enterprise (financial services for MFI) and focus on building capacity in the ecosystem. Examples include financial literacy, bookkeeping, debt management and so on. In our sample, 28 percent of diversified firms engage in this form of diversification.

The promise of microfinance has been to uplift people at the base of the economic pyramid out of poverty by unlocking their latent entrepreneurial energies. Microloans, the flagship product of MFIs help borrowers engage in income-generating entrepreneurial activities that can potentially transform their lives and at the same time provide interest income to MFIs to sustain their operations. However, the success of microfinance for the borrowers and for the MFI depends on their target community's capacity to make prudent financial decisions and use credit for income-generating activities. We found that a common challenge for many MFIs was the lack of awareness among their target audience about financial products and their usage.

Take the example of MFI-I, which wanted to scale among the urban poor. While their target markets had a somewhat better access to education, sanitation, energy and water, they lacked financial literacy. The borrowers were using the loans not for income generation but rather to meet consumption needs that took them away from income generation and kept them in a debt trap. It also affected the repayment rates. The organization realized that this problem was more acute among women, who were their main borrowers. Therefore, they created a separate subsidiary to provide personal and business finance programs in their target areas. The founder of MFI-I explained:

“We are talking about women, largely in the slums . . . clothing and tailoring is a huge thing. Some of them run small shops, that kind of segment. They need loans to put their kids to school or to upgrade their housing or they had a medical emergency . . . if you allow diverting the loan for consumption, you are promoting bad habits. So, we have formed a separate organization where

the main work that they do is financial literacy because that is a very important aspect of this. They have actually trained over a million women. Generally, we have seen that women who have gone through financial literacy are much more disciplined borrowers. They don't default that much and also they have saving habits, so this has definitely a positive impact."

Several other MFIs reinforced the importance of responsible lending by increasing awareness among their borrowers and creating a safety net for them. The CEO of MFI-D, an MFI, which works with the households of migrant laborers said:

"We have a large financial literacy programme that operates on two main principles-information to action looking at literacy modules that translate into real behavior and enrolment into specific products. The second one is around consumer protection i.e., identification and prevention of financial frauds".

The CEO of MFI-F echoed:

"What we did was to train all the members before we gave out loans or other products. We need to be responsible. Only after they understood the training modules—household budgeting, necessary and unnecessary expenditure, debt management, insurance and pension—did we roll out the products".

It is clear from these vignettes that hand-in-hand with the microloan business, MFIs have diversified into capacity building activities that create awareness about financial products and promote responsible lending/borrowing. This diversification has a direct impact on the number of people availing the various financial products offered by MFIs as well as their ability to deploy microcredit towards productive activities. This means that related developmental diversification enhances social impact and may even make MFI loan portfolios less risky. Table 3 captures the social and financial impact of this form of diversification.

Table 3. The impact on social and financial performance based on diversification strategies.

Quadrant	Social Impact	Financial Impact
Related-Developmental	High (Empowers beneficiaries to take informed decisions and make productive use of credit)	Med (Synergy with core product but involves additional costs upfront)
Unrelated Developmental	High (Builds capacity and resilience in target community)	Low (Little synergy with core product, Indirect and long-term impact if any)
Unrelated Commercial	Low (Threat of making the beneficiaries over indebted)	Med (Direct and immediate but involves additional costs upfront)
Related Commercial	Med (Complementary products build household resilience)	High (Direct and immediate)

However, at the same time, this diversification involves a recurring expenditure that may see diminishing returns over a period of time. As markets start to mature, the nature of frictions that characterized the economy also change. Persisting with capacity building in such cases is fraught with rising costs, which can hamper MFI's ability to grant loans.

The principal of MFI-E explained that the geographies they operated in initially required them to engage in capacity building, but saturation and overall development of the sector meant that they could deemphasize this aspect and focus their attention on other types of diversification.

"The initial first two, three years, we were getting into a lot of financial literacy. We had people from outside, I mean our field officers were not able to train them. So, we had external people coming in, helping our customers with financial literacy and bookkeeping but as the microfinance penetrated, the awareness level of the customer was very high. So, we slowly withdrew this kind of training."

4.2.2. Related Commercial Diversification

The bottom-right quadrant captures diversification into commercial products that are related to the core sector of the social enterprise, i.e., financial services in the MFI context. Examples include savings, insurance, pension, different types of credit products and other financial products. In our sample, we found that about 20 percent of diversified MFIs were offering related products and services.

As MFIs have engaged with their target communities, they have developed a deep understanding of the range of financial needs and aspirations of their customers. This understanding has moved them towards diversifying into related financial products. Several of our respondents spoke of this gradual movement towards related financial products:

“We started with credit. In addition to credit, people also started saying they wanted savings. At that point we started something called the gulakbachat (savings box) program. It’s a savings box with a lock and key. The gulak (box) is with the customer and the key stays with us. Once a month, when we come to collect credit installments, the gulak is opened publicly and the customers pay from it. This supported daily regular savings which went towards loan installments and other needs”. —CEO of MFI-D

“We did a massive household survey of 10,000 members and we tried to see what they wanted/needed. Our survey revealed that they wanted insurance and pension products. We became one of the early aggregators of the national pension scheme. We also started voluntary life insurance product in partnership with IDBI.”. —CEO of MFI-F

As MFIs started to grasp the needs and aspirations of their customers, they were not only able to offer a bouquet of financial services such as savings, insurance and pension but were also able to offer tailored credit products that catered to a variety of customer needs. The following quotes are indicative of this trend:

“Our core credit product was a livelihood enhancement loan. Over time, we noticed that about half the loan was going towards house repairs. Even after 5–6 years, the family was spending half the money towards the house and it was never getting completed. So, we came up with Purthi, a house completion loan. It was large sized loan and we combined it with mason advisory service.” —CEO of MFI-D

“We made the loan products specific. We had three products—One was cattle loan that was tied to insurance, second for asset purchase and third was working capital. We also offered education loans. Smaller amount loan over a six-month duration given out during the start of the school year to help with school uniform, fees, books.” —CEO of MFI-F

Related commercial diversification provides BoP communities access to a comprehensive financial infrastructure. A full range of credit products address the different needs of BoP households, while products such as savings, insurance and pension provide them with a safety net and make them resilient to adverse events. In short, related commercial diversification can create a significant social impact. At the same time, they also lead to an increased volume of transactions that contribute to revenue and profits. Since this diversification is in the related area of financial services, MFIs can build on their existing operational infrastructure and partnerships with financial institutions such as banks; i.e., they can leverage economies of scope. This enhances the financial sustainability of the MFIs. In sum, the MFIs can scale on both social and financial dimensions through this form of diversification. The founder of MFI-J summed up how related commercial diversification, by focusing on the organization’s core capabilities, allows it to scale effectively.

“We were very clear about one thing. What is my core strength? I can do finance . . . As long as borrowers are having any income generation activity-agriculture, non-agriculture, industrial, trading-doesn’t make a difference. Besides the credit

portfolio, we are doing retail banking, little bit of corporate banking, business correspondent and the entire finance vertical. You can scale this up and build as a commercial institution, at the same time it takes care of the social bottom line and that was the key.”

4.2.3. Unrelated Developmental Diversification

The top-left quadrant of Figure 1 represents unrelated developmental diversification. About 46 percent of diversified MFIs in our sample operate in this quadrant; i.e., they offer products and services outside the financial services sector that build capacity in the target communities. Examples include vocational training, awareness about health and sanitation, educational services and so on.

The high representation of capacity-building diversification is not atypical, especially since most MFIs operate at the base of the pyramid where institutional voids in many basic services are quite prevalent. MFIs operating in rural India often have to think of holistic development of the ecosystem if they are to deliver on their promise of bringing a change in the lives of their beneficiaries via microfinance.

MFI-C was well aware of the institutional lacunae that often prevented their beneficiaries from fully realizing the income potential of their businesses. They recognized that if their beneficiaries had to come out of poverty, along with access to microcredit, they needed holistic development. In particular, they diversified into health, skill development and general education. The principal at MFI-C expanded on the motivations for diversifying into unrelated capacity building.

“Our objective was to help people, to help them come out of their poverty, have a better quality of life. We had multiple products and services. We used to measure the poverty level, and how they are progressing. If you say that you need to improve quality of life, that means support income generation, education, health, emergency needs. We were always supporting it. If not, they (may) actually fall back into poverty.”

These sentiments were echoed across the board with MFIs engaging in a range of awareness, skill building and support activities that enhance the resilience and overall well-being of the communities in which they operate.

“The goal for our education program is that at least one child of each borrowing family should complete high school. We have setup MFI-A education centers that do two things—coach dropouts from lower grades so they get back to school and provide specialized coaching for higher grades.” —CEO of MFI-A

“We have built awareness around health and hygiene practices. We also provide info about govt programs and how to avail those benefits.” —CEO of MFI-H

“Our aim was always to have microfinance and then layer it with other non-financial services. We started the legal rights awareness training program. We trained women on different laws related domestic violence and sexual harassment, basics of gender and patriarchy. We also picked out community catalysts who were vocal and wanted to work on these issues. We gave them additional training to become change agents at the grassroots level.” —CEO of MFI-F

Lack of awareness, weak skills and poor health and nutrition leading to sick days can all significantly dent the ability of borrowers to successfully participate in markets and realize their full potential. By filling these gaps through unrelated developmental diversification, MFIs create enormous social impact.

However, this form of diversification requires additional investment from the MFIs, whether they engage in this on their own or through partners. Some of this investment may translate into direct financial benefits for the organization if there are suitable catchment products. For instance, MFI-D partners with another organization to offer vocational training. They have also created new financial products that plug into these training programs to help customers set up small businesses.

“Our partner has a skill training academy through which they do a lot of vocational training (e.g., mobile phone repair, two-wheeler repair). We started a loan product for alumni of the training program who had undergone an apprenticeship and were setting up their own businesses.”

More often though, unrelated developmental diversification does not directly translate into financial gains and has an indirect, qualitative impact on the MFI by enhancing the goodwill for the organization in their target communities.

“Customers see us as a preferred institution, they trust us more. We have better relationships with them, due to our products and processes.” —CEO of MFI-H

Since most unrelated developmental diversification cannot be monetized in the short term, MFIs need to tread with caution in this space. There are intangible benefits such as increased cooperation and loyalty that may help MFIs expand and scale in the longer term. In such cases, partnering with NGOs and governmental organizations that specialize in addressing various human development challenges, and raising grant money to rollout these activities, would ensure that they remain financially sustainable.

4.2.4. Unrelated Commercial Diversification

The bottom-left quadrant represents unrelated commercial diversification, which encompasses market transactions in products and services that fall outside of the organization’s core sector. The products and services in this category are typically BoP substitutes for things that are more consumption-oriented. For MFIs, examples include offering solar lamps to provide lighting in areas with frequent power cuts or lack of electric utilities; water filters for clean filtered water; solar/smokeless cookers for cooking with minimal energy footprint, which also have health benefits; and mobile phones, television and other aspirational products. Unlike developmental diversification, where MFIs offer products and services that mitigate needs that arise from endemic voids due to lack of institutions, unrelated commercial diversification seeks to meet the demand for aspirational products. MFIs partner with companies offering these products and leverage their operating infrastructure to facilitate transactions. Transactions are monetized by charging a commission, which provides an additional source of revenue for the MFIs. However, we see only about 6 percent of our sample MFIs engaging in unrelated commercial diversification.

The reason for the low percentage in this quadrant is two-fold: First, MFIs are divided over whether, and to what extent, this form of diversification is beneficial for their customers. Some MFIs assert that these products are aspirational and enhance the quality of life of their customers. Second, they also help them in their entrepreneurial pursuits. The following quote from the CEO of MFI-H emphasizes this view:

“We first started with Microcredit. Many of our members approached us for help with mobile phones. As a company, we saw this as an opportunity because mobiles are leading to digitization. The price at which they were purchasing in the rural areas was 20–25% higher. We approached Samsung, they were able to customize to the demand and deliver to the doorstep. We provided the financing. We also got a marketing fee of 7–8%. The customers realized a saving of 10–15%. It is a win-win. For Samsung, they were paying commission to multiple layers of dealers which they were able to avoid with this direct model. Some customers want two-wheelers because it helps them with their businesses. It given them mobility and they can reach their customers. Road infrastructure is improving, they can sell their products in nearby markets, which is difficult on bicycles. We haven’t yet started this but there is demand.”

However, MFIs are deeply divided about this form of diversification. Many MFIs say that they have stayed away from engaging in this form of diversification because it tempts consumers to prioritize wants over needs and leads them into a spiral of indebtedness. Others opine that we should put faith in the customer’s ability and let them decide what is right for them. The following quotes bring forth these divergent views.

“We always tell them (borrowers) take it (microloans) for income and do not take it for consumer goods, do not take it for things where there is no return. Every customer is very important, every customer needs to be protected against multiple loans.” —CEO of MFI-B

“For these customers, the aspirational value is different from what it is for those of use elsewhere. Their aspirations are not really aspirations, they are bordering on necessity. When we talk about a solar lantern, a pressure cooker, a mixer—these are all bordering on necessity. They only take it when they know they have use for it and they can earn out of it. It’s foolhardy of us to assume that they are vulnerable and don’t know when they should stop taking debt”. —CEO of MFI-G

Therefore, there is an inherent moral dilemma about the appropriateness of diversifying into these products. Beyond the dilemma, a second reason for very few MFIs getting into this form of diversification could be linked to the level of development in the communities they work in. MFIs working in highly economically backward communities might stay away from it, while those working with slightly more affluent communities might be open to the idea. This comes through in what the CEO of MFI-D shared with us:

“We also work in a really impoverished community. The average incomes here are around 8000 Rupees a month. So, our idea is to focus on the basic needs rather than go beyond to products like these.”

Consequently, many MFIs are taking the middle ground. They do not diversify into consumption products, but as the economic status of their borrowers stabilizes, they offer them loan products tailored to meet their emerging consumption needs.

Overall, unrelated commercial diversification is still a contested and nascent area. The financial returns for the MFI could be attractive if they can achieve volumes that can offset the investments in new partnerships and capabilities required to deploy these products. However, there is a question of whether this form of diversification runs counter to the broader mission of microfinance, which promises to lift people out of poverty by empowering them to engage in productive activities. In short, it is unclear whether it leads to sustainable development.

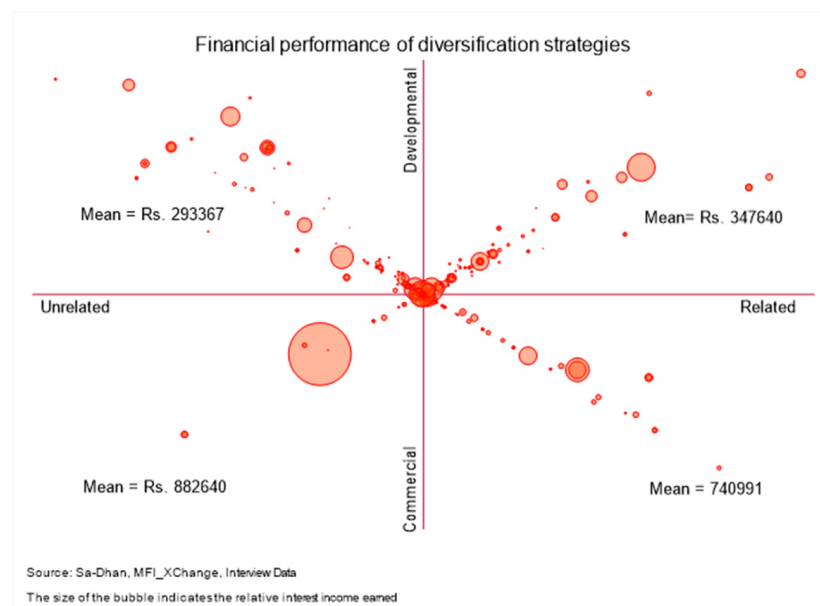
5. Discussion

5.1. *Balancing the Tradeoffs in Product Diversification*

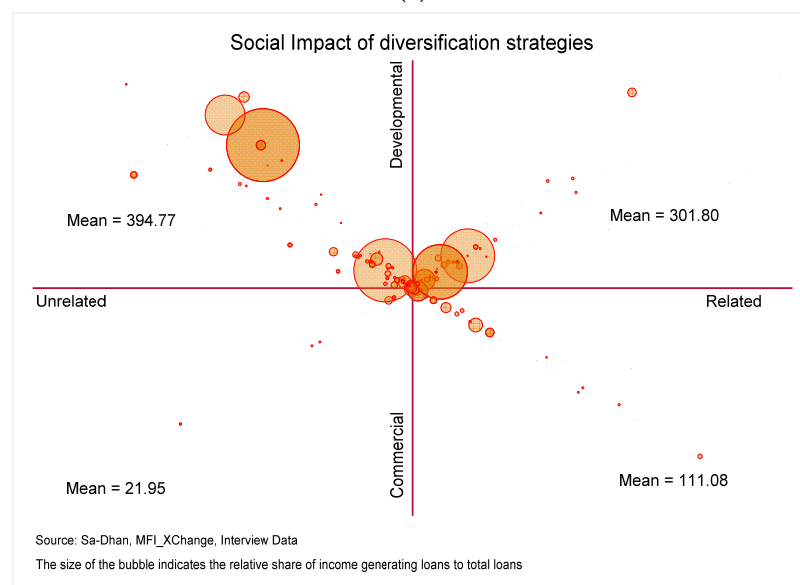
Social enterprises thrive on creating a self-sustaining business model—one that creates synergy between social and financial goals to support sustainable development. For the MFIs, this means being able to offer microloans that are primarily used for productive economic activities, which allows faster and reliable returns, which in turn allows the MFIs to grow their operations, setting up a virtuous cycle between financial performance and social impact. This model is disrupted when there is market saturation or when there are strong voids that limit the scalability of social enterprises. To overcome this challenge and grow, social enterprises may opt to diversify into multiple products and services.

Our analysis has revealed that product diversification is a viable strategy to scale social enterprises. It is used quite extensively in the MFI sector alongside replication strategies. MFIs diversify along two dimensions (relatedness and locus of impact) into one or more of the four quadrants depending on the nature of their borrowers, the broader operating context and their own capabilities. As they do so, they often have to trade off social impact for financial growth and vice versa. For example, developmental diversification can help build the capacity for market development, but it can stunt scaling by impeding financial performance, especially as MFIs venture into unrelated sectors. On the other hand, commercial diversification may increase the financial returns for the MFIs but make the borrowers more indebted, negatively impacting the social goal of the organizations. Successful scaling through diversification involves striking a fine balance in the product portfolio such that the social enterprise enhances its social impact and financial growth. We elaborate on this below.

Figure 3a shows the financial performance associated with different diversification strategies. As per Figure 3a, engaging in developmental diversification that builds capacity in the target communities (top-right and top-left quadrants) is associated with lower financial performance as measured by the MFI's interest income, as compared to commercial diversification (bottom-right and bottom-left quadrants). This is likely due to greater operational costs involved in creating the foundational infrastructure and institutions necessary for creating markets where none exist. Many activities undertaken by MFIs in the top-right and top-left quadrants are those that traditionally come under the purview of governments. Spending resources in these quadrants is less likely to yield financial gains in the short term. On the other hand, we see that engaging in commercial diversification, which builds on existing albeit weakly functioning markets leads to higher financial performance.



(a)



(b)

Figure 3. (a): Financial performance of diversification strategies; (b): Social impact of diversification strategies.

Figure 3b shows the social impact associated with different diversification strategies. Here, we see that engaging in developmental diversification has a large social impact (top-right and top-left quadrants) as measured by the amount of loan disbursed towards income generating activities. It empowers borrowers and enables them to engage in productive economic activities—in effect furthering the social impact. On the other hand, engaging in commercial diversification (bottom-right and bottom-left quadrants) has a lower social impact. This is because the option to transact across a wide portfolio of products and services can veer borrowers away from productive economic activities towards consumption-oriented activities. This can in turn push them into a spiral of debt. For sustainable growth, it would be prudent if developmental products and services such as saving and financial literacy could go hand-in-hand with access to commercial products and services.

This means that, as social enterprises try to scale using a product diversification strategy, they need to wrestle with the central paradox of social enterprises, balancing social and financial performance for sustainable development. As can be seen from Figure 3, there are tradeoffs in achieving both outcomes: while building capacity enhances the social impact by directing more money towards building capacity in the target community, it imposes a penalty on financial performance by lowering the share of profit income, which can hamper scalability. Similarly, diversifying into commercial products and services that facilitate transactions can increase financial performance but do so while reducing the share of loans used for productive economic activities, i.e., social impact.

The findings from this study further the scholarly conversation on scaling social enterprises [3,15,19,25,26]. In particular, we examine the potential and tradeoffs of diversification as a scaling strategy and advance a typology of diversification strategies. In contrast to the “scaling up” or “replication” strategy, which takes a supply-side perspective, diversification takes a demand-side perspective and promises to add a new dimension that can advance work on the scaling of social enterprises. Future research can build on this to examine how diversification strategy may evolve over time, the long-term impact of diversification on the social and financial performance of the social enterprises, and if/how replication and diversification can be deployed in tandem.

5.2. Practical Implications

Based on the insights from this study, we put forth three recommendations for practitioners. First, we suggest that social enterprises should remain close to their core capabilities and engage in related diversification. Even when capacity building in basic amenities is a necessity, focusing on related developmental diversification yields relatively greater gains on both financial and social goals. It keeps incremental costs low and ensures the organization remains close to its stated social mission. Some level of unrelated diversification, especially to fill institutional voids that create a hurdle for the organization’s core mission, is desirable. However, these are best undertaken in partnership with other organizations that have resources and deep expertise in that area.

Second, social enterprises should view the different types of diversification as a toolkit and use them dynamically to create a balance between social and financial goals. Sustainability scholars have often highlighted the imbalance between dual goals of MFIs that affects their potential for enhancing economic development [9,10,13]; we contribute to this conversation by proposing how diversification can be leveraged to achieve balance. Depending on the relative balance or the lack of it, social enterprises can choose to increase or decrease their commitment to different types of diversification. For instance, if social enterprises suffer from lower financial performance, investing in related and unrelated commercial products and services may enhance their finances. Similarly, if greater levels of commercial products and services increase indebtedness and consumption, then investing in unrelated developmental products and services can shift the needle towards greater social impact.

Finally, social enterprises need to evolve their product portfolio as the communities in which they operate evolve. For instance, as the public healthcare system improves, there may not be a need to offer health camps. Similarly, as road and electricity infrastructure improves, rural entrepreneurs can engage in a wider range of productive activities and address larger markets. They may need different types and sizes of loans and other financial services. Social enterprises need to constantly keep their ear to the ground and adjust their product portfolio to accommodate the changing customer needs. Often, this also requires a supportive and dynamic policy environment, especially in sectors such as microfinance. MFIs are heavily regulated in terms of whom they can lend to, how much they can lend and for what purpose. These policies have been designed to protect the borrowers. However, as communities evolve, there is a need to revisit the policies and perhaps customize them for different regions. A responsive policy framework is instrumental for maximizing impact through product diversification.

6. Conclusions

This study has taken a small step towards understanding if and how product diversification strategy can help scale social enterprises in a sustainable manner. The nature of diversification can influence the way social enterprises manage the tradeoff between social and financial goals. However, our study has certain limitations. It is based on qualitative data from a small number of companies; it is focused on the MFI sector; and it is set in a developing country context. Further research is necessary to generate a robust body of evidence and create knowledge that can be generalized across contexts.

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