



Rethinking Boundaries:

Leadership, Innovation and the Global Recession

By Nicholas Sabin and Allison Stewart

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Enterprise and innovation are as much about people and culture as ideas. How can leadership help to harness entrepreneurship and innovation to combat the global recession?

Leadership and the Global Recession

As Matt struggled with his own organization in 2007, a much larger crisis began to ripple throughout the global economy. The near-collapse of the U.S. mortgage market disrupted financial institutions throughout the world and spurred a global recession.² Responding to the crisis, leaders have been faced with the question of how they can combat the severity of the recession and prevent its recurrence. In this article, we attempt to offer some insight to this monumental issue by considering a much smaller, more personal story. Matt Flannery's creation and resilient direction of a global microfinance company illustrate innovative leadership principles that are supported by new findings in management and organizational research. We suggest that these principles may be of great value to leaders attempting to combat the global recession.

To overcome drastic changes to the status quo, leaders benefit from a dynamic ability to harness innovation. Most leaders are aware that people and culture are critical resources for affecting change. But *how* leaders can practically direct these resources to improve innovation and entrepreneurial activity is a challenging question. What can leaders specifically do in their respective positions to maximize the value of people and culture

in their organizations? Here we offer one answer to this question that is readily actionable and well-

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illustrated by the leadership decisions of Matt Flannery. We suggest that leaders rethink boundaries.

Active consideration of boundaries provides a medium with which leaders can shape innovation, both in the sense of defining individuals' roles and by influencing an organization's culture. The study of how leaders can spur and harness innovation and entrepreneurial activity has a rich history, drawing on diverse theoretical approaches.³ While

San Francisco, 2007. When Matt Flannery reached for the phone at 3 am, he had a feeling that it wouldn't be good news. Nothing, however, could have prepared him for the devastating revelation that came next. Matt had been betrayed by one of the co-founders of his fledgling microfinance company, Kiva.

*The phone call from Uganda that night revealed that Moses Onyango had constructed an illegal shell company to funnel money away from their organization. A substantial amount of the organization's funding had vanished. As Matt slowly hung up the phone a fear began to creep in: 'How could the young organization possibly recover from such a disaster?'*¹

Note: The authors have developed a fictional narrative of Kiva (italicized throughout) based on true events described in publically-available documents.

considerable research has identified the role of ideas in the innovation process (see for example the work of industrial economists on technological innovation⁴), an alternative strand of research focuses on people and culture. In particular, researchers of innovation in recent years have found that boundaries play a critical role at multiple levels of analysis, from the macro intersection of conflicting cultures to the micro definition of employee responsibilities⁵.

In this article we explore how this approach may be of value to leaders facing the global recession. Four ways in which leaders can rethink boundaries to harness innovation and entrepreneurial activity are put forth and illustrated by the case of Matt Flannery's leadership of Kiva. We conclude with a discussion of how leaders, both in central and fringe positions, can readily apply these concepts to combat the global recession.

Innovation at the Intersection of Conflicting Boundaries: The Founding of Kiva

Uganda, 2004. It's unbearably hot and Matt is squeezed into a bus with his wife, Jessica, a family of Ugandan farmers, and their chickens. His shirt sticks to his back, but he's oblivious to the noise, dust and dirt as he and Jessica discuss the idea that has been forming in their minds over the last few weeks of their trip. What if they could enable people from the US to loan money directly to these farmers, and



Rosennette Pateño, a low-income entrepreneur from the Philippines, received a small loan through Kiva to invest in her confectionary business. Source: Kiva.org; Photo Credit: John Briggs.

people like them in Uganda? They knew their friends would love it. Could it be possible?

Upon his return to the US, Matt embarked upon an arduous journey to achieve the vision they had created on a bus in Uganda. The concept behind Kiva was simple. Matt wanted to create an online lending platform that allows individuals in the developed world to loan to small businesspeople in the developing world. Despite his enthusiasm, Matt's idea quickly came up against criticism for precisely the reason that would ultimately make it so successful: it was unique. The idea of giving person-to-person micro-loans to individuals in developing countries fell outside of every known regulatory status. In

particular, there was a significant amount of ambiguity around the classification of the organization with respect to the SEC – was it a security or not? Was Kiva commerce or charity? As Matt recalled in an article for Forbes, “We were in this weird social entrepreneurship space, trying to fight perceptions... I read all the policy and case law on it, and I couldn't find anything that said it was illegal. So we just started doing it.”⁶

The answer in Kiva's case was that they were not commerce or charity; they were both. Kiva sits at the intersection of these two often highly distinct areas,

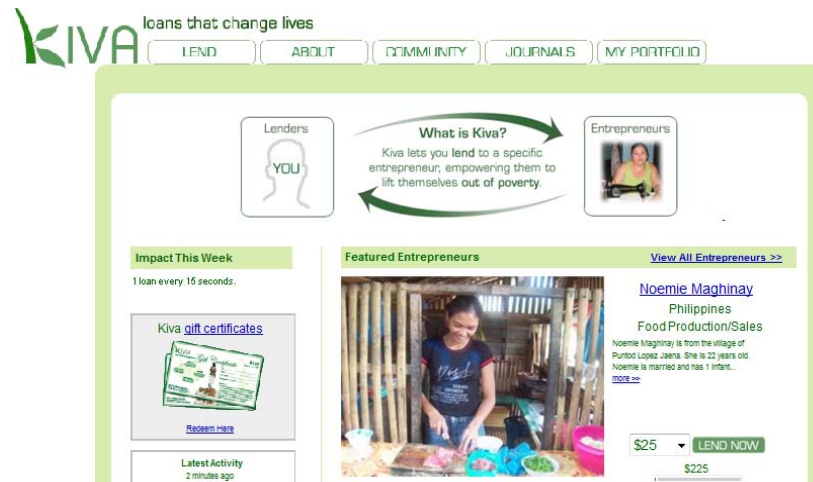
right in the heart of the developing social entrepreneurship landscape. Though originally overlooked by both venture capitalists and

Kiva: An online lending platform that allows individuals in the developed world to loan to small business people in the developing world.

charitable foundations, Kiva has since become a poster-child for social innovation.

This case illustrates the first way in which leaders can rethink the role of boundaries. Rather than avoid the space of conflicting ideologies, leaders can embrace the intersection of macro-level boundaries as a key source of innovation and entrepreneurial activity. There is significant research that indicates that conflicting boundaries produce the seeds of innovation and offer the opportunity for reshaping generally accepted barriers. Research by Friedland and Alford⁷ suggests that where macro boundaries overlap, the contradictions can generate friction which produces the sparks required for innovation. Successful leaders transform institutions by exploiting the contradictions. Santos and Eisenhardt's⁸ study of five industry-redefining organizations, further suggests that such boundaries can effectively be reshaped through entrepreneurial activity. They find that successful entrepreneurs in nascent fields actively consider the role of boundaries to find structural gaps in which their organizations fit. Thus, leaders can partially harness the value of conflicting cultures by viewing the intersection of macro boundaries as opportunities for innovation and entrepreneurial activity.

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Kiva's user-friendly website allows people from previously disparate regions around the world to easily connect.
Source: Kiva.org

Bridging of Distinct Boundaries: Kiva's People-Centered Platform

San Francisco, 2005. The smell of roasting coffee permeates Matt's exhaustion. He's been working for the past two hours at the late-night donut shop in the Mission neighborhood of San Francisco, trying to stay awake. He's been moonlighting this way for four months: TiVo employee by day, Kiva founder and coder by night. As Matt designs the beta version of a website that

will hopefully connect people from disparate areas of the world, he continually asks himself, 'How can I make philanthropy an addictive experience?'

At the core of the original objectives for Kiva was the idea

that *people* would play a central role in the success or failure of the business model. Matt knew that allowing people from drastically different countries to loan to each other would be a formidable challenge. However, he enthusiastically accepted the task of bridging the boundaries, both geographical and cultural, between the US, Uganda, and other countries. To accomplish this, Matt wanted to create an interactive lending platform that would come alive for the clients; they weren't just lending money, they were investing in people. Though this would be the first person-to-person microfinance platform, his goal was a comfortable user experience that could easily be adopted by people.

Hargadon and Douglas's⁹ research echo's Matt's goals by suggesting that the successful adoption of an innovation is not only driven by the technology, but by also by people. They find that the introduction of new technology requires a

combination of good ideas and social acceptance. Innovations are more likely to be adopted that have a cognitively familiar base and reflect the importance of user interaction. Kiva's user-friendly website was created with the intention of being an easily adoptable solution for new customers, and resembled cognitively familiar websites like Facebook. Using this approach, Kiva was easily adopted by users and able to connect previously disparate peoples. This example illustrates the second way in which leaders can benefit from actively considering boundaries. Groups of people that have previously been viewed as distinct may offer opportunities for boundary bridging that allow for innovative business models.

Redefining Organizational Boundaries: Kiva as an Open-System

*S*an Francisco, 2007. Matt is sitting cross-legged on the floor in the middle of the large room, his laptop on his knees. He glances up as someone walks by him – it's a new programmer that they've hired to keep up with the ever-increasing complexity of managing the demand of the website. As Kiva's popularity had grown, so had the staff required to maintain it. Matt is now one of ten programmers, microfinance experts and public relations staff that make up the multi-million dollar organization.

In 2007 Kiva raised and distributed \$17 million USD to low-income entrepreneurs around the world¹⁰. How can this small group of people

possibly be responsible for the sourcing and distribution of millions of dollars of loan volume? Kiva is built on an unconventional idea of organizational boundaries which treat the company as an open-system. The idea of an open-system in organizational theory is well-captured by Chesbrough's¹¹ concept of open-system innovation and Scott's¹² open-system classification. As compared to a closed organizational system, which refers to self-reliant entities that focus on controlling processes internally, an open organizational system makes use of the landscape of abundant knowledge and resources, tearing down the traditional

boundaries of the firm. By using this approach, Kiva is able to harness ideas and the value of diverse people not just from within the organization, but also outside the organization's formal boundaries.

By treating an organization as an open-system, it is possible to unleash an exponentially greater set of resources embodied by people outside the formal boundaries.

In addition to the core staff members employed by Kiva, there is a massive group of external individuals that work with Kiva to create a truly unique organizational form. Partners and volunteers are two examples of Kiva's open system approach.

Partners: As of 2009, Kiva partners with over 100 microfinance institutions around the world to distribute microloans to borrowers. Through this model, Kiva relies on the strength of microfinance



Kiva treats its organization as an open system by relying on volunteers to travel to its partner countries. 'Kiva Fellows' are used to interview and provide progress updates of entrepreneurs. Source: Kiva.org

specialists in foreign countries with specific knowledge of the local cultures to effectively interact with borrowers.

Volunteers: Kiva uses volunteers to leverage the skills of people outside the formal boundaries of the organization. Kiva uses translators from around the world with different cultural backgrounds and language proficiencies to translate borrower descriptions. Kiva also uses volunteer 'fellows' to travel to microfinance institutions abroad and ensure a strong working relationship with Kiva.

The design of Kiva's organizational boundaries highlights the third way in which leaders can rethink boundaries to harness the value of people and culture. By considering the value of treating an organization as an open-system, it is possible to unleash an exponentially greater set of resources embodied by people outside the formal organization.

Bi-Directional Boundaries: Kiva Chooses Transparency

San Francisco, 2007. Three weeks ago Matt received the 3 am phone call in which he learned of the betrayal by one of his co-founders. Today, Matt sits at a meeting of Kiva's board of directors. He has just provided them with an overview of the results of his investigation in Uganda and the extent of the issue. Kiva has lost \$125,000 USD in funds, distributed to borrowers that don't actually exist. The directors are shocked; how can they possibly address the shortfall? Kiva's budget is incredibly tight as is.

Kiva opted for the hard road in addressing the betrayal, choosing to be completely transparent with users about what had happened. On August 22, 2007, dubbed 'Black Wednesday', Kiva announced the deception to their users and

issued a full refund to cover the shortfall.

The response was overwhelming. The transparency and openness displayed by Kiva was repaid in full; the vast majority of refunds were returned to Kiva in the form of loans to new borrowers. Kiva had survived their greatest setback to date in shining form; their honesty encouraged users not only to stay with the organization, but in fact increased their trust in Kiva to 'do the right thing'.

This is the other part of open-system innovation at which Kiva has excelled: bi-directional boundaries. Not only is Kiva keen to gather the resources and input from people outside of the organization, they also match the input with far more output and transparency than most organizations. Kiva has consistently chosen to provide as much information as possible to their clients, showing the repayment track record, keeping clients informed of their challenges as they grow, and operating with a transparency that is a refreshing change to many businesses. Thus, the fourth way in which leaders can rethink boundaries is by considering their directionality. Where organizational boundaries exist, long-term innovation and enterprise growth can be supported by providing individuals on both sides of the boundary with transparent information.



This woman's weaving business was funded by a Kiva loan. Kiva maintains transparency by reporting to lenders even if she defaults on her loan. Source: Kiva.org; Photo Credit: John Briggs

Discussion: Rethinking Boundaries, Leadership and the Global Recession

We have suggested that explicit analysis of boundaries can provide leaders with a means for harnessing the value of people and culture through innovation. Using Kiva as an illustrative case, we identified four ways in which leaders can harness innovation and entrepreneurial activity: (1) the use of positive friction between the intersection of ideological and cultural boundaries can produce innovation, (2) bridging boundaries via technology can allow for the beneficial interaction of previously unconnected people, (3) the redefinition of organizational boundaries into an open-system structure can transform an organization's human resources and magnify its potential for innovation, (4) making boundaries bi-directional for the betterment of people on both sides promotes long-term enterprise growth and innovation.

These leadership decisions have helped Kiva to perform with unusual resilience during the financial recession. Despite the financial crisis, loan volume at Kiva in 2008 was \$36 million, double that of 2007¹³. Kiva also recently launched their first US partnerships in June 2009, partnering with ACCION USA, a microfinance institution that lends to 48 states across the U.S., and Opportunity Fund, a community development financial institution based in San Jose, California¹⁴. While other organizations, both for- and non-profit, just hope to survive the storm, Kiva is expanding.

In light of the current economic environment, we suggest that by rethinking boundaries, leaders can combat the global financial crisis in both the short and long term.

Short Term: Overcoming the current financial recession in the coming years will be aided by increased innovation and entrepreneurial activity. Boundary bridging and redefinition are key innovation concepts that maximize the value of people and culture. These approaches allow leaders to enable previously undervalued human resources. Enabling these resources for innovation allows for stimulation of economic activity in the short term.

Long Term: As we recover from the current financial crisis, leaders will be asking how to mitigate such recessions in the future. We suggest that the leaders of financial institutions, international businesses and governments actively debate the boundaries of their organizations. For example, would treating such traditionally closed entities more as open-systems increase their robustness? Are the boundaries of these entities appropriately bi-directional such that people within and outside the organizations are appropriately informed? Debating such issues may allow leaders to combat the ongoing risk of global recession by developing more robust and flexible organizations.

Rethinking Boundaries: A Leader's Active Role

We have argued that leaders should rethink boundaries at various levels to spur innovation and combat the global recession. At this point, you may be inclined to conclude that the real opportunities to harness innovation through dramatic boundary redefinition are only relevant to leaders in nascent, entrepreneurial fields. Perhaps active assessment of boundaries is only relevant if you are Matt Flannery creating an organization from scratch in a late-night donut shop. But what if you are a manager or executive in a well-established organization?

New management research has indicated that the ability to consider boundaries and affect meaningful change is indeed relevant to leaders in both central and fringe positions. Fringe actors, those not in well-established organizational

positions, are certainly well-placed to produce such change because they are attempting to innovate from

By rethinking boundaries, leaders can combat the global financial crisis in both the short and long term.

an external source. It is generally accepted that such fringe actors are less bound to a set of institutional rules and can provide an exogenous source of change¹⁵. However, recent research by Suddaby and Greenwood¹⁶ has found that innovation can be additionally pioneered by leaders in central positions. Their research explored the role of executive leaders in the accounting

industry, a mature and institutionalized field. They found that executives in central positions actually possess an advantage for producing change. Leaders in central positions have a unique macro perspective to see the extent of the existing boundary misalignments and determine how best to bridge those boundaries within the current framework. As such, leaders of companies both big and small, industry leaders or fringe players, can all benefit from looking at boundaries from a fresh perspective. This is a crucial source of innovation for combating the global recession.

Oxford, 2008. *Matt's palms are sweating as he sits in the auditorium. There are so many unfamiliar faces. The speaker calls his name into the microphone and Matt gets up with Premal, the president of Kiva, to receive the award. For its innovative approach for creating social change, Kiva has been given the Skoll Award for Social Entrepreneurship*¹⁷.

Later that day when the applause has passed, he reflects on the last four years since he started Kiva. He remembers the original business plan and objectives for the company. He remembers how naïve he was. Was all this success a result of his ideas? No, he concludes, Kiva is a part of something greater than himself. It was the countless people within and outside the organization that made the innovative company a success. Those people deserved the award.

Endnotes

¹ The fictional narrative throughout the article is based solely on public accounts available in: Flannery, M. (2009). *Kiva at Four in Innovations: Technology, Governance, Globalization*. MIT Press, Cambridge; Flannery, M. (2007). *Kiva and the Birth of Person-to-Person Microfinance, in Innovations: Technology, Governance, Globalization*. MIT Press, Cambridge.

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¹³ Flannery, M. (2009). p. 44.

¹⁴ Rao, L. (2009). Kiva Brings Microlending Home To U.S. Entrepreneurs In Need. Accessed through TechCrunch.com on June, 2009.

¹⁵ See e.g. DiMaggio, P. and Powell, W.W. (1983). The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields. *American Sociological Review*, 48(2): 147-160.

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