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MICRO FINANCE LOANS – ENHANCING BUSINESS OR MEETING PERSONAL EXPENSES?

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ABSTRACT

The main objective of micro finance activity is to alleviate poverty and generation of employment for those poor people who were excluded from formal financial services. Malwa region of Madhya Pradesh, India, with a rural population of approximately 13977860 (2001) is a new developing area in terms of Micro Financing. The funding activity has picked up few years back but there is lack of proper training to the beneficiaries of micro finance. This research tries to study the issues which contribute in success of micro enterprise and micro finance of Malwa region. By a survey done on sample of borrowers in eight villages, the research explores the fact whether the borrowers have an understanding and appreciation for the facility of micro finance being provided to them or not. In this empirical study, the results indicate that majority of the borrowers have a tendency to misutilise the funds borrowed. They treat micro finance funding as just another source for meeting personal expenses. The research has identified this as serious concern for micro finance organizations.

KEYWORDS
Alleviate poverty, financial planning, micro enterprises, profitability, sustainability.

INTRODUCTION
Micro finance institutions of Bangladesh sound assertion, that micro finance has successfully enabled extremely poor people to engage in self employment projects that allow them to generate an income and in many cases begin to build wealth and exit poverty. The astonishing success and sustainability of micro finance in Bangladesh, has worked as a motivator for many researchers to do research in micro finance. In India the role of micro finance & micro enterprises in poverty eradication has long been recognized as vital, that's why the number of micro and small enterprises has increased steadily, according to the 1990 Economic Census Report of the central statistical organisation, there were a total 1, 27, 98,245 micro enterprises. But number of micro enterprises increased manifold as per the economic census report of 2005 the total count was 41.83 million enterprises. But, the state-wise growth of micro finance and micro enterprises in India is uneven. States like Himachal Pradesh, Chattishgarh and Madhya Pradesh are having slow growth in comparison of other states. While there can be many reasons for this disparity, but what is very common for micro enterprises of all states is that there is a need to give impetus to the growth of these enterprises.

Therefore, it is necessary to explore the problems faced by micro finance institutions and the small and micro enterprises who are the beneficiaries of funding facility. The extent of funding needed by micro enterprise and the repayment of loan depends on the successful running of the business. But, successful running of the small business is an issue, which depends on many factors like local market, skills of the promoter etc.

In Madhya Pradesh, the central part of India, Micro Finance activity is yet to gain momentum. There are a few MFIs working in this field. They provide funding support as well as technical guidance to the owners of small businesses. The repayment of loans and successful running of small business is necessary for sustained growth of these institutions. This study focuses on the issues faced by small and micro enterprises that avail the funding facility from micro finance agencies. The paper tries to address two issues – First it identifies the factors which affect the repayment of loans, second it tries to list the issues related to financial management which contribute to success of micro enterprise. Beside that research emphasize on critical issues which should be properly dealt by MFIs for success of micro finance in this region.

MICRO FINANCE SCENARIO IN MADHYA PRADESH
In Madhya Pradesh, micro-enterprise and micro-finance development have emerged as one of major strategies to combat the twin issues of poverty and unemployment. However, Micro enterprise development in Madhya Pradesh is still lagging. Micro finance is still in nascent stage of growth in Madhya Pradesh in comparison of other states viz. Andhra Pradesh etc. In Madhya Pradesh though micro finance started in 1985 but still the total number of micro finance institutions are twenty three and total client outreach is 5, 51,235 Approximately. On the other hand, states like Andhra Pradesh has the total number of micro finance institution are forty and total client outreach is 4,949,393. (Source: The Bharat Micro Finance Report)

Malwa region of Madhya Pradesh, which is one of the poorest, most remote and hardest to serve region in Madhya Pradesh with over 40% of the population living below the poverty line. The employment picture in rural areas for Malwa region over the past 20 years has remained consistently bleak. This high level of unemployment is an impediment to poverty reduction and requires urgent attention. In the rural context of Malwa region, micro enterprise development is a best strategy for eradication of poverty and unemployment.

In Malwa region approximately fifteen micro finance institutions are active viz. spandana, sporty financial ltd., Basix, Priya sakhi mahila sangh, Unnati mahila sangh, Sks, Share, Lok biradari trust etc.

A general observation and a preliminary discussion with the clients revealed that there is a need to educate them on the proper utilization of micro finance funds. In some of the cases it was found that beneficiaries are using the funding facility for uses other than business.

OBJECTIVES OF RESEARCH
1. Identification of issues, related to financial management which can contribute in the success of micro enterprises.
2. Establish a relationship if any, between loan repayment and profitability of micro enterprises.
3. Find out the difference if any, between the loan repayment and profitability of micro enterprises which utilize the loan for the purpose it is sanctioned and the ones that don't utilize the loan for purpose.

LITERATURE SURVEY

Poverty is often linked to insufficient income and lack of livelihood and employment (Dreze and Sen, 1989) describe poverty as a severe failure of basic capabilities. Historically poverty eradication program bases on employment creating livelihood has worked effectively. The importance of micro and small enterprises (MSEs) in eradication of poverty and generation of employment is well documented (see, e.g. Machaira, 1997; UNIDO, 2003). (Michael Pretes, 2002) stated that micro enterprises are firms with fewer than five employees; they are usually unregistered and do not pay taxes. Basically a micro enterprise is smaller than small and medium enterprises. It is a very small (micro), informally organized business undertaken by poor people, each micro enterprises is different, so the size, type of business and legal arrangements can vary a great deal. (Raman .T. Ayco)

Micro enterprise development is feasible only when capital and liquidity needs are well addressed especially in an environment with imperfect capital market. Credit is critical in two ways depending on the conditions under which it is used. If credit is accessible and reasonably priced, it allows firms to address liquidity constraints, thus boost profitability and growth. However, credit may negatively affect profits and survival if firms are not prudent borrowers (Fisman & Raturi, 2004) or operate under poor economic conditions and bear high borrowing cost (Bigsten & Shimeles., 2003; Beck, Demirguc-Kunt, & Maksimovic, 2002; Steel & Andah, 2004)

Loan default risk increases manifold in case of imperfect markets (Von Pilschke, 1992) and charging high borrowing cost does not resolve the problem either (Stilgitz or Weiss, 1981). On the other hand, credit on the economical and easy terms provided by institutional sources was not utilized properly for the purpose; it was granted and intended too (Dasgupta, 2001).The achievement of high money turnover, good repayment rates, coverage of costs and huge number of low income clients does not necessarily imply that poverty alleviation is achieved in developing countries (Johnson, 1997).

In various well documented cases relating to the Grameen Bank of Bangladesh (Rahman 1999, Goetz and Gupta, 1996), borrowers have to refinance loan to make payments (often borrowings from moneylenders or other MFIs) have to sell household assets or their own food supplies to make payments or have to leave their home village for an urban area to work on daily wages in order to repay their loan. As (sinanowitz, 1999) observed in his study the fact that If client maintains good loan repayment schedule they get privilege of further loans and this advantage act as a motivator to borrow new loans to repay existing loans on time. And this perception become dangerous and give rise to over indebtedness and excess dependency.

Micro finance institutions following the conventional Grameen group model are known to follow rigid repayment schedules. The weekly repayment schedule normally followed by these MFIs puts an excessive pressure on the members to maintain regular repayment. The client's even resort to borrowings from informal agencies at very high rate of interest to repay the MFIs loans to maintain their access (Sinha and Matin, 1998)

To return the loan on time many clients start working on daily wages. The increase in the share of casual labour in total employment is regarded as an indication of deteriorating employment is not associated with job security or other employment benefits. Rising prices may increase the inherent value that micro finance customers place in their access to credit, which may cause them to make sacrifices elsewhere in order to remain in good reputation with their lender. (Tim Ogden, 2008)

Micro enterprises operate at the margins, there fore high interest rates and other service charges can easily consume the already meager profits of the borrower .When poverty eradication is viewed in terms of social or human development, it provides the long term objectives that is needed for sustainability of efforts. And for sustainable and successful micro enterprise development, it is essential to identify and fill the gaps, which are crucial to the development and sustainability of micro enterprise.

There is a significant literature devoted to the constraints to micro enterprise growth and the factors which contributes in micro enterprise development (see, e.g. Mead & Liedholm, C, 1998; Snodgrass & Biggs, 1996).However; there is a paucity of studies which highlight the issues related to financial management for the success of rural micro enterprises.

RESEARCH METHODOLOGY

This research deals with identifying the major factors related to financial management which can contribute in the success of micro enterprises and MFIs. The first step is to identify the correlation between loan repayment and success of micro enterprise. The loan repayment of customers is assessed by the "number of installments repaid" and the success of micro enterprise is measured by the "average profit per month". Both the variables are scale variables. Pearson Product Moment Correlation is calculated to establish the relationship.

In the second step, the sample is divided into two prominent categories; one consisting of those micro enterprises which use the micro finance funding for the purpose it has been sanctioned. The second group consists of those micro enterprises, which use the loan amount for purpose other than the one sanctioned. The comparison in these two groups is done on the basis of One Way ANOVA. The differentiating variables being – Educational background of borrower, amount of loan taken, type of business, reasons for difficulty in repayment, financial performance, profit per month.

SAMPLE DESCRIPTION

The population of the study includes the clients of micro finance institutions; it includes NBFC, NGO, Societies, trust etc of Madhya Pradesh. These MFIs are working predominately for poor people. In all there are twenty three agencies who have funded approximately 2.2 lacs of clients (Source:-The Bharat Micro finance Report-2009). Out of these twenty three, fifteen approx. are based in Malwa region, i.e., districts of Indore, Ujjain, and Ratlam. The sample is selected for study is clients of these MFIs. A sample size of 54 micro enterprises was selected from eight villages on the basis of their population from Indore district. These micro enterprises are run by either joint liability group or self help group .Data was collected by interviewing these micro entrepreneurs with a structured questionnaire to get insight into their financial management. Through this exercise, internal dynamics and external factors influencing the micro enterprise operation, which contribute in success or failure of micro enterprise, were ascertained. The information about type of business, type of loan, gestation time allowed for loan, period of loan, interest rates, recovery procedure, major problems faced by micro enterprises, performance of micro enterprises, major reasons of failure of micro enterprise, type of business successful and area's cash economy etc. were ascertained from the micro entrepreneurs and from employees of micro finance institutions was collected.

FINDINGS AND DISCUSSION

Sustainability of micro finance institutions and micro enterprise are mutually dependent on good prospects of repayment beside other factors. Out of total sample of micro enterprises 50% micro entrepreneurs have not used the loan for the purpose it is taken. They used the loan for personal purpose or in other business that they find suitable. The total micro entrepreneurs used loan for purpose are 50% and loan not used for purpose are 50%.

TABLE 1: LOAN USAGE

Status	Loan used for purpose (50%)	Loan not used for purpose (50%)
Profitable	39.5%	-
Break-even	13.95%	36.4%
Loss	46.51%	63.6%

TABLE 2: CORRELATION BETWEEN LOAN REPAYMENT & PROFIT

		Number of Installments repaid	Profit Per Month
Number of Installments repaid	Pearson Correlation	1	.050
	Sig. (2-tailed)		.720
	N	54	54
Profit Per Month	Pearson Correlation	.050	1
	Sig. (2-tailed)	.720	
	N	54	54

Out of total sample size 19.75 % micro enterprises are profitable where as loan repayment rate is 96.23%, which is very high. Correlation for loan repayment and profitability (table 2) is only 0.05, and it is not significant. This means that, all the borrowers whether they are earning profit or loss, are repaying the installment in time. This may be because of the fact that many of them have supplemental incomes and the micro finance institutions keep a strong follow up for repayments. Further, the average age of the loan is only six months to one year. This may be one of the reasons for proper repayment

TABLE 3: DESCRIPTIVE STATISTICS

	N	Minimum	Maximum	Mean	Std. Deviation	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
Educational Background of Borrower	54	0	3	.43	.602	1.643	.325	4.413	.639
Amount of Loan taken	54	1	3	1.26	.521	1.927	.325	3.021	.639
Age of Business	54	0	3	1.91	.401	-2.602	.325	10.974	.639
Type of Business	54	2	14	5.11	3.830	1.559	.325	.924	.639
Whether the loan is used for purposed	54	1	2	1.20	.407	1.514	.325	.301	.639
Number of Installments repaid	54	0	4	2.22	.664	.527	.325	3.361	.639
Reasons for Difficulty in payment	54	0	2	.35	.677	1.701	.325	1.454	.639
Financial Performance	54	0	3	1.96	1.027	-.358	.325	-1.268	.639
Profit Per Month	54	-400	1000	144.44	607.397	.603	.325	-1.449	.639
Valid N (list wise)	54								

The table 3 shows the descriptive statistics for the data collected from 54 groups. The variables under study are as shown in the above table. As seen, the conditions for normality are fulfilled by almost all the variables. The values for skewness and kurtosis fall between the acceptable range of +2 and –2 for 7 variables. For two variables, it does not follow a normal distribution. These variables are Age of Business and Number of installments repaid. The probable reason for this may be the fact that micro finance is a relatively new activity in the region and the awareness about this facility is rare among the people.

An ANOVA was applied to test the effect for seven variables on the usage of loan taken by the borrower. The effect was seen for the fact whether they use the loan for business purpose or use it otherwise. A Man Whitney test (non- parametric) was applied for the remaining two variables which did not follow a normal distribution.

Table 4 summarizes the results for one way ANOVA. As seen, out of seven variables, namely 'amount of loan taken' and 'reasons for difficulty in repayments' were found significant at 99% confidence level and 'profit per month' was only marginally significant. While, Educational Background of Borrower, Amount of Loan taken, Type of Business and Financial Performance not found significant.

TABLE 4: ONE WAY ANOVA FOR TESTING DIFFERENCE BETWEEN PEOPLE USING LOAN FOR BUSINESS & THOSE USING IT OTHERWISE

		Sum of Squares	df	Mean Square	F	Sig.at 1%
Educational Background of Borrower	Between Groups	.197	1	.197	.540	.466
	Within Groups	19.006	52	.366		
	Total	19.204	53			
Amount of Loan taken	Between Groups	.929	1	.929	3.592	.064
	Within Groups	13.442	52	.258		
	Total	14.370	53			
Type of Business	Between Groups	19.959	1	19.959	1.370	.247
	Within Groups	757.374	52	14.565		
	Total	777.333	53			
Reasons for Difficulty in payment	Between Groups	1.947	1	1.947	4.526	.038*
	Within Groups	22.368	52	.430		
	Total	24.315	53			
Financial Performance	Between Groups	2.408	1	2.408	2.340	.132
	Within Groups	53.518	52	1.029		
	Total	55.926	53			
Profit Per Month	Between Groups	1177181.113	1	1177181.113	3.331	.074
	Within Groups	1.838E7	52	353387.543		
	Total	1.955E7	53			

Thus, we may interpret that, the borrowers who use the loan in the right way, i.e. they utilize it for the purpose of business for which it is sanctioned, differ from the ones who take the loan and use in the wrong way. Such borrowers do not realize the importance of financial discipline. These two groups differ with respect to amount of loan taken, difficulty in repayment and profit per month. It is obvious that the profitability differs for the two groups as the basic principle of finance suggests that the long-term capital should be used for long term investments only and it should never be used otherwise. This is a very important finding for the institutions engaged in micro finance activity. They measure the quality of their work in terms of installments repaid by the borrowers, but, what they actually fail to realize is that, the idea of micro financing is to make the borrower self sufficient. This also calls for the attention to the fact that the borrowers need to be trained in financial management of their businesses.

Further, the two groups of borrowers did not differ with respect to Educational Background, Type of Business and Financial Performance (in terms of cash available every month). This indicates that, the utilization of funds is not a function of type of business or availability of cash for repayment. There are people who have multiple source of income. They borrow from Microfinance institutions and repay the installments in time irrespective of the fact that they use the money for purpose it was given or not. They use the money as resource in their other businesses or for personal requirements. The micro finance institutions are not able to differentiate between the borrowers on the basis of their business sense. It seems to have become a habit of people to consider the micro –finance facility as a resort to fulfill the immediate requirement of funds and treat it as just another source of short-term funds. Further, there seems to be a gross misunderstanding among the people in terms of cash received and profitability. When asked about the financial performance, they measure it in terms of cash collected. They don't consider the expenses to be made, repayments to be done etc. This again highlights the need for financial training to the borrowers.

TABLE 5: MAN WHITNEY TEST STATISTICS FOR TWO VARIABLES

	Age of Business	Number of Installments repaid
Mann-Whitney U	126.000	161.000
Wilcoxon W	192.000	227.000
Z	-4.352	-2.113
Asymp. Sig. (2-tailed)	.000	.035
a. Grouping Variable: Whether the loan is used for purposed		

The Man Whitney test (Table 5) further confirms our observations.

The α level: $\alpha = .05$

Ho: There is no significant difference between the groups using loan for purpose and not for purpose in respect of Age of business and Number of installments paid.

$H_{1:}$ There is significant difference between the groups using loan for purpose and not for purpose in respect of Age of business and Number of installments paid.

Since the exact p value is less than the specified α level (.05) 0.035 < 0.05 .We fail Ho. Thus we have sufficient evidence to conclude that the two groups of people differ significantly with respect to the remaining two variables, namely, 'Age of Business' and Number of installments repaid. The average age of business and installments repaid is less for the group of people who don't use the loan for right purpose. This may be due to the fact that the when the micro finance activity started, people took it in right sense and used the loan for business purposes. But, with the passage of time, they realized that the micro finance institutions are not interested in their business, rather they are only concerned about the installment repayment. Therefore, many people started taking loans from these institutions and used them for whatever purpose they desired. Now, most of them had some other sources of income as well, so, they continued to repay the installments.

Thus, the findings of this research draw attention to a very serious problem creeping into the micro finance activity. The institutions need to take care that they select the borrowers very carefully, train them in financial management of business and evolve a mechanism for a continuous monitoring.

CONCLUSIONS

The main objective of micro finance activity is to alleviate poverty and generation of employment for those poor people who were excluded from formal financial services. But MFIs are defeating the main objective. MFI's financial health is sound because of excellent loan repayment rate but profitability status of micro businesses is not satisfactory. The main reasons are that, MFIs are not paying attention on educating the client on how to use loan amount in an effective and profitable way. Besides this, the owners of micro enterprises are not trained to understand the basic concepts of finance such as calculating profit of business and working capital requirement. Training in this aspect is must so that they can do the necessary financial planning for their business and can think ways for effective development of their business.

Training to micro entrepreneurs on prudent use of funds for business will definitely contribute in success of micro enterprise and ultimately success of micro finance. The clients using loans for other purposes are facing consistent loss or are able to just breakeven somehow. Micro finance institutions must develop proper check and balances for clients not using loan for purpose it is taken otherwise it will give rise to over indebtedness and increased consumption pose a threat to sustained livelihood. Proper check and balances will arrest other problems such as harassment of borrowers and suicides in case of non repayment.

Reckless borrowing will ruin both MFI clients as well as MFI in long term. Clients who are spending loan amount in fulfilling their social obligation or religious tradition, for them a proper training on how to use loan amount, should be imparted so that they can professionally bring equilibrium in their business needs and social needs. This training will ultimately contribute in the success of micro enterprises. Beside that it will improve quality of services provided by MFI.

Success of micro business is closely related to MFIs, so due attention must be given on client's economic upliftment beside their own financial success.

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