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MICRO-FINANCE AND MICRO ENTERPRISES – THE SIAMESE TWINS OF ECONOMIC WELFARE

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Abstract

One of the problems poor people in the rural and urban areas face is lack of capital. Formal banking procedures marginalize the poor borrowers out of the picture. Poor borrowers want small and uneconomic sums which are exposed to high risks through the eyes of the formal banking system. Shumacher's book on 'Small is Beautiful' observed the importance of small units. Economic participation has to be increased by opening a large number of small industrial ventures to provide employment opportunities and to achieve balanced regional development. The promotion of micro enterprises requires multi-faceted intervention which presupposes deeper understanding of the structure and composition of the micro enterprise sector and flow of finance.It is argued that micro-finance interventions and other financial services help low income people to improve household and enterprise management, increase productivity, smooth income flows and meet their consumption costs, enlarge and diversify their business as well as increase their incomes. Against this background, an attempt has been made to assess whether micro finance and micro enterprises have any influence on economic welfare of the target group or not. Also the study explored the credit gap, repayment behavior of borrowers as well as the problems faced by micro enterprises. Primary data were collected from fifty sample micro enterprise owners who have availed the loan from micro finance institutions and started their ventures. The results reveal that due to micro finance intervention and starting of micro enterprises, the owners were able to increase their wealth by means of increase in income, employment and asset creation. Also it is observed that majority (48%) of them availed the loan for business purposes. The overall demand and supply analysis shows that 74 percent of the total amount was contributed by the MFIs and the majority (54%) of borrowers reported that the required amount of loan was not sanctioned by the micro finance institution. Further, the majority of borrowers incurred borrowing cost such as transport cost, incidental cost and indirect cost between Birr 50 and 100 to avail the loan. The repayment behaviour of borrowers is quite encouraging. From the analysis it is concluded that Micro Finance and Micro Enterprises are moving hand in hand and ultimately they are likely to increase the standard of living of the poor people as well.

Prelude: Increasing welfare requires an enabling environment which includes food, shelter, employment, health services, financial services and education infrastructure. The most potent tool against human deprivation is building human capital among the weaker sections of the society, through sustainable development. In any developing society, self realization and self-initiative are the two most powerful weapons to improve the standard of living.

Credit is a powerful tool that can be used effectively when it is made available to the credit worthy among the economically active poor, participating in at least a partial cash economy – people with the ability to use loans and the willingness to repay them. Micro-Finance Interventions are well-recognized world over as an effective tool for poverty alleviation and improving socio-economic conditions of the poor. In Ethiopia (Horn of Africa) too, Micro-Finance is making headway in its effort to reduce poverty and also improve the welfare of the people.

The term Micro Finance refers to loans, savings, insurance, transfer services and other financial products targeted at low-income clients. In addition to financial intermediation many Micro Finance Institutions (MFIs) provide social intermediation services such as group formation, development of self-confidence, training in financial literacy and arrangement capabilities among the deprived sections of the society. Microfinance Services can help low-income people to reduce risk, improve management, raise productivity, obtain higher returns on investments, increase their incomes, and improve the quality of their lives and those of their dependencies. Hence Micro Finance is not only mere banking but it is a Development Tool also.

Participation of people in economic activity is imperative and it has to be increased by opening a large number of small ventures to provide employment opportunities and to achieve balanced regional development. Shumacher's book on 'Small is Beautiful' observed the importance of small units. The small-scale sector has a high potential for providing employment, promoting entrepreneurship and earning foreign exchange to the country. Hence even the developed countries try to promote small enterprises. Micro-Enterprises in Ethiopia are those business enterprises with a paid up capital of less than Birr 20,000 (National Currency) and excluding high tech consultancy firms and other technology establishments.

Many Micro - Enterprises help to keep people out of social exclusion and away from a dependency on benefits as well as contributing to local economic regeneration. For this reason, micro-enterprise development is often viewed as a holistic approach to development because it embraces poverty alleviation, human development and economic development strategies. The promotion of micro enterprises requires multi-faceted intervention which presupposes deeper understanding of the structure and composition of the micro enterprise sector and flow of finance. The entrepreneurial strength depends on factors such as calculated risk- taking ability, achievement motivation and willingness to work towards a goal in a time bound manner with commitment, initiative and problem solving attitude, systematic planning as well as ability to manage their double burden tactfully and skillfully. There is no denying the fact that the above factors are crucial but Micro Finance is a necessary condition for Micro Enterprise Promotion.

Objective of the Study : This paper is based on a research study carried out among sample beneficiaries who have availed the loan from MFIs and started Micro Enterprises in Mekelle Town, Ethiopia with the major objective of analyzing the importance of Micro Finance and Micro Enterprises in the economic welfare of the people. The specific objectives are

i) To find out the credit needs and the percentage of contribution by the Micro-Finance Institutions (MFIs) to develop the ventures

ii) To assess the other requirements, apart from the financial aspects, to develop the Micro-Enterprises

iii) To analyze the impact of Micro-Finance and Micro Enterprises in terms of employment creation, income generation and asset creation

iv) To scan the problems faced by the small enterprises

v) To suggest ways and means to improve the credit disbursement by the MFIs to develop the Micro Enterprises.

Hypotheses

i) There is no gap between credit requirement and credit sanctioned

ii) Micro Finance and Micro Enterprises did not have significant impact on economic welfare

iii) Micro Enterprises are not facing much problems in operation

Review of Literature : Various research studies in Ethiopia have been perused and some of them are presented in this paper. A study carried out by Chant (2003) reveals that Microfinance can potentially reduce women's vulnerability by helping micro entrepreneurs, diversify their sources of household income, increase their saving, expand their options for credit, and improve household money management. According to Asmelash (2004) as cited in Baviah (2007), MFIs had impact on housing improvements, on food security, on direct condition and improvement on ownership in rural areas, improving income, school enrolment and access to health facilities and general welfare improvement. Woldehanna's (cited in Baviah, 2007) study showed that there is positive impact on poverty reduction, improvement in income, assets and consumption levels in just five years and women are more food secure and less vulnerable to shocks than men. Findings of the research conducted by Checol (2006) in Northern Ethiopia reveal that the program has a positive impact that could be explained in terms of consumption smoothing, asset protection and asset accumulation.

Methodology : The study is a descriptive one, based on the Survey Method, encompassing primary data collected directly from respondents (Beneficiaries of MFIs) to justify the objectives. For the purpose of relevant data and inference, fifty sample units of Micro Enterprises were selected randomly. Data were collected with pre-tested interview schedule from the owners of sample units. The information about the loan amount and the address was collected from the Micro Finance Institution (Debit Credit and Saving Institution), Mekelle.

Analytical frame work : Collected data were classified into different categories for purposes of analysis such as a) Socio-Economic Profile of respondents which includes the characteristics – age, marital status, educational attainment and their monthly income, b) Description of their venture includes nature of the venture, credit needs, loan applied and availed from MFIs as well as credit gap and also the way in which they managed such gap along with borrowing cost and c) Impact of loan in terms of increase in income and employment, asset creation, improvement of status etc.

The statistical significance of the difference between two different mean values of parameters studied under the impact of loan was statistically tested. The difference in the values of parameters (i.e., increase in monthly income, generation of employment in man days and creation of household assets) were statistically tested with the following null hypothesis.

H_0: *There is no change in the value of studied parameters.*

(*i.e.* H_0: $\mu_1 = \mu_2$)

The alternate hypothesis was,

H_1: *There is difference between the two.*

(*i.e.* H_1: $\mu_2 > \mu_1$)

The level of significance used is one and five (i.e. α = 0.01 and 0.05.). The following formulae were used. Estimated Standard Error of difference between means,

$$\hat{\sigma}_{\bar{x}_1 - \bar{x}_2} = \sqrt{\left(\frac{\hat{\sigma}_1^2}{n_1} + \frac{\hat{\sigma}_2^2}{n_2}\right)}$$

Where $\hat{\sigma}_1^2$ = estimated variance of the distribution before loan

$\hat{\sigma}_2^2$ = estimated variance of the distribution after loan

Z – test was used to see the significance between differences of means since sample size is more than 30.

$$\text{Therefore } Z = \left| \frac{(\bar{x}_1 - \bar{x}_2)}{\hat{\sigma}_{\bar{x}_1 - \bar{x}_2}} \right|$$

The Z value was calculated and compared with the tabulated value at 0.05 level of significance, H_0 was accepted if $Z_{calculated} < Z_{tabulated}$ and was rejected if $Z_{calculated} > Z_{tabulated}$.

I : Socioeconomic Profile of the Respondents : The detailed analysis of the study reveals that 34 percent of the sample beneficiaries belonged to the age group of more than 40 years and 32 percent of them were between 31 and 35. Also it is evident that 60 percent of the sample respondents were male and remaining were female. This shows that male beneficiaries' availed micro finance more than female respondents. This may be due to the fact that male heads of households are the bread winners of the family.

The perusal of data also shows that of the 50 sample borrowers interviewed, 84 percent of them were married and remaining were unmarried. Among the married, 44 percent of them were having 4-6 children, 34 percent of them having 1-3 children and the remaining had more than six children. This brings to light that majority had to shoulder a large family size which might have compelled them to start small ventures to generate income. Further, majority (54%) of the borrowers attained primary education and only 24 percent of them were illiterate. It is pertinent to note that vast majority (70%) of the sample borrowers were below Birr 500 monthly income category. Twenty percent of the sample respondents were having a monthly income between Birr 501 and 1000. This indicates that the economic condition of the majority of borrowers was economically poor.

II : Venture Details: It is obvious to understand the different types of ventures for which loans were availed by the borrowers. This implies the borrowers' preference activities in the selected area and this has a socio-economic significance to the regional development. From the sample beneficiaries of Micro Finance, majority (48%) of them availed the loan for business purposes which included grain sales, vegetable vending, running of small restaurants and small kiosks. Twenty percent of them availed the loan for production purposes like wheat grinding and the remaining 12 percent took the loan for service activities such as carpentry work, welding shop and automobile workshop.

The Credit Needs Analysis shows that majority (56%) of the borrowers needed more than Birr 5000 for starting their venture and hence they applied for the same. This shows that the capital investment required to start small venture is more than Birr 5000. Only 44 percent of the total sample applied for less than Birr 5000 since their ventures were very small. They used the borrowed amount for small business such as vegetable sales and grain sales etc. It is inferred that the required amount to start the Micro Enterprises is more than Birr 5000. Hence it is recommended that the amount can be disbursed according to the required capital nature of the ventures.

Further, majority (54%) of the borrowers reported that the required amount of loan was not sanctioned by the Micro Finance Institution. This might be due to the maximum limit of loan size and inadequate value of assets holding. Only 46 percent of the borrowers obtained the loan as demanded by them. The overall Demand and Supply Analysis shows that 74 percent of the total amount was contributed by the MFIs.

An intensive examination of the responses reveals that among the 27 borrowers with inadequate credit, 22 of them recorded the credit gap of Birr 100 to 3000 and the remaining recorded inadequate fund between Birr 3001 and 6000. This insufficient amount was managed by other sources viz. own contribution and private loans. Micro Finance Institutions have been developed to wean away low income groups from money-lenders and to spur unconventional integration of huge financial market with the rest of the economy (Milkho Kaur et al. 2000). But in this study it is worthy of note that 46 per cent of the borrowers were also indebted to other financial sources. And only 30% of them managed their ventures by their own money. This shows that inadequacy in sanctioning of loan amount leads the beneficiaries to go for further loan from private sources with high interest rates and also unreasonable levels of indebtedness. It is inferred that in spite of continued credit support to the borrowers over the years by extending the functional coverage of institutional set up, there exists credit gaps. To reduce this credit gap, it is better to sanction the loan according to their demands.

One of the objectives of deployment of credit for the purpose of carrying out small ventures is provision of cheap credit with minimum borrowing cost. Hence an attempt has also been made in this regard to find out whether the sample borrowers incurred cost while availing the credit. Borrowing Cost refers to the expenditure incurred in availing loan from the Micro Finance Institutions by the borrowers. The borrowers in the study incurred a variety of expenses such as a) *Transport Cost* - The expenses incurred by the borrowers in undertaking journeys to the MFIs. This depends on the distance to the banks and the number of visits made by the borrowers. b) *Incidental Cost* – In order to get the loan from banks, the borrowers had to prepare some essential documents. Expenses on this and refreshment constitute incidental cost. c) *Indirect Cost:* The prospective borrowers often had to spend some days in preparing loan documents and meeting the officials concerned to secure loan assistance. During this process, they lost several man-days of employment if they were already employed. The wage earnings foregone by these borrowers for the man-days lost in securing loan, constitute indirect cost.

It is pertinent to note that 74 percent of the borrowers incurred borrowing cost for availing such loan. Among them, 22 percent spent between Birr 100 and 150 and 30 percent spent Birr 50 to 100 for the same purpose. This shows that the borrowers incurred cost in availing the credit from institutional sources, which in turn increased their burden of loan, along with actual interest payments. Therefore one of the most important corrective measures in the area of credit disbursement is to bring down the Borrowing Cost by simplifying the loan procedure and making it hassle- free.

It is also observed during the Survey that the borrowers did not carry out any Feasibility Study before starting such ventures. This indicates that because of their weak economic background, they applied for the loan without full-fledged knowledge about the success chances of their ventures. This might also be one of the reasons for receiving less incremental income. For instance, one woman beneficiary started a restaurant with the help of the availed loan from MFIs. But she was not able to run the business because of insufficient customers. To avoid such inconsistencies, the MFIs can also extend some sort of professional service in conducting Feasibility Analysis along with financial services. Only then the objectives of MFIs could be fulfilled.

The financing institutions should focus on creditworthy purpose rather than on credit worthy person; feasibility of the project than the availability or adequacy of security and the end-use of the credit, apart from the end-result of it (Muniraj, 1987). Use of credit for productive or unproductive purposes depends upon the nature of utilization of the credit. If the loan amount is utilized for productive purposes, it may generate its own means of repayment. But diversion of credit creates some major problems and ultimately restricts the repayment (Patnaik et al., 1999). MFIs are mostly engaged in providing credit facilities to the poor people for productive purposes. The philosophy behind such a lending is that the loan amount, if utilized for productive purpose for which the loan was demanded, will generate income sufficient not only to support the family but also to repay the loan installments. In other words, the utilization of loan for productive purpose has a direct bearing on the repayment behaviour of borrowers. It is quite likely that credit was availed by the needy people for meeting their consumption or social needs under the pretext of productive purposes. In the absence of incremental income from the investment, the borrower turns out to be a defaulter. A few divert the loan assistance to productive purpose other than the prescribed ones, expecting higher profit or due to lack of experience/skill in the scheme or inadequacy of loan amount for which the loan amount was sanctioned. Therefore an attempt has been made in this study to find out the utilization/misutilisation/diversification of loan availed by the sample borrowers. It is interesting to note that almost all the sample borrowers utilized their loan amount for the purpose for which they had availed.

Recovery is as important as advance for any financing institution. Timely recovery of loan not only keeps the business running but also benefits the borrowers by reducing the load of debt and keeping them eligible for getting fresh loan in future. It is therefore pertinent to examine the performance of the borrowers with regard to repayment. The study indicates that the repayment behaviour of borrowers was quite encouraging. This is due to the incremental income from the venture coupled with the follow up by the bank officials.

III. Impact of Loan on Income and Employment :

The financial assistance from the banks, when properly utilized, serves twin purposes. They yield a stream of income for the borrowers and also provide them with employment. Credit, as a catalyst, triggers a host of production activities, resulting in the creation of productive assets and generating incremental income, which in turn should enable the beneficiaries to plough back into the system. For this purpose, data on income of the sample borrowers before and after the loan were collected and analyzed. Income, in this instance, is defined as the net income received by the beneficiaries after the deduction of all business expenses, actual or notional, after payment of interest or repayment of loan installments.

The impact of the loan from the MFI shows that almost all the sample borrowers obtained incremental income from the venture even though the amount was not attractive. Only 20 percent of the sample respondents received an incremental monthly income of Birr 500 and above. Majority (60%) of the beneficiaries obtained an incremental income below Birr 300. This might be due to a reduced amount of investment and also majority of the ventures were involved in business. It would be necessary to drive home the fact that the rate of increase in post-loan income might have been higher in some cases either because of very high amount of post loan income or because of very low amount of pre-loan income or due to both factors.

One of the main objectives of the Micro Finance is to tackle the unemployment problem in the society by creation of employment opportunities. In order to find out the impact of loan on duration of employment, an attempt was made to compare the number of man-days of employment per month of the loanees in the pre loan period and the post loan period. It is noted that the establishment of new ventures created additional employment days between 16-30 days per month for 58 percent of the borrowers and remaining were benefited up to 15 days of employment per month. Micro Finance also generated employment not only to the borrowers but also to their family members and others who were associated with the activities of the beneficiaries. It is evidenced that 50 percent of the borrowers' family members obtained full time employment and 24 percent of the borrowers' family members obtained part-time employment. In addition to this, 21 per cent of the borrowers could give fulltime employment and 28 per cent could provide part time employment to the people outside the family. This shows that MF is a catalyst to create employment opportunity for the borrower, family members and others through micro enterprises which will reduce the unemployment problem in the economy. The significant result of the statistical analysis also confirmed these findings.

Micro Finance could play an important role in assisting the poor to build up their productive assets also. In the present investigation, 56 percent of the beneficiaries could create assets in different forms. It is noteworthy that 22 percent of beneficiaries could construct new houses (though it was small) and 10 percent could improve the structure of the houses, 16 percent of the sample could acquire electrical or electronic appliances and 8 percent could increase their land holding. It is inferred that MF and Micro Enterprises assist vulnerable households by allowing them to maintain their assets in a crisis also.

Micro Finance also allows people to smooth their consumption patterns over a period of time. The Survey brings to light the fact that 50 percent of borrowers improved their food habit because of establishment of Micro Enterprises. Others could manage their daily food without interruption. It is also reported by few respondents that the support from MFIs also increases children's nutrition and education. The Study found that 22 percent of beneficiaries could improve their children's education through the income from micro enterprise activities.

Microfinance is also seen as a possibility for enhancing self development and self esteem. This can happen in a number of ways and at many different levels. MFIs, by placing trust in their clients and treating them with dignity, can build people's confidence. Female clients could learn to become economically independent and both men and women could gain confidence by being supported to overcome severe setbacks and to work their way out of poverty. Majority of respondents opined that their confidence had increased after establishing the ventures.

The micro enterprise owners also faced some sort of shortcomings in running small ventures just like other enterprises. According to them i) poor access to business infrastructure, ii) low ability to acquire skills & managerial expertise, iii) lack of business premises at affordable rent, iv) lack of access to business information vii) irregular and erratic supply of raw materials (viii) stiff competition (ix) insufficient customers are the major problems faced by majority of respondents. These specific issues need appropriate interventions.

To conclude, Micro Finance stimulates micro enterprise development which triggers employment creation, income generation through efficient use of local resources, reduction in regional and social imbalances through credit based programs and improvement of the repayment ethics among borrowers. Microfinance is a highly useful tool that provides access to financial and non-financial services to low income entrepreneurs. It is not by itself, a 'magic ingredient' for poverty reduction. There is a need for close monitoring of the ongoing micro finance initiatives and suitable modifications or formulation of innovative and forward looking policies based on the ground realities of successful MFIs in Ethiopia. With the development of a commercial approach, the MFIs can become sustainable and help in achieving the single minded vision of alleviating poverty through providing financial services to the poor. The measures suggested in the Study would go a long way in further improving the operations of Micro Finance Institutions as well as Micro Enterprises. Hence it is concluded that Micro Finance and Micro Enterprises are the Siamese Twins in the process of Economic Welfare.

Policy Implications : The term 'Micro Finance' is considered as 'Social Banking' which refers to a policy of induced credit delivery by banks to economically weaker sections of the society to establish micro enterprises as identified from time to time. Following suggestions are made on the basis of findings of the Study to realize the objectives of MFIs and development of micro enterprises.

§ There is no denying the fact that Micro Finance is a necessary but not a sufficient condition for micro enterprise promotion. Other inputs like training, skill development, contact and communication skills and marketing skills are required especially in a market led approach for sustainable development of micro enterprises.

§ Special emphasis is needed in disbursement of finance to agri - allied activities such as mini dairy, poultry, sheep/goat rearing etc. which is the virgin area to be concentrated in Ethiopia.

§ The MF activities can also be demand - driven rather than supply - driven.

§ Need based loan should be given priority in the disbursement of loan.

§ Delay in the deployment of loan and the borrowing cost can be reduced by simplifying the procedures.

§ The unit cost may be fixed according to the nature of activity which may reduce the burden of borrowers who are compelled to avail additional loan from other sources.

§ Preparation of credit plans needs scrutiny so that all bankable activities based on local resources availability are included in the credit plans.

§ SHGs have proved to be very effective in many developing nations. Possibilities should be explored to adopt them on a larger scale in the urban areas also.

§ Group based lending system can be adopted to promote the entrepreneurial development. In this regard, NGOs can be involved in the lending, monitoring and follow-up action.

§ Among the borrowers, there is an emerging gap between credit needs and credit supply and unless the gap is reduced, the social momentum of the objective may be affected adversely.

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Table 1 : Socio – Economic Description of the Sample Respondents

1. Age-wise Distribution

25-30	31-35	36-40	41<	Total
08 (16 %)	16 (32%)	09 (18%)	17 (34%)	50 (100%)

2. Sex-wise Distribution

Male	Female	Total
30 (60 %)	20 (40%)	50 (100%)

3. Distribution on the basis of Marital Status

Single	Married	Total
08 (16%)	42 (84)	50 (100)

4.Distribution on the basis of Education

Illiterate	Primary	Secondary	Total
12 (24%)	27 (54%)	11 (22%)	50 (100%)

5.Distribution on the basis of Number of children

Nil	1-3	4-6	6<	Total
07 (14%)	17 (34%)	22 (44%)	04 (08%)	50 (100%)

6.Distribution on the basis of Income

Up to 500	501-1000	1001-1500	1501-2000	2001<	Total
35 (70%)	12 (24%)	-	01 (02)	02 (04)	50 (100%)

Source : Primary data

Table 2 : Venture Details

1.Types of Venture

Production	Service	Business	Total
10 (20%)	06 (12%)	24 (48%)	50 (100%)

2.Credit Needs

Up to 5000	5001-10000	10001<	Total
22 (44%)	12 (24%)	16 (32%)	50 (100%)

3.Credit Gap

Up to 3000	3001-6000	6001-9000	9001-12000	12000<	Total
22 (44%)	17 (34%)	03 (06%)	05 (10%)	08 (16%)	50 (100%)

4.Amount Sanctioned According to the Demand

Yes	No	Total
23 (46%)	27 (54%)	50 (100%)

5. Management of Inadequate Fund

Own Contribution	Private Loan	Total
15 (30%)	23 (46%)	38 (76%)

6.Borrowing Cost (in Birr)

< 50	51-100	101-150	151-200	Total
11 (22%)	15 (30%)	11 (22%)	-	37 (74%)

Source : Primary data

Table 3 : Impact of Loan

1.Increase in Monthly Income (in Birr)

Up to 100	101-200	201-300	301-400	401-500	>500	Total
12 (24%)	08 (16%)	10 (20%)	03 (6%)	07 (14%)	10(20%)	50 (100%)

2.Increase in Employment (Man days)

Up to 15	16-30	Total
21 (42%)	29 (58%)	50 (100%)

3.Additional Labours Employed

Full-time	Part-time	Total
21 (42%)	14 (28%)	35 (70%)

4.Family Labours Engaged

Full-time	Part-time	Total
25 (50%)	12 (24%)	37 (74%)

5.Assest created after loan

New House	Improvisation of the Structure of house	Change in land holding	Electrical/Electronic appliance	Total
11 (22%)	05 (10%)	04 (08%)	08 (16%)	28 (56%)

6.Improvement in Status

Economic	Social	Food Habit	Education for children
31 (62%)	31 (62%)	25 (50%)	11 (22%)

Source : Primary data