MICROFINANCE IS A NON-PRODUCTIVE AND EXPENSIVE SOURCE OF BORROWING: A CASE STUDY OF DISTRICT SARGODHA (PAKISTAN)

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HIGHLIGHTS

- According to the results microfinance productivity is negative due to small loan size and high cost of borrowing.
- The major three factors of livestock productivity are the amount of interest rates, milk production and feed cost which are responsible to make efficient use of loan amount in its productivity.
- The productivity of the borrowing amount for large farm size was positive which is three times greater as compared to the microfinance for small farm size.
- The main reason for the high productivity of livestock financing in large farming is its large economies of size.
- Replacement of dilapidated equipment with modern equipment is one way to increase productivity in an organization.
- Productive capacity is a basic characteristic of large farm size and loan productivity depends on productive capacity.
- The study concluded that the microfinance banks in Pakistan have no significant impact on the productivity of livestock farming.

ABSTRACT

The study examines Pakistan’s microfinance institutions’ performance and checks the productivity of microfinance institutions. For this purpose primary data was collected from a sample of 260 respondents from 6 microfinance banks in Sargodha District. This paper examined the livestock sector and the impact of microfinance on livestock productivity. According to the results of the role of microfinance was non-productive due to the high cost of borrowing, small loan size, high feed cost and use of the loan in a non-productive term. According to the results microfinance productivity is negative due to small loan size and high cost of borrowing. While the productivity of borrowing amount for large farm size is positive which is three times greater as compared to small farm size. So results showed that the efficiency of production increase through large scale farming. Small loan size and high cost of borrowing is a basic cause of negative microfinance productivity. Small loan size is not benefited for investment because the loan amount is unable to meet the basic requirements at the farm level for the increase in productivity of livestock farming. The main reason for the high productivity of livestock financing in large farming is due to its economies of size. Replacement of dilapidated equipment with modern equipment is one way to increase productivity in an organization. Large loan size decreases the inefficiency in input costs. The major three factors of livestock productivity are the amount of interest rates, milk production and feed cost which are responsible to make efficient use of loan amount in its productivity. Productive capacity is a basic characteristic of large farm size and loan productivity depends on productive capacity.

Keywords: Microfinance; livestock, productivity; Sargodha; Pakistan.

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Introduction

Microfinance, also known as microcredit, is a financial service that offers loans to poor’s, small business owners who don't have access to traditional sources of capital. The goal of micro-financing is to provide individuals with money to invest in themselves or their business. The major objective of
offering microfinance to small farmers in livestock by
the micro-financing intuitions in Pakistan is to stop the
exploitation of the poor caused by costly informal
credit and to offer facilities to provide small loans to
poor at a comparatively lower cost. One of the main
features of a microcredit institution that distinguishes
it from other commercial institutions is that it provides
an alternative to informal lending; In fact, security is
not required; There are simpler processes and less
documentation; mostly group loans; simple and
flexible repayment plans; Financial support for group
members in case of emergency; The most vulnerable
segments of the population are targeted, as well as
group interactions with each other. At present, one of
the main problems arising in the process of economic
growth and development is to fight against poverty.
Poverty is a multifaceted phenomenon that includes,
but goes beyond, insufficient income. In many
countries, the main goal of development has been to
eliminate all aspects of poverty.

The concept of microfinance is a very effective
tool in developed countries but if and only if the prime
objective is to facilitate the poor segment of the
society and if we deviate from this objective then
results are very dangerous like the poor segment of
society will become poorer and move towards hunger
and starvation. The stark reality is that the poorest
people in the world still lack access to sustainable
financial services such as credit, savings, and
Insurance. Most developing countries including
Pakistan offering financing services to an only minor
segments of the population. The majority do not
receive credit from any financial institutions. Several
studies have attempted to examine the role of
microfinance on poverty alleviation and income
generation by using different methodologies. Imai et
al. (2010) showed a positive impact of microfinance
on household’s poverty reduction by using national
household data of India. Berhane & Gardebroek et al.
(2011) showed that borrowing causally increased
consumption and housing improvements. According
to Mahmood et al. (2016) microfinance had been
playing an important role in poverty reduction and
improvement of the living standard of people in
developing countries, like Pakistan. Positive
assessment of the microfinance contribution towards
poverty reduction has convinced many individuals,
governments and NGOs to put efforts in supporting
microfinance institutions and their activities (Dunford,
2006). Microfinance is a simple solution to
poverty reduction (Rena et al., 2006). The demand for
microfinance is growing day by day, particularly in
underdeveloped countries due to the increasing rate of
poverty (Bhatt et al., 2001). Westover (2008) failed to
find a direct link between microfinance programs and
poverty reduction.

Microfinance does not apply to the poor (Scully,
2000) or to the fact that the poor are deliberately
excluded from microfinance programs (Simanowitz,
2002). The criticism of microfinance raises some
criticism: first of all, the very poor often prefer not to
participate in microfinance programs because they
lack confidence or they consider loans too risky. The
poorest of the poor, the so-called Poor indigenous
people, are usually too risky to take credit for future
investments. Second, indigenous poverty is often not
accepted by other group members in group lending
programs because they are considered as bad credit
risk (Mosley and Hulme 1998). Thirdly, employees
of microfinance organizations may prefer to leave the
main poor, since lending is considered extremely risky
for them. Finally, microfinance critics have doubts as
to whether this has a positive effect on women. Studies
showed that women were more reliable and have
higher wage rates. Besides, women spend more on the
education and health of their children (Pitt and
Gupta, 1996). Various microfinance NGOs did
not meet the needs of the poor for loans because of the
high cost of lending programs (Henry, 2004). The
current study underhand is conducted to check the
impact of microfinance on livestock productivity.

Methodology

This study is based on primary data collected by
the pretested questionnaire. The primary data was
collected by a direct interviewing technique from 260
active clients of 6 microfinance institutions. These six
microfinance institutions include Khushhali
Microfinance Bank, Mobilink Microfinance Bank,
Telenor Microfinance Bank, U Microfinance Bank,
First Microfinance Bank and Finca Microfinance
Bank in Sargodha district. Selected loan size is
Rs.100000 and livestock farmer/investor purchases
one animal against this loan. The questionnaire is
distributed among the sampled responded and the data
collection process was completed in 5 working days.
The sample of the study consists of both male
and female respondents within the age group as per
standard average loan eligibility declared by selected
microfinance institutions. All selected respondents
predominantly engaged in agricultural activities
especially linked with livestock farming. The simple
random approach was used to select a sample for data
collection. The data was collected by a simple random
sampling technique and all microfinance institutions
in the study area had an equal chance of being
selected.
Cost of Borrowing

The total charge taking on a debt obligation that can involve interest payments and other financing fees.

Formula: \[ \text{COB} = I + DC + IC + TC + WTC \]

- \( I \) is the rate of interest
- \( DC \) is the documentation Cost
- \( IC \) is the insurance Cost
- \( TC \) is the traveling Cost
- \( WTC \) is the withholding tax cost

Cost of Purchased Animal

Cost = Feed + Vaccination + Opportunity cost of labor + Opportunity cost of land (per year)

Output of Purchased Animal/ Rate of Return

Output = Milk in liter (per year) x Market Rate

Rate of Return

Rate of return is the amount of profit on an investment over a specific time, expressed as a proportion of the original investment. The time period is typically one year, in which the rate of return is referred to as annual return.

Net income from investment = Output of animal or rate of returns – Cost of business

Results and Discussion

Some economists pointed out that small loan size is just supportive of income not for generating income and borrowers are unable to increase the standard of living in the long term. During the collection of primary data, it was observed that people were not interested in productive terms due to inefficient use of borrowing amount. It’s also observed the money shortfall and repayment shortage was the main cause of clash in home and social structure. According to the opinion of sampled borrowers, the employee’s behavior of microfinance institutions was very harsh for recovery. Collected data showed another picture of poverty in decreasing income level and savings because 128 respondents out of 260 repay the loan from the savings.

According to the results shown in table 1 microfinance productivity is negative due to small loan size and high cost of borrowing. Furthermore, the values explained output (milk) in a litter is 2403 and the market rate is 63.3 rupees but on the other side input cost (feed, vaccination, and land, labor) is very high. It is observed that small loan size and high cost of borrowing is a basic cause of negative microfinance productivity.

Table 1: Annual Productivity Analysis of Microfinance for Small Farm Size

| Activity                                      | Average Values (Rs) |
|----------------------------------------------|----------------------|
| Net Interest Rate                            | 30.19%               |
| Feed Cost (Per Year)                         | 100639               |
| Vaccination Cost (Per Year)                  | 4722.22              |
| Opportunity Cost of Land (Per Year)          | 1900.37              |
| Opportunity Cost of Labor (Per Year)         | 12838.9              |
| OutPut (Milk) in LTR (Per Year)              | 2403                 |
| Milk Sale Rate in Market                     | 63.3                 |
| Productivity (Output-Cost)                   | 31543.88             |
| Productivity of Borrowing Amount             | -676.6               |
| (Net Interest Rate – Productivity of Project)|                      |

Source: Author’s calculations

Small loan size is not benefited for investment because the loan amount is unable to meet the basic requirements at the farm level for the increase in productivity of livestock farming.
Table 2: Productivity Analysis for Large Farm Size

| Activity                                      | Average Values (Rs) |
|----------------------------------------------|---------------------|
| Net Interest Rates                           | 11.5%               |
| Feed Cost (Per Year)                         | 77986.1             |
| Vaccination Cost (Per Year)                  | 4911.11             |
| Opp Cost of Land (Per Year)                  | 1611                |
| Opp Cost of Labor (Per Year)                 | 19600               |
| Output (Milk) in LTR (Per Year)              | 2907.33             |
| Milk Sale Rate in Market                     | 62.8                |
| Productivity (Output-Cost)                   | 78442.36            |
| Productivity of Borrowing Amount (Net Interest Rate – Productivity of Project) | 66942.36 |

Source: Author’s calculations

According to results given in Table 2 productivity of the borrowing amount for large farm size is Rs. 66942.36 which is three times greater as compared to small farm size. So results showed that the efficiency of production increase through large scale farming.

The main reason for the high productivity of livestock financing in large farming is due to its economies of size. Replacement of dilapidated equipment with modern equipment is one way to increase productivity in an organization. Large loan size decreases the inefficiency in input costs. The major three factors of livestock productivity are the amount of interest rates, milk production and feed cost which are responsible to make efficient use of loan amounts in its productivity. Productive capacity is a basic characteristic of large farm size and loan productivity depends on productive capacity.

Conclusions

According to the results microfinance productivity is negative due to small loan size and high cost of borrowing. While the productivity of borrowing amount for large farm size is positive which is three times greater as compared to small farm size. So results showed that the efficiency of production increase through large scale farming.

Small loan size and high cost of borrowing is a basic cause of negative microfinance productivity. Small loan size is not benefited for investment because the loan amount is unable to meet the basic requirements at the farm level for the increase in productivity of livestock farming. The main reason for the high productivity of livestock financing in large farming is due to its economies of size. Replacement of dilapidated equipment with modern equipment is one way to increase productivity in an organization. Large loan size decreases the inefficiency in input costs. The major three factors of livestock productivity are the amount of interest rates, milk production and feed cost which are responsible to make efficient use of loan amounts in its productivity. Productive capacity is a basic characteristic of large farm size and loan productivity depends on productive capacity. Because in the existing microfinance sector of Pakistan the maximum loan size is 50000 to 100000 rupees. This small amount of loans in the livestock sector is unable to make productive contributions to the livestock sector. The absence of government intervention in this sector is very alarming for our livestock growth because the institution’s policies move towards its own profit maximization rather than poverty reduction through microfinance.

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