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Factors Affect Microcredit's Demand in Pakistan

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Abstract

The purpose of this study is to find out the factors which affect demand of micro credit in Pakistan. Microfinance institutions (especially NGO's) are providing the services of microcredit, savings and insurance to poor people in Pakistan. The main purpose of microcredit loan is to reduce the poverty and for empowering the women mostly in developing countries. Data has been collected through questionnaire, descriptive research and interviews from Microfinance Banks and some of their clients. Credits are not available to the farmer on time in rural areas and very high interest rate is charged on loans. So there is great potential of Micro Financing. According to the research data, it is concluded that there are many factors which may affect the demand of microcredit. These includes the interest rate, relationship between lenders and borrower, government policies, gender differences, credit worthiness of borrower, transaction cost, limited access to credit, economic condition and the availability of information. This helps in analyzing the barriers which creates hurdle for borrower and lender for operating microcredit in country. So microfinance institutions have to take under consideration about the factors which may effect in the demand of microcredit.

Keywords: Microcredit, Pakistan, Demand

Introduction

It is believed that the idea of giving loan to poor is wastage of money. However, poor households required financial services to save their selves from financial crisis, sickness and they were concerned with maximization of saving, decreased risk of loss and high interest rate. The proper financial mediators like commercial banks usually were less helpful for these domestic poor people because of two reasons. First, their business form was commonly unsuitable for a microfinance business. Second, conventional lending is based on collateral. One of the main reasons for the people in developing countries to remain poor was due to unavailability of credit.

The concept of microfinance started gaining importance in 1980s. These programs were introduced in various developing countries during the past ten years. After the 1974 when the Yunus introduce the Grameen bank model, Micro financing emerged as a viable way to reach the needy and poor people. The borrower arranged in a group and the each member of the group acts as a granter for the repayment of loan. Group based liability and the regular repayments make the micro credit feasible without the collateral (Chaudhuri, n.d). The purpose of micro financing is only to provide the capital to poor people and reducing the

poverty level. The purpose is to create such institutions which provide the financial services to those people who are not capable to gain the formal loan (Otero, 1999). The interest rates charged on the microcredit loans is higher than other loans. This happens because the credit services provided are for small sums of money and the cost of these small loans makes the interest on them very high (Fernando, 2006).

Major determinant which affect the access of credit is the distance of bank from the borrower who live in remote areas (Bakhshoodeh & Karami, 2008). Demand of Loans is higher in those districts where the literacy of female is high and more agricultural labor (Chaudhuri, nd). The factors which have an impact on the demand of credit are the relationship between the lender and borrower, economic condition, government policies, gender differences, the purpose of use of micro credit, transaction cost etc. This study is held to critically examine the factors which have an influence on demand of micro credit in Pakistan.

Literature Review

Micro finance: Micro finance includes wide range of facilities of services to poor such as savings microcredit and the insurance (Chakravarty & Shahriar, 2010). Microfinance institution provides the small loan to poor people who are disqualified for the formal loan (Morduch, 1999).

According to Conroy (2002), Micro finance is the wide range of provision of financial services included services of payment, accepting deposits, lending loans transfer of money and insurance to low income and poor people. Whereas the two terms such as micro enterprises and micro credit financing include the value of borrowing as well as savings. Microfinance is the whole field whereas the other two terms are specifically related to provision of credit (Maria, 2004).

Micro credit: Micro credit can also be called micro lending it can be defined as “A very small loan given to poor people for helping them to be self-employed”. It is given to poor ones for increasing the living standard of loan taker by investing it in income giving activities (Fernando, 2006).

The main characteristics of micro credit are: These loans are too small, no collateral required, mostly have weekly payments, short term such that less than one year loan, it is mostly for the women and poor people who are not eligible for borrowing the formal loan. In micro credit, the interest rates are high due to high micro credit program running cost (Nawai, 2010). This rate can be reduced by reducing its high-cost operation by innovation, efficiency and by enhancing market competition (Fernando, 2006).

Micro financing institutions: With the passage of time the number of banks and financial institutes entering in the market of micro financing (Delfiner & Peron, 2007). With the increase in competition the banks need to find the niche and does something change then the traditional operations (Delfiner & Peron, 2007). The idea of microfinance institution suggested by then Muhammad Yunus, his purpose is to eliminate the poverty from his country Bangladesh. In 1983 he initiated the Grameen bank, it is the first institution which used this concept and started micro financing in proper way (The Norwegian Nobel Committee, 2006).

In developing countries different NGOs and government are using the micro finance as an instrument to reduce the poverty (Llanto, 2003). The basic purpose of micro credit is to provide the money to low income people and the poor to use it in activities of businesses and also for improving their life standards (Nawai, 2010). They act as the financial intermediaries like the formal banks. The main difference between the MFLs and the formal banking is that formal banking focus on rich client and the MFIs focus on poor client (Nawai, 2010).

Institutes provide the services of microfinance in Pakistan:

- NRSP(NATIONAL RURAL SUPPORT PROGRAME) MICROFINANCE BANK;
- Kashaf Foundation;
- First Microfinance bank;
- Khushhali Bank;
- Akhuwat foundation.

Factors Affect the Demand of Micro Credit

Interest rate: The interest rate on microfinance credit should be calculated on the base of these combinations of costs:

Interest rate = Administration cost+ Cost of capital+ Cost of default (Johnson, 1997).

Poor people and the females are mostly more sensitive to price than other people. Due to decreasing the interest rate increase the demand of loan by the poor and the females (Karlan & Zinman, 2008). Policy makers expressed that caps in interest rate may reduce the access of poor people to financial services (Helms & Reille, 2004).

According to Helms and Reille (2004), the poor people consider more important to the ongoing concern on credit than the actual cost of credit. The interest rates charged on the microcredit loans is higher than other loans. This happens because the credit services provided are for small sums of money and the cost of these small loans makes the interest on them very high (Fernando, 2006). Mostly the Microfinance lending institutions in the region charged the nominal interest rate from 30-70% a year (on the basis of reducing balance). Because of fees and commission charged by the micro finance institutions, the effective rate of interest is high. Other factors which affect the interest rate are the repayment frequency of loan, system use for collecting the repayment and the necessary deposit required for getting the loan raises the effective rate of interest (Fernando, 2006). If the interest rate is low it increases the depth and range of accessibility of funds affordable for the poor households (Fernando, 2006).

Limited access to credit services and non-availability of information: According to Von Pischke and Adams (1980), lack of access to credit by those areas where poor rural households are living have negative impact for agricultural and nonagricultural output creation and for the benefit of family circle (Diagne & Zeller, 2001). The rural poor have usually little knowledge about from where to get credit for their output actions. Another problem is that if the farmer will know that where they get credit and the formal credit sources, then the high interest rates and complicated terms of these such loans depress the farmers and others. Major determinant which affect the access of credit is the distance of bank from the farmer who live in remote areas far from the bank make the less access to credit (Bakhshoodeh & Karami, 2008). Due to lack of entrance of credit information, the range of the scared market by existing financial institutions is large. This gap of incomplete information for credit is a main hurdle by providing social capital through its peer screening effects, peer monitoring effects and the peer security effects (Ajani & Tijani, 2009).

Transaction cost: The transaction cost is another hurdle for the poorer to getting loans. The growth of sound microcredit or microfinance policies highlight the path of a better approach to solve the incapacitation of the poor in rural and poor areas to move out of deficiency. The high interest rate and the high transaction cost have a difficult task for the farmers in those areas where information not send immediately and properly, that's why the

farmers and others that they not getting loans for their work. The transaction cost includes the boring and lengthy paper work, practice loan process connected with formal loans (Foltz, 2004), securities risk (Boucher et al., 2007), incomplete information, the political reasons (Zander, 1994) and also the accessibility of formal credit institutions. (He, 2007) have been recognized as these are important obstacles for the demand of the formal credit markets.

According to Rosenberg, Gonzalez and Narain (2009), although the interest rate is the main issue while discussing the microcredit, and it received the more attention, but it is not the only cost which the poor have to face. It is necessary to give attention to other cost such as the borrower's transaction cost which contain the transportation cost, time spend away from their own business and the badly impact of delay in getting the loans. These cost are mostly less quantifiable but are my taken in consider by the borrower while deciding where to obtain the loan. So the interest rate is not the only one factor which affects the access and demand of micro credit loan.

Economic condition: The economic factor includes various factors which are inflation, Market condition, demand and supply factor and business environment and consumer behavior. These are those factors which create problem in getting loans. Health, temporary usage requirements like weddings and debt/income ratio for the previous year considerably affects the chances of being credit controlled.

Hashemi and Morshed (1997) show in their study that the Grameen bank should not only condensed poverty and enhanced benefits of participating but also superior the household capacity to continue their gains over time. Kamal (1996) noted that the maximum increase in per capita income is due to microcredit program. Thus demand side factors are mostly linked to the income, education, health, profession and asset. The supply-side factors are associated to the cost of credit where the distance to the adjacent bank, output of the crops (minimizes doubt of refund), future share of credit (policy-driven) and weather characteristics.

Gender differences: Demand of Loans is higher in those districts where the literacy of female is high and more agricultural labor (Chaudhuri, nd). The male receivers of loan mostly take the loan to expand their currently running business such as poultry farm and retail shop etc where as the female take the loan to start new business. But the increase in income is recorded as expanding the existing business as compare to starting the new one. Generally access of microcredit proved the opportunity for the poor people specially the landless households and the female, to invest this in income generating activities. It also provides the self-employment opportunity to improve the economic condition of country (Taj et al., 2008).

Microcredit is one of the most effective technique used for reducing the poverty between the poor people to become the self-employed specially for women, because most of them are not allowed according to social customs looking for the wage employment (Khandker, 1998; Shaw, 2004). One of the social barriers in development of equitable enterprises and economy is the "gender discrimination". For involvement in the economic activity it is necessary to create the gender equality (Heyzer, 1987). Overall the access to microcredit is increased by the landless household and females (Taj et al., 2008).

Creditworthiness: Trustworthiness and creditworthiness are nearly synonyms. The purpose of financial intermediaries is not only providing the money but also establishing the confidence on the borrower's skill of using the money in effective way and also paying back the principle plus interest rate to lender after the achievement of his investment projects (Becchetti & Conzo, 2009).

Derban et al (2005), founded that the demand of credit can be affect by the creditworthiness of borrower in such a way: first, inherent borrower's characteristic and his business may make doubtful in repayment of loan. Second, the features of the financing institutes and the appropriateness of the product providing to borrower, it also help in determining whether the borrower can repay the loan or not? The third and last one is the systematic risk which can come from external factors such as environment of business, economic and political in which borrower operates. The act of lending institutions, of conferring the confidence has not only private but also has the social effect too. This relationship perceived as a strong bond in which the lender's trust contributes towards the trustworthiness of the response of the borrower, it is the bond which helps in creating the mutual trust between the lenders and borrowers. If the borrower has a good experience with the microfinance institutions, it helps in creating the trust of relatives and friends of borrower on micro-financing institutions (Becchetti & Conzo, 2009).

Government polices: The barrier in the development of micro enterprises include lack of particular procedures of law and administrative, limited access to the micro credit institutions, lack of skill development opportunity and imperfect market information (Census of Establishment and Enterprise 2005). The policies of government such as the aim for the generating the employment, skill and training, it become the major tool for helping the poor people to become beneficiaries of micro credit (Delfiner & Perón, 2007). According to Helms and Reille (2004), the government should have to expand the scope of financial sector by promoting the innovation, transparency and the competition through the suitable regulatory and legal framework and polices of consumer protection.

Hypothesis

H0= The microcredit demand is not affected by different factors.

H1= The microcredit demand is affected by different factors.

For testing the above hypothesis, different statistical test are applied on gathered data through a sample survey.

Theoretical Framework

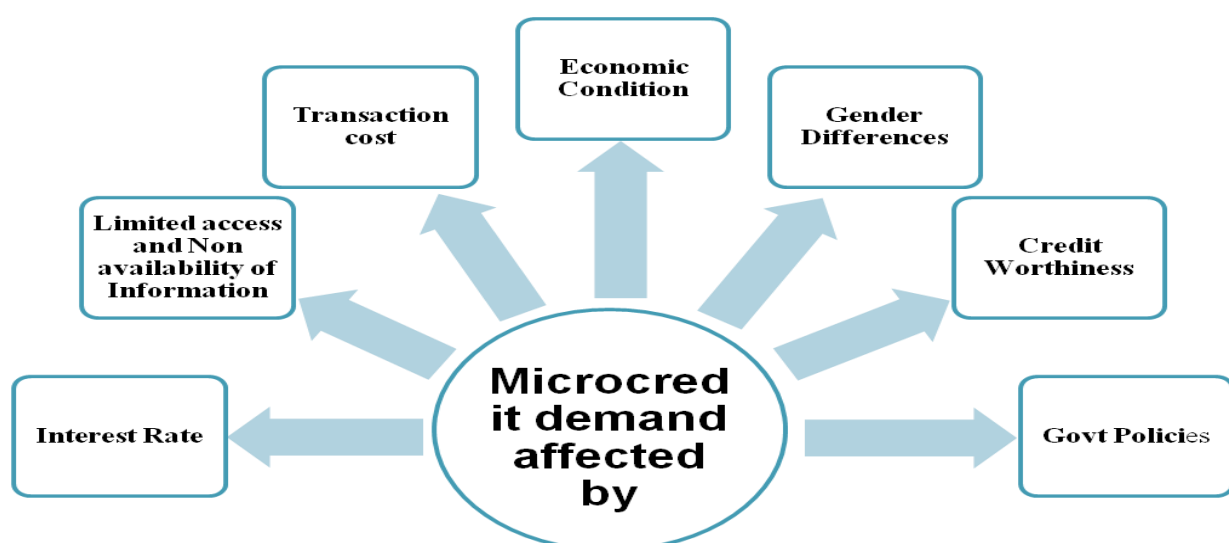


Figure 1.

Findings

Table 1

Results

Variables	N	Mean	Std. Deviation	Variance
Interest Rate	50	4.36	.663	.439
Limited access and Non Availability of Information	50	4.24	.981	.962
Transaction Cost	50	3.78	1.093	1.196
Economic Condition	50	3.48	.995	.989
Gender Difference	50	2.84	1.267	1.607
Credit Worthiness	50	3.92	.986	.973
Govt. Policies	50	3.98	.845	.714

Results & Discussion

This report is about the analysis of the factor which affects the demand of microcredit. In it, Questionnaires are filled from clients of different microcredit institutions and check the results. Details of these calculations are given below:-

First variable is Interest rate. Here results are interpreted on the basis of three values:- Mean S.D and Variance. Mean value is 4.36, S.D 0.663 and Variance is 0.439. There is inverse relationship between interest rate and demand of microcredit. Increase in interest rate cause decrease in demand of microcredit. 2nd variable is Limited access and Non availability of Information. Mean value is 4.24, S.D 0.981 and Variance is 0.962. There is strong negative relationship between Limited access and Non availability of Information and demand of microcredit. Increase in Limited access and Non availability of Information cause decrease in demand of microcredit. 3rd variable is Transaction Cost. Mean value is 3.78, S.D 1.093 and Variance is 1.196. There is negative relationship between Transaction Cost and demand of microcredit. Increase in Transaction Cost cause decrease in demand of microcredit. 4th variable is Economic Condition. Mean value is 3.48, S.D 0.995 and Variance is 0.989. There is positive relationship between Economic Condition and demand of microcredit. Better and good economic condition cause increase in demand of microcredit. 5th variable is Gender Difference. Mean value is 2.84, S.D 1.267 and Variance is 1.607. There is weak negative relationship between Gender Difference and demand of microcredit. Gender Difference causes a little variation in demand of microcredit. 6th variable is Credit Worthiness. Mean value is 3.92, S.D 0.986 and Variance is 0.973. There is positive relationship between Credit Worthiness and demand of microcredit. More the Credit Worthiness of institution more the demand of microcredit. 7th variable is Govt. Policies. Mean value is 3.98, S.D 0.845 and Variance is 0.714. There is strong positive relationship between Govt. Policies and demand of microcredit. Good Govt. Policies causes increase in demand of microcredit. Therefore accept **H1**. Result shows that Demand of microcredit is affected by above factors in Pakistan.

Conclusions

Microfinance institutions are providing the services of microcredit, savings and insurance. The main purpose of microcredit loan is to reduce the poverty and for empowering the women mostly in under development countries. It is concluded that there are many factors which may affect the demand of microcredit by the borrowers. These includes the

interest rate, relationship between lenders and borrower, government policies, gender differences, prospective, credit worthiness of borrower, transaction cost, limited access to credit, economic condition and the availability of information. Microfinance institution provides the small loan to poor people who are disqualified for the formal loan. Micro finance is the wide range of provision of financial services included services of payment, accepting deposits, lending loans transfer of money and insurance to low income and poor people. At the end, we conclude that the basic purpose of micro credit is to provide the money to low income people and the poor to use it in activities of businesses and also for improving their life standards. There are different factors like interest rate, economic condition, credit worthiness; non availability of information, gender difference and govt. policies etc affects the demand of microcredit in Pakistan.

Recommendation

- The loan amount is too small it could be increase to fulfill the requirements of the farmers and other people.
- The interest is too high that's the main reason the farmers and other people discourage to getting loans so, and it could be reduced.
- Government should have to establish specialized microfinance institutes, to reduced operating cost.
- Organizations should expand their branches for regular information.
- Specialize banks should be open to reduce the transaction cost.
- Loan borrowing procedure should be easy because in many research paper the loan lending procedure is to lengthy that, many farmers and others people is not fill it so, it could be easy.
- Factors which decrease the demand of microcredit borrower should be given attention to reduce their negative effects.
- Microfinance programs also reach to the poorer persons also.

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