



Full Length Research Article

ROLE OF MICROFINANCE IN THE GROWTH OF RURAL ENTERPRISES

***Fiasorgbor A. Doris and Accrachie Samuel Samed**

Faculty of Development Studies, Presbyterian University College, Ghana, Akuapem Campus

ARTICLE INFO

Article History:

Received 26th May, 2014
Received in revised form
21st June, 2014
Accepted 10th July, 2014
Published online 31st August, 2014

Keywords:

Microfinance,
Rural Enterprise,
Growth,
Walewale

ABSTRACT

Traditionally, micro financial institutions have targeted the poorest of the poor. In promoting social uplifting through providing microfinance services, micro financial institutions have achieved tremendous results which are unprecedented in development cooperation. Commercial banks generally do not serve the needs of the rural poor because of the perceived high risk and the high transaction costs associated with small loans and savings deposits. The principal aim of the study was to assess the effect of microfinance on rural enterprises in the Walewale community. The sample size is seventy-eight (78) people from the target groups. All the 78 client and staff respondents were selected within the Walewale township. The findings of the study suggest that the beneficiaries were engaged in varied economic activities such as food processing, petty trading, tailoring etc. Overall, the respondents expressed satisfaction with their increased working capital as a result of participation in the schemes. There is no denying the fact that the effect of microcredit on small and medium enterprises in Walewale is remarkable. The findings of the study had confirmed most of the earlier studies undertaken into the operations of microfinance institutions.

Copyright © 2014 Fiasorgbor A. Doris and Accrachie Samuel Samed. This is an open access article distributed under the Creative Commons Attribution License, which permits unrestricted use, distribution, and reproduction in any medium, provided the original work is properly cited.

INTRODUCTION

Microfinance is the provision of financial services to low-income clients, including consumers and the self-employed, who traditionally lack access to banking and related services. Microcredit, or microfinance, is banking the un-bankables, bringing credit, savings and other essential financial services within the reach of millions of people who are too poor to be served by regular banks, in most cases because they are unable to offer sufficient collateral. In general, banks are for people with money, not for people without (Littlefield, 2003). Traditionally, micro financial institutions have targeted the poorest of the poor. In promoting social uplifting through providing microfinance services, micro financial institutions have achieved tremendous results which are unprecedented in development cooperation. Access to financial services has empowered and improved the lives of millions of micro financial institutions clients (Ackerly, 1995). Worldwide, entrepreneurs have benefited greatly from the improved access to finance. However, notwithstanding the importance of financial services, developing sustainable small enterprises also requires access to non-financial services. For small enterprises to grow and flourish, they need entrepreneurial competencies and access to markets.

Research and experience indicate that access to business development services greatly enhances small businesses' performance, in an economic as well as in a social and environmental sense (Kabeer, 2001)

Just like other countries, small and medium scale enterprises in Ghana have the ability to be a source of livelihood to the poor, create employment opportunities, generate income and contribute to economic growth. Despite its increasing roles, access to credit by small and medium scale enterprises remains one major worry. Another major worry is how effectively this credit is being used when they are accessed (Murdoch and Haley, 2002). Small and medium scale enterprises have been accepted worldwide as the engine of economic growth and for promoting equitable development. The major advantage of the sector is its employment potentials at low capital cost. The labour intensity of the SME constitutes over 90% of total enterprises in most of the economies and is credited with generating the highest rate of employment growth and account for major share of industrial production and exports (Simanowitz and Brody, 2004), and the rapid expansion of small enterprises in economies of developed countries in the 1980s and 1990s has created a generally accepted belief that small and new ventures are the most important source of entrepreneurship and as a dynamic and innovative factor, they contribute directly to economic growth. In Ghana, the need for micro-finance is high as the demand for credit to start small

***Corresponding author: Fiasorgbor A. Doris**

Faculty of Development Studies, Presbyterian University College, Ghana.
Akuapem Campu.

and medium scale enterprise by the poor people, but efforts to deliver formal credit and financial services to the rural poor in developing countries have failed over the years ((Navajas *et al.*, 2000). Commercial banks generally do not serve the needs of the rural poor because of the perceived high risk and the high transaction costs associated with small loans and savings deposits. In order to make amends many governments have tried to deliver formal credit to rural areas by setting up special banks or directing commercial banks to loan to rural borrowers. However, these programs have almost failed because of the political difficulty for governments to enforce loan repayment, and because the relatively wealthy and powerful, rather than the poor, received most of the loans (Adams *et al.* 1984). In Ghana, credit has been recognized as an essential tool for promoting Small and Micro Enterprises (SMEs) (Morduch, 1999). More than half the percentage of the population is engaged in the informal sector or in agricultural production, small and rural enterprise inclusive. The principal aim of the study was to assess the effect of microfinance on rural enterprises in the Walewale community.

MATERIALS AND METHODS

The study area

The study was carried out in the West Mamprusi District of the Northern Region of Ghana. The West Mamprusi District is one of 45 new districts created in 1988 under the Government of Ghana's decentralization and local government reform policy. Carved out of the old Gambaga District in the Northern Region. The districts' administrative capital is Walewale, which lies on the Tamale-Bolgatanga trunk road, approximately 68 miles away from Tamale. District is predominantly rural with more than 75% of the population living in rural settlements with population less than 2000. Even though the district is a predominantly agrarian economy, there is an amount of micro-scale industrial activities, which people engage in so as to aid and promote their general wellbeing. Generally all entrepreneurs provide their own initial investment capital

(<http://www.ghanadistricts.gov.gh/districts/?news&r=6&=90>) The district being predominantly a farming one, the main source of finance may be through credit facilities but access to this is also very discouraging since only 30% of people who seek for credit hardly get access to it. The problem is with security for the loans and the interest rates. With some people also taking loans and not being able to pay back scares them from going for loans. The practice has also limited their chances to all kinds of loans passing through the Community bank. Walewale town was purposively selected for the study. The area is the largest town in the district and has a number of micro financial institutions (WCIC, 2014). The sample size is seventy-eight (78) people from the target groups. All the 78 client and staff respondents were selected within the Walewale Township. The sample comprised MFIs staff (8), petty traders (15), micro and small scale manufacturers (10), hairdresser (10), dressmakers and tailors (15), food vendors (10), wholesalers and retailers (10). Two sampling techniques were used for the study; the client sample of 70 respondents and 8 lender respondents or MFI staff. The first of the two sample methods used was to select the client respondents. A list of clients from all the micro financial institutions in the Walewale district who use loans collected for small business was

acquired. The list was divided into different groups based on the enterprise they were engaged in. The names were put on pieces of paper, each name to a piece of paper. The names were then placed in bowls based on the enterprise they are engaged in. The names were then selected from each bowl using the lottery method of the simple random sampling technique. For the MFI staff the random sampling method was used. Employees were picked at random for the study using the random sampling technique so as not to be bias. Interviews were conducted on clients and staff of micro financial institutions in order to get some important documents and reference materials. Two structured interview guides were also administered to the staff and clients of micro financial institution living in the study area. This was done by identifying SMEs that benefit from MFIs and MFIs that give out loans to SMEs in Walewale. To get all data into compatible format, all responses from respondents were grouped taking into consideration the items that demanded those responses. In effect, there was manual and electronic analysis of data. Manual analysis was mainly editing and coding of responses. With regards to the electronic analysis, the SPSS was used.

RESULTS

Demographic Characteristics

The results indicate that out of a total of 78 participants (clients), sixty five (65) were females and five (5) were males, representing 83% and 17%, respectively. The age composition showed that 40% of the respondents were between 20 to 39 years of age, 31% were also between 40 to 49 years old, while 23% were between 50 to 59 years and only 6% were age sixty (60) and above. The level of education of the participants was essentially low. About 42% of the respondents had no formal education, 31% had basic level education, 23% had secondary education while only 4% had tertiary education.

Types of economic activities by MFI Clients

In the Table 1 below it is indicated that out of the seventy (70) beneficiaries of microcredit schemes in the Walewale community, 21% were Food vendors, 20% were engaged in hairdressing, 18.5% were engaged in multiple economic activities, 17% were petty traders, 16.5% were tailors/dressmakers and 5% were in the other artisans (blacksmiths, masons, carpenters, plumbers etc.) category.

Table 1: Activities of Rural Enterprises in Walewale

	Type of business	Frequency	Percentage
Valid	Food vendors	15	21
	Hairdressers	14	20
	Multiple economic activities	13	18.5
	Petty traders	12	17
	Tailors and dressmakers	11	16.5
	Other artisans	5	7
	Total	70	100

Access and Use

Credit by definition is a liability and therefore in order for it to be beneficial it must be a means to generating income. Thus, it is not only the access to micro-credit that is of importance to the businessman/woman; rather, it is the productive use of it that would translate it to a thing of benefit (Ackerly, 1995). In this study, 72% of the respondents had taken loans up to three

times; 22% had taken loans between four and six whereas 6% had received loans between six and ten times.

Loans Size

As compared to loans from commercial banks, micro-credit loans are very small loans to poor individuals as a way to spur entrepreneurship and a means to earn an income. The majority (95%) of the participants have taken up to GH¢ 200.00 as their first loans. The first time loans were generally considered by most of the clients as too small. The prospects of getting larger loans were dependent upon repayment of preceding loans; this served as a motivation to repay loans on time.

Repayment Practices

With regard to repayment it was found out that the vast majority constituting 90% repaid the loans they took from the MFIs because it later served as a prerequisite for qualifying for subsequent loans. The staff also indicated that repayment of loans may be effected by daily instalments, weekly or monthly depending on the type of business a client is engaged in. These arrangements are made in such a way that clients are able to efficiently pay back all loans. At the time of the study, most participants (65%) were repaying their loans every week, 30% repaid on bi-weekly basis while a minority of 5% repaid on monthly basis. When the issue of delayed repayment schedule came up, respondents emphasised that when repayments delay, one of these three is done. Firstly, the client would be contacted through phone in which he/she is reminded of the indebtedness. Secondly, the client would be paid a working visit and thirdly, a strong worded letter would be written serving notice of demand. According to Tackie (2004), these are all part of the conventional measures in place to deal with defaulting clients.

Effects on rural enterprises

The beneficiaries indicated that they significantly improve or expand their businesses which led to increased ability to meet basic needs and wants as well as make investments and acquire property. In order to measure the effect of micro-credit on business performance, four variables such as working capital, profit, and investment were assessed. The analysis revealed that there was a significant upsurge in the economic empowerment. Microcredit has meaningfully enhanced the working capital of the rural businesses. About 71% of the respondents were initially working with capital less than GH¢100.00. However, after connection with microcredit, about 59% have surpassed this sum. The study found that a significant proportion of about 78% of the participants faced the problem of inadequate or lack of working capital as their major economic constraint until they became clients of microfinance institutions (MFIs). The ability of the respondents to purchase raw material was meaningfully improved due to their access to microcredit. A large number of businesses (57) said they could not stock their shops in time for customers to be able to get whatever they wanted from their business units. However, after accessing microcredits; 62 rural business owners indicated that they could buy most of the necessary materials/stock their customers needed. Similarly, before access to microcredit, only five (5) out of the fourteen (14) hairdresser respondents were able to purchase about 87% of the chemicals and materials they needed for their work.

There was also significant improvement in the ability of the petty traders to purchase goods for sale. Out of the twelve (12) traders who before participating in the schemes could only purchase up to GH¢100.00 worth of goods per month for sale, eleven (11) could now do more purchases. Similarly, only three (3) of the seventy (70) respondents could initially purchase goods worth more than GH¢500.00 per month. After participation, thirty seven (37) of the respondents could purchase in excess of GH¢1000.00 worth of goods per month. Two (2) of the respondents were able to make purchases worth between GH¢ 2000.00 and GH¢ 5000.00 every month. Overall, there was significant improvement in the ability to buy more goods, thereby substantially improving the turnover of businesses following participation in the micro-credit program. While two (2) of the respondents did not improve their turnover, about twenty nine (29) had up to 100% increases. Another twelve (12) of the respondents had turnover increases between 150% to 400%, while four (4) also had increases above 400%. In terms of personal income, the results indicate that out of seventy (70) respondents, only fifteen (15) previously made a weekly income of more than GH¢100.00.

Following participation in the microcredit, over fifty two (52) respondents were able to make weekly income in excess of GH¢ 100.00. The participants significantly improved their incomes by about 65%. Participation in the micro-credit schemes also allowed the rural businessman/woman to cultivate savings culture through personal savings. The results indicate that members of the MFIs required individual accumulated savings for at least twelve weeks before participants could receive their first loans, while some of the schemes required that members paid 10% of their first loans as compulsory savings. The MFIs, in addition encouraged optional savings during the repayment periods. This action indicates the savings capacity of the rural poor, which could contribute to their empowerment in coping with financial crisis. Nonetheless, out of 16 respondents who indicated that they were making some savings prior to their participation in the scheme only three (3) saved at commercial banks, while eleven (11) made use of 'susu' with friends and another two (2) saved at home.

Challenges

Expanding outreach to the poor is held back by the sparsely located geographical positions of the needy areas. Most of the rural communities in the poverty ridden places are isolated and unreachable making it nearly impossible for formal and rural banks to be located near them. In such situations, only non-governmental organisations, microfinance institutions and credit union associations are able to help. However, these are also constrained by inadequate resources and since outreach requires investment in both human resource and logistics such as transport and offices it is difficult for them to reach out to those in the poor and isolated areas. Sustainability of programme impact on clients could be hurt because there is no link between microfinance institutions (be it NGOs, Credit Unions or Rural banks or the government) to establish solid links between them and formal financial institutions such that beneficiaries can graduate successfully into the mainstream banking for constant access to financial services.

DISCUSSION

Demographic Characteristics

More than half of the respondents fell between the active working age group of 20 to 49 years. This is the age bracket in which people are more likely to seek employment and consolidate their positions. Also, it is clear that the clientele of MFIs in Walewale are mostly female (83%) this is in consonance with the findings of Akyeampong (2002). On education it was found out that majority of the microfinance clients (42%) had no education. This observation may suggest that the various micro-businesses they are engaged in do not require high levels of education. However, Simanowitz & Brody (2004) indicate that sometimes, the level of a business person's formal education is an advantage to the running of the entity. Also, this may explain why the design of micro-credit requires limited paper work thereby making it appropriate for the poor with low educational background.

Economic activities of MFI Clients

The findings of the study suggest that the beneficiaries were engaged in varied economic activities such as food processing, petty trading, tailoring etc. However, the majority of the beneficiaries were food vendors/processors who were mostly women. This supports the findings of Ranjula and Fan (2009) who stated that women make up approximately 80% of reported microfinance clients.

Access and Uses

The fact that the majority of the MFIs clients as at the time of this study had taken loan up to three (3) times is an indication of not only their ability to repay (and manage) loans but also shows a kind of commitment that the Walewale businesses make towards repayment schedules since regular repayment and ability to pay back are important pre-requisite for repeat loans. Besides reflecting the relative benefit derived from the scheme may also result from the micro-credit being the only available source of financial services, in part because they are not able to graduate out of micro-credit to the level where they can access formal financial services from the commercial banks; this is an issue that may necessitate further research.

Loan repayment practices

In contrast to bank debt contracts, the microfinance contracts found in the study area required that repayments start nearly immediately after loan disbursement and occur weekly thereafter. Repayment was done daily, weekly, bi-weekly or monthly in equal instalments. However, majority of the clients repaid their loans because repayment ensured that they could always get loan from the MFIs in future.

Effects on businesses

Overall, the respondents expressed satisfaction with their increased working capital as a result of participation in the schemes. They explained that buying inputs on credit as a result of the lack of working capital was very disempowering, in part because they are usually unable to negotiate better prices and conditions. For the women in the sample, the

absence of a permanent business structure or a reliable collateral security meant that buying inputs on credit is a real problem because the few suppliers dare give them goods or do so at very high prices which negatively affect their profit margins. The respondents also noted that access to working capital made it possible for them to choose who to buy goods from and thereby reduced their over-dependence on wholesalers and retailers. They viewed empowerment as a process involving regaining bargaining power and expanding their choice of where and whom to purchase inputs from. All the MFIs clients agreed that MFIs had helped them to cultivate the habit of saving because of the "susu" method used. Clients noted that even though MFIs are in for profit, their activity has helped them to polish their literacy skills. This finding matches what Christen, Rhyne and Vogel (1994) found in their respective studies. It was seen that those studies that adult literacy programme run for some of the women has helped them to answer telephone calls, write messages and are able to keep accounts on their business transactions. No doubt, the responses on the educational levels of clients shows that some of them did not have formal education but with the activities of the MFIs they are now literate.

Conclusion and the way forward

There is no denying the fact that the effects of microcredit on small and medium enterprises in Walewale. The findings of the study had confirmed most of the earlier studies undertaken into the operations of microfinance institutions. Again the findings confirmed that MFIs in Walewale use procedures and processes which are used by many micro financial institutions, and also methods of ensuring repayment of loans, monitoring and training systems among others. Also, the effects of microcredit on SMEs had been highlighted. It was seen that MFIs had a large female clientele as against male even though their activities were not solely targeted at women. But when it is looked at in the context of typical microfinance operations, the female dominance would not be out of place, since most of the literature reviewed concerned women economic empowerment through micro finance. On the whole impact, constraints, challenges and how to deal with the constraints and challenges were basically the same as earlier studies in the developing world particularly that of Ghana and Tanzania. In view of the challenges above, it is recommended that since micro-credit could help the growth of rural enterprises, there is a need for government and other institutions to support the creation of an enabling environment for the future development of the sector.

The government should remove institutional and regulatory obstacles and provide incentives to microfinance institutions that meet established standards for delivering financial services to rural businesses. Efforts should be made to encourage the NGOs and credit unions that have wider outreach to most of the un-bankable areas in the country by removing restrictions on their operations. For example, the NGOs are restricted by the current Financial Institutions (Non-banking) law 1993 (PNDC Law 328) from providing savings services in the un-banked areas (GoG, 2004). An alternative institutional framework that allows sound financial NGOs, credit unions and other community-based intermediaries to obtain a licence to offer deposit services to the general public and obtain funds through apex organizations, without endangering the integrity

of the financial sector may be needed. Also, in order to sustain programme impact on clients, there is the need for credit institutions (whether, NGOs, Credit Unions or Rural banks or the government) to establish a solid link between them and formal financial institutions such that beneficiaries can graduate successfully into the mainstream banking or into individual credit for continues access to financial services.

REFERENCES

- Ackerly, B.A., 1995. "Testing the tools of development: credit programmes, loan involvement and women's empowerment", in "Getting Institutions Right for Women in Development", IDS Bulletin, Vol.26, No.3
- Adams, D. W. and Pischke, J. D. V. 2005. Fungibility and the design evaluation of agricultural credit projects. *American Journal of Agricultural Economics*, 62(4),719-26.
- Adongo, M. (2009). Factors influencing access to credit facilities in Apac District. Accessed on 13th November 2009 from <http://hdl.handle.net/123456789/1432>.
- Akyeampong, K. 2002. Microcredit for African women. Accessed on 13th November 2012 from <http://www.modernghana.com>
- Bartels, K. 2003. Microfinancing is imperative for nation's development Accessed on 2th November 2012 from www.ghanaweb.com/GhanaHomePage/NewsArchive/artikel.phpcweimpactrevu1oct01.pdf (accessed 29 September 2004).
- Government of Ghana, 2004: Strategic framework for the Micro-finance Sector in Ghana. Accra: Ministry of Finance and Economic Planning Government of Ghana 2014: Ghana Districts. Accessed 24 April 2014. http://www.ghanadistricts.gov.gh/districts/?news&r=6&_=90. <http://ci-c-walewale.blogspot.com/p/profile-of-west-mamprusi-district.html>
- Kabeer, N. 2001. Conflicts Over Credit: Re-Evaluating the Empowerment potential of Loans to Women in Rural Bangladesh. In: *World Development*, Vol. 29, No.1 pp63-84, 2001
- Khandker, S. R. 1998. Fighting poverty with Micro credit: experience in Bangladesh. New York: Oxford University Press.
- Littlefield, E. and Rosenberg, R. 2004. Microfinance and the poor. *Journal of Development Economics*, 78(2).
- Littlefield, E., Murdoch, J. and Hashemi, S. 2003. Is microfinance an effective strategy to reach the millennium development goals? Focus Note Series no. 24. Washington: CGAP -Consultative Group to Assist the Poor.
- Mahammoud, M. 2006. Government loan for women is just chop money. Accessed on the 13th December 2012 from <http://www.ghanaiian-chronicle.com/thestory.asp?id=927223.02.06>
- Malielegaoi, T.S. 1998b. The 1998-1999 Budget Statement. Minister of Finance, Government of Samoa, june. Accessed on 1st November 2012 from
- MkNelly, B. and McCord, M. 2001 "Credit with Education Impact Review No. 1: Women's Empowerment" Freedom from Hunger, available from <http://www.ffhtechnical.org/publications/pdfs/>
- Murduch, J. and Haley, B. 2002. Analysis of the Effects of Microfinance on Poverty Reduction, New York University Wagner Working Paper, No. 1014 (Hull, Quebec, Canadian International Development Agency
- Navajas, S., Schreiner, M., Meyer, R.L., Gonzalez-Vega and Rodriguez-Meza, J., 2000: Microcredit and the poorest of the poor: Theory and Evidence from Bolivia. In *World Development*, Vol., 28 No.2.Pp 333-346, February, 2000.
- Otero, M. 1999. Bringing developments back into microfinance, *Journal of Microfinance*. 1(1), 8-19.
- Oti-Boateng, P. and Dawoe, E. 2005. Transformation of microfinance Schemes from Subsistence living to Small-scale enterprises: Analysis of policies that affect the technological capabilities of small and medium scale enterprises in Ghana. Paris: UNESCO
- Ranjula,, B.S. and Fan Yang, W. (September 2009) Does microfinance empower women Evidence from self-help groups in India, 'International Review of Applied Economics' Vol. 23, No. 5, 541– 556, [http:// pdfserve.informaworld.com/595379_758077589_913075296.pdf](http://pdfserve.informaworld.com/595379_758077589_913075296.pdf).
- Robinson, M. S. 2002. The Microfinance revolution: Sustainable Finance for the Poor. Washington D.C: World Bank Office of the Publisher.
- Schein, E. H. 2004. Organizational culture and leadership. San Francisco: Jossey-Bass
- Simanowitz, A and Brody, A. 2004. Realising the potential of microfinance, *Insights*. 51, 1-2.
- Tackie A. M. 2004. Ghana country paper on gender poverty reduction and enterprise development. Paper presented at a workshop on strategy for West Africa on gender, poverty reduction and enterprise development at Akosombo
