
GROWTH AND DEVELOPMENT OF SMALL BUSINESS THROUGH MICROFINANCE ACTIVITIES IN NEPAL

*Chandra Prasad Dhakal, PhD**

Abstract

Small businesses play important role for economic development and stability. It develops access in financial services through enhancing economic activities. The study analyzes the growth and development of small businesses that enhance through the support of micro finance in Nepal. Descriptive and inferential were used to collected data and collected data were analyzed through using multiple linear regression analysis. Only 124 small business owners were selected for this study. The study helps to find out the growth of microfinance institutions (MFIs) and small businesses in emerging economy in Nepal. It also assists MFIs to assess the effectiveness of their services and help to efficient utilization of available resources in the economy of Nepal.

Keywords: Growth, small Business, Microfinance Institutions (MFIs), Entrepreneurs, Nepal

Introduction

Micro finance play important role to enhance small business in Nepal. Growth and development of small business is inevitable for the overall economic development of nation. Carpenter (2001) notes, "The growth and sustainability of them, however, many small businesses are unable to grow due to lack of financial support and assistance from financial institutions". Small businesses have no access to Bank for economic supports. These institutions have taken loan from the non-bank financial institutions like the microfinance institutions. Microfinance institutions play a vital role to growth small businesses through the provision of insurance, education, training on financial literacy on working capital management, records keeping, repayment schedule and inventory management. These activities help small businesses to reduce the risk. Thus, there can be seen significant contributions of MFIs towards the growth of small businesses.

In the context of Nepal small businesses like dairy, pickle making, tea shops are established in support of micro finance institutions. Role of micro finance is valuable to develop small businesses in Nepal. The study also highlights the importance of micro finance institutions in the sense assisting to assess the effectiveness in growth small businesses. The study focuses on the effective utilization of available limited resources leading to growth of businesses, and contributes to the relationship among micro finance institutions and small business growth. The paper includes five sections like reviews literature discusses the methodology used for the study, results and discussions, concludes the study.

* Assistant Professor of Saraswati Multiple Campus (Humanities Faculty: Economics Department), Tribhuvan University, Nepal.

Literature Review

Theoretical Review

Microfinance is a system that distributes small loans to poor people in order for them to generate income and start their own small businesses (Lapenu & Zeller, 2001). Correctly point out that this kind of keenness for microfinance rests on an appealing win-win proposition that: The poor lack access to institutional finance institutions, such as banks, because they are unable to provide collateral and the rules and regulations to get loans is too complicated to understand for the uneducated poor (Roy, 2003). Many stake holders in the microfinance industry especially donors and investors argue that, "Microfinance can pay for itself, and must do so if it is to reach very large numbers of poor households" (Murphy, 2006, p. 32). Given the assumption that microfinance is already beneficial to the poor, the "win-win" proposal further assumes that the amount of household poverty reduced is directly comparative to the number of households reached with microfinance (Murphy, 2006). But some of the previous literature has reported that there was no any contribution of microfinance for poor people. It also is stated that a number of studies found that several microfinance programs did not help the poorest, as is so often claimed (Coleman, 2006). Though, many literatures and practices also had shown the positive impact of microfinance to change the life of poor people Microfinance is a development tool that grants or provides financial services and products such as very small loans, savings, micro leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses. Microfinance activities help to mobilize rural savings and have simple and straightforward procedures that originate from local cultures and population easily understand (Germinis, 1991).The lack of financial power is a contributing factor to most of the societal problems. These problems emanate from poverty and it is clear that with poverty one is bound to suffer so many consequences ranging from lack of good health care system, education and nutrition.

Small Business in Nepal

History of small businesses institutions is long in Nepal. It had begun from the time of ancient time. Kautilya mentioned the Nepali product and Nepali small business industries and its product in his book economics. However, Nepali ruler began the small business industries during the time of Rana regime. Nepalese arts and crafts industry and the entire home based industries in general suffered a great deal due to the general liberal import policy of the government. Prior to the establishment of British regime over India and entering a peace treaty with Tibet in 1904 AD, Nepal was interpreted as the main route to Tibet for external trade with other countries. Nepal also enters into the age of industrialization. Small businesses are generally operated from home. This can have an adverse impact on the home environment, depending on the enterprise (e.g. poultry raising, wool carding, chemical dyeing, welding, furniture repairing). Small businesses tend to be more profitable entities because of the non-valuation of family labor and reduced overhead. In developing countries like Nepal, small businesses are one of the most viable options to create employment opportunities and consequently to reduce poverty. These enterprises are not regulated under the various industrial acts of Nepal, although they are generating significant income and local employment and are often ignored by the government.

Small businesses are the starting point of development in the economies towards industrialization.

However, these businesses have their significant effect on the income distribution, tax revenue, and employment, efficient utilization of resources and stability of family income. The contribution of small businesses to employment, growth and sustainable development is now widely acknowledged (UNCTAD, 2001). Their contributing to job creation and output growth is now widely accepted in both developed and developing countries. It can also help to achieve a more equitable distribution of the benefits of economic growth and thereby help alleviate some of the problems associated with uneven income distribution. Small businesses cover a diverse group of businesses from small shop that make handicrafts for a village market to sophisticated engineering firms selling in overseas markets (Fischer & Reuber, 2003). There are numerous definitions for small businesses based on size, turnover, activity, ownership and legal status in Nepal.

Microfinance Services

Micro Loan

Dhakal and Nepal (2017) talk about the microloan and define, "Micro loan is an important aspect of microfinance and it has been described as the premise of microfinance institutions". Micro loan is lunched to small enterprises or individual business owners over a period of time. In the context Nepal up to ten Lakh is noted as the loan for small businesses. The amount of the loan can be launched by the micro finance by using fast track. Nepal Rastra Bank monitors such organization in accordance to the micro finance act and banking act of Nepal.

Micro Savings

Micro savings includes part of business incomes given to micro financial institutions or bankers on daily, weekly or monthly basis that are accumulated to bank account. Commercial banks have the mandate to mobilize micro savings; however they have not fully entered rural markets and the informal sector. The microfinance institutions take care of the micro savings needs of the small businesses in the rural and informal market to help save, invest and grow the businesses. Micro finance institutions help to improve the poor household finance, and protect low-income economic agents to accumulate worth for some period that can be used in profitable investment or other important purposes (Dhakal, 2018).

Micro Insurance

According to Oscar and Abor (2013), this type of product is very important since it insures microfinance client's activities. Fauster (2014) defines micro insurance as a low value product that requires different design and distribution schemes like premium that is based on community risk rate. Microfinance institutions integrate insurance with client's credit and savings activity so that it reduces credit risk on loans (Oscar & Abor, 2013). Micro insurance covers life, health, property or agricultural products and other valuable items of business owners. The services of micro insurance decrease risk. The low income clients buy insurance products to safeguard their assets against theft and fire, and also protect them against accident and ill health. Micro insurance enables the poor and low-income earners to insure their assets and operations against any disaster, and also helps small businesses to safeguard their resources that enable them to manage risks and avoid debts.

Education

Microfinance provides financial educational services through handling training for the clients. It helps to improve the activities of small businesses through efficient utilization of resources, inventory management and enhancing accounting methods. The microfinance education usually takes maximum of 30 minutes in relevant areas to enhance and empower Entrepreneur's literacy. The accounting or financial literacy can help business owners or managers to make sound and objective decisions on finance that can help grow their businesses (Sarpong-Danquah, Gyimah, Poku & Osei-Poku, 2018). Most of the microfinance educational services are modified towards utilization of micro credit and other social services which is aimed at improving the working capital and the social lives of the beneficiaries to increase productivity.

Empirical Review

Various scholars and researchers studied about the growth of small business through support of micro finance. For instance, Fauster (2014) investigated the impact of MFIs on the growth of small businesses and the result indicates that microfinance products or services have positive impact on sales of small enterprises. The result also shows that loan has negative impact to the performance of small enterprises.

Microfinance Institutions (MFIs) also offer a wide range of monetary services, such as savings and insurance options (Premchander, 2009). It is also expensive and time overwhelming for banks to deal with small-scale clients (World Bank, 2009). As a result, MFIs started to share out loans to the poor because banks would not (World Bank, 2009). Furthermore, many microfinance programs use the group-based format. MFIs give loans to members only, thus keeping the group unit intact (World Bank, 2009). The impact of microfinance transcends the geographical boundary of a region or a country; it has universal ramifications. It has been a universally accepted fact that microfinance activities are hugely successful in alleviating poverty. Many policy makers these days are contemplating on making microfinance everlasting and increasing the domain of its access. The overall essence in this argument is that unless microfinance providers charge enough to cover their costs, they will always be restricted by the scarce and uncertain supply of subsidies from governments and donors. The inherent postulation in this argument suggests at the ubiquitous necessity of microfinance for poor and needy as it has already been proven a huge success around the globe. The "win-win" situation both for the investor and the poor can be explained as follows: The investor in microfinance programs follows good banking practices with the possibility of some profit, while the poor continue to benefit by accessing reliable credit that is assumed to be beneficial to their welfare (Zuberi, 2011). The supporters of the "win-win" proposition stress (mostly by assumption) that the capability to repay loans by the poor is a good indicator that whatever investments the poor make with their micro credit loans must be giving back profits (Okibo & Makang, 2014). The efficiency of microfinance in reducing poverty in fact has been broadly and meticulously debated over the last few decades. On one side are researchers insisting that microfinance has strongly optimistic impacts.

Methodology

The study is based on quantitative analysis to examine the linkage between microfinance and small business growth and development in Nepal. The study uses primary data and employs structured questionnaire to obtain favorable and accurate response from 124 small business owners of different areas of the country by using random sampling method. The study tests the correlation among the variables, ANOVA, and uses multiple linear regression models for the available data. The multiple regression models are used to examine microfinance effects on the growth of SMEs in Nepal. The model is presented as:

$$GWTH = \alpha + \beta_1 MLOAN + \beta_2 MSAVI + \beta_3 MEDUC + \epsilon \quad \dots\dots\dots(1)$$

Where:

GWTH	= Growth in sales
α	= Constant
β	= Slope of regression line
MLOAN	= Micro loan
MSAVI	= Micro savings
MEDUC	= Micro education
ϵ	= Error term/Stochastic term

The independent variables were measured using the five point Likert scale from 1 to 5. Finally, the study tests three hypotheses and they are as follows:

- i) Hypothesis related to micro loans:
H₀: Micro loans do not have any influence on the growth of small businesses.
- ii) Hypothesis related to micro savings:
H₀: Micro savings have no influence on the growth of small businesses.
- iii) Hypothesis related to Micro education:
H₀: Micro education does not influence the growth of small businesses.

Findings

Descriptive Statistics and Correlations

Table 1 shows the descriptive statistics and correlations among the variables used for the study. From Table 1, micro loan has the highest effect on the growth of business with the highest average score of 3.86 and standard deviation of 0.69. The implication is that the growth of small business depends mostly on loans. Micro savings offered by micro finance institutions record an average score of 3.54 and standard deviation of 0.84. The result also indicates that, the savings made by entrepreneurs or business owners help them to accumulate funds that are ploughed back to business operations or other profitable investment. Micro education records an average score of 2.08 and standard deviation of 0.96. The result implies that some business owners agree educational services contribute to the success of their business, others assert otherwise.

From Table 1, the correlation result indicates that there is a strong positive correlation between microloan and small business growth due to high r-squared value of 0.81 and correlation is significant ($p < 0.01$). Also, micro education shows significant ($p < 0.05$) positive correlation with growth at r-square value of 0.61. Moreover, the result shows that there is high positive significant correlation between micro savings and small business growth ($p < 0.05$; r-square = 0.54). The correlation result reviews that micro loan, micro savings, micro insurances and micro education has significant effect on growth of small business because the significant levels are all less than 0.05.

Table 1. Descriptive statistics and correlations (N=124)

Variables	Mean	S.D.	1	2	3	4	5
1 GWTH	3.75	0.78	1.00				
2 MLOAN	3.86	0.69	.72**	1.00			
3 MSAVI	3.54	0.84	0.54**	0.28**	1.00		
4 MEDU	2.08	0.96	0.61**	0.13*	0.14*	0.28*	1.00
			0.000	0.014	0.100	0.037	
			0.032	0.082	0.100	0.037	

Significant Level: *** $p < 0.01$

** $p < 0.05$

* $p < 0.10$

Results

Result in Table 2 shows that the dependent variable has strong relationship with the independent variables because the multiple regression r-square value is 0.83. This implies that 87 percent of the variance in growth of small businesses is explained by independent variables whereas the remaining 17 percent is explained by other variables that are not in the regression model.

From Table 3, the linear regression equation records a p-values less than 0.01 ($p = 0.0002$) and this implies that the independent variables are significant in assessing the growth of small businesses in Nepal. From Table 4, using the beta coefficient of the independent variables, the model is:

$$\text{Growth} = -0.091 + 0.313\text{MLOAN} + 0.276\text{MSAVI} + 0.271\text{MEDUC}.$$

Thus, holding all the independent variables constant, the growth of small businesses can decrease 8 percent without the product or services provided by micro finance institutions. However, holding all the independent variables constant, a unit change in micro loans leads to a 31.3 percent increase in growth; a unit increase in micro savings increases growth by 27.6 percent and finally, a unit increase in micro education results to a 27.1 percent increase in growth.

The regression result in Table 4 shows that at significant level ($p < 0.05$), micro loan ($\beta = 0.276$, $p = 0.009$), micro education ($\beta = 0.271$, $p = 0.020$) significantly affect small business growth at a confident level of 95percent ($p < 0.05$).

Table 2. Model Summary

Model	R	R-Square	Adjusted R-Square	Standard Error of Estimate
1	0.87(a)	0.83	0.81	0.21

Independent Variables: MLOAN, MSAVI, MEDUC, (constant).

Table 3. ANOVA

Model	Sum of Square	Degree of Freedom	Mean Square	F	Significant Level
Regression	84.12	2	41.25	303.72	0.0002(a)
Residual	12.13	122	0.043		
Sum	96.25	124			

Independent Variables: MLOAN, MSAVI, MEDUC, (constant).

Table 4. Coefficient of Independent Variables

Model	Un-standardized Coefficient Beta	Standard Error	Standardized Beta	T	Significant Level
1					
(constant)	-0.091	0.006		-11.462	0.004
MLOAN***	0.313	0.023	0.303	17.042	0.000
MSAVI***	0.276	0.018	0.438	17.632	0.009
MEDUC**	0.271	0.014	0.426	17.006	0.020

Independent variables: Independent variables: MLOAN, MSAVI, MEDUC, (constant).

Dependent variable: Growth in scale

Significant level: *** $p < 0.01$;

** $p < 0.05$;

* $p < 0.10$

Discussion

From the analysis, micro loans report r-square of 81 percent at significant at 0.01. This shows that it affects the growth of small businesses in Nepal. The regression model result shows a positive significant coefficient ($\beta = 0.313$, $p = 0.000$) for micro loans. The finding is consistent with study done by Fauster (2014) who found that micro loans positively contribute to growth of small enterprises.

Also, micro savings report r-square of 54 percent at 0.05 significant level and model result gives significant positive coefficient ($\beta = 0.276$, $p = 0.009$). This shows that there is a positive relationship between micro savings and small business growth and development.

The final product, micro education reports r-square of 61 percent at 0.05 significant level and the regression model result shows that there is strong relationship between the micro education and small business growth ($\beta = 0.271$, $p = 0.020$). The finding agrees with the results of Fauster (2014) study that found that micro education has positive effect on small business growth and development.

Conclusion

The purpose of the study is to find out the effect of microfinance product or services on small businesses in emerging economy, Nepal. The result indicates that, at 1 percent significant level, micro loans increase the growth of small businesses in Nepal since it reported p-values less than 0.01. Therefore, the study rejects the null hypothesis (H0) that micro savings have no significant effect on small business growth. The study also rejects the null hypothesis (H0) for micro savings and micro education that report p-value less than 0.05.

Micro finance institutions' services affect the growth of small businesses in Nepal, and the greatest influence product is micro loans due to high R-square value of 81 percent and significant p-value less than 0.01 ($p = 0.000$). This is followed by micro education with a high R-square of 61 percent and coefficient in the regression model is significant at 0.05 ($p = 0.020$). Micro savings follow with R-square value of 54 percent significant at 0.01. It shows, micro finance institutions should continue to provide educational or entrepreneurial training on regular basis that can gear toward the growth and profitability of small businesses in emerging economies. Finally, It should increase their asset credits or loans duration and spread loan reimbursement over long periods to enable businesses owners to have greater use of credit over long period for the acquisition of capital assets and technology that can help them grow.

References

- Abor, J., & Quartey, P. (2013). Issues in SME development in Ghana and South Africa. *International Research Journal of Finance and Economics*, 39(6), 215-228.
- Coleman, B. (2006). Microfinance in Northeast Thailand: Who Benefits and How Much. *World Development*, 34(9), 1612-1638.
- Dhakal, C.P. (2018). Micro-finance for Poor and Non-poor Communities of Nepal. *Tribhuvan University Journal*, (32), 135-142.
- Dhakal, C.P. & Nepal, G. (2017). Microfinance Services and Poverty Level of Rural Farmers of Syangja District of Nepal. *International Journal of Accounting & Finance Review*, (1)1, 31-41.
- District Cordination Committee.(2018). Annual Report. Syangja, Nepal: Author
- Fauster, A. (2014). The Impact of Micro-Finance on the Performance of Small-Scale Enterprises: A Comparison of Sinapi Aba Trust and Maata-N-Tudu Associations in WaMunicipality, Ghana. *Ghana Journal of Development Studies*, 11(2), 1-13. <http://dx.doi.org/10.4314/gjds.v11i2.1>
- Fischer, E., & Reuber, A. R. (2003). Targeting export support to SMEs: Owners' international experience as a segmentation basis. *Small Business Economics*, 20(1), 69-82.

- Germinis, D. (1991). *Financial systems and development: What role for the formal and informal sector?* Paris: OECD development centre.
- Lapenu, C., & Zeller, M. (2001). *Distribution, Growth and Performance of Microfinance Institutions in Africa, Asia, and Latin America*. Washington DC: International Food Policy Research Institute.
- Mathur, M.S. (2010). Corporate Political Strategies. *Accounting & Finance*, 51(1), 82.
- Murphy, C. (2006). *The United Nations Development Programme – A Better Way?* Cambridge, UK: Cambridge University Press.
- Roy, A. (2003). *Women empowerment and gender planning*. New Delhi: Rajat Publishers.
- Oscar, A. J., & Abor, J. (2013). Risk management in the Ghanaian insurance industry. *Qualitative Research in Financial Markets*, 5(1), 26-42. <https://doi.org/10.1108/17554171311308940>
- Okibo, B. W., & Makanga, N. (2014). Effects of micro finance institutions on poverty reduction in Kenya. *International Journal of Current Research and Academic Review*, 2(2), 76-95.
- Premchander, S. (2009). *Multiple meanings of money: how women see microfinance*. Los Angeles: SAGE Publications.
- Sarpong-Danquah, B., Gyimah, P., Poku, K., & Osei-Poku, B. (2018). Financial Literacy Assessment on Tertiary Students in Sub-Saharan Africa: A Ghanaian Perspective. *International Journal of Accounting and Financial Reporting*, 8(2), 76-91.
- UNCTAD (2001). *World Investment Report, 1999: Foreign Direct Investment and the Challenge of Development*. United Nations publication, sales no. E.99.II.D.3, Geneva.
- World Bank. (2009). *Information and communications for development: extending reach and increasing impact*. Washington D C: World Bank.
- Zuberi, S. (2011). *Policy Brief - Women at Work*. Karachi: Social Policy and Development Center.