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## **THE IMPACT OF MICROCREDIT ON THE ECONOMIC DEVELOPMENT OF THE SMALL ENTREPRENEURS: EVIDENCE FROM SOUTHERN, SRI LANKA**

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### **Abstract**

Microcredit has become one of the most popular development strategies in developing countries as it has been instrumental in the success of the small entrepreneurs. As a part of a survey conducted to examine the contribution of one of the major microcredit programs in the Southern province, Sri Lanka, this study endeavors to examine the impact of microcredit programs on the economic development of the small entrepreneurs in the Southern Province, Sri Lanka. Four variables were selected to examine how microcredit influences the economic development of small enterprises: increase in the employment; new business commencement, developing the existing business, and generating considerably higher income. The sample of the study consisted of 584 small entrepreneurs who have received the microcredit from one of the leading projects in Southern Province, Sri Lanka. A formal questionnaire was developed to address the economic developments of the small entrepreneurs selected in the survey. Kruskal Wallis test was applied to examine whether the frequency test results differed among three districts. Study results revealed that microcredit have significantly impacted to increasing the income of the small entrepreneurs regardless of the district. In addition, it was found that the impact of microcredit on employment generation, commencement of new businesses and development of the existing business is at moderate level..

*Keywords:* Economic Development; Micro credit; Small Entrepreneurs

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### **1. Introduction**

Micro credit has been observed to be one of the important determinants of the success of the small entrepreneurs. In developing countries, microcredit has become one of the most popular development strategies of the last few years (Anderson and Locker 2002). The microcredit movement exists to alleviate poverty (Cheston and Reed, 1999). Promoting micro entrepreneurs is the prime objective of microcredit programs. As small entrepreneurs play a crucial role in the economic and social development in any society the role of microcredit is particularly critical in the national efforts to eradicate poverty. However the effectiveness of these micro credit programmes are poorly understood due to lack of systematic enquiry in the relevant field. Especially as far as Sri Lankan context is concerned there is a clear contextual gap in the area of evaluating micro credit programmes.

This study is a part of a survey conducted to examine the contribution of one of the major microcredit programs in the Southern province, Sri Lanka. Thus, as part of it, the objective of this study is to examine the impact of microcredit programs on the economic development of the small entrepreneurs in the Southern Province, Sri Lanka. This would provide insights on the effectiveness of the microcredit programs, in terms of the small entrepreneur development. Economic development is basically considered as it is one of the critical determinants of the success of the small enterprises. It is assumed that the economic development of an enterprise leads the other development aspects i.e. social developments of the entrepreneurs.

## **2. Literature Reveiw**

### *2.1 Microcredit Programmes*

Evans and Jovanovic (1989) found that individuals with more assets are more likely to become self-employed. Moreover entrepreneurial households hold a much larger share of overall household wealth, and even non business assets owned by specific households increase the likelihood as well as success of a given entrepreneurial activity. As small entrepreneurs are not always seen as profitable customers by formal financial institutions, new businesses have to rely heavily on credit from informal sources (Huck et al., 1999). Financing from Informal sources are very flexible however especially in Sri Lankan context comes at a very high price (Buddhika et al, 2008). In this context 1990's gave rise to a new business model themed micro entrepreneurship, micro enterprise or microfinance (Woodworth, 2000). This model focuses on tapping the resources of micro entrepreneurs who initially discredited as un-bankables by the formal financial systems, for the development of the economy. Microcredit is essentially a small collateral-free loan to encourage income generation through self-employment for poverty reduction or a poverty-relief program that provides micro and small loans to micro entrepreneurs (Fairley 1998). Thus, microcredit approach has been identified as a new paradigm to look at economic development (Morduch, 1997). Prof. Muhammad Yunus, a Bangladeshi economist' re-wrote microcredit approaches with his "Grameen Bank" concept. Grameen Bank which was initially established in early eighties today is been used as a widespread model for such programmes. Since then microcredit institutions have spread rapidly, especially among developing economies. Snow & Buss (2001) identifies following advantages of micro credit as a initiative towards poverty reduction, among those are, ability to bypass corrupt and inactive central governments, ability to promote free marketing, ability to reduce dependency of poor and promote democracy. The main objective of a general micro credit program is to ease the credit constraint of poorer households or to provide them with capital to initiate an activity, thereby increasing their income and consumption (Shahidur et al, 1998) or symbolizes small loans provided to the poor for economic activities that would generate income for them and their families (grameenfoundation.org). Beneficiaries targeted by these microcredit programs are typically regarded as un-bankables by formal lending agencies mainly due to high transactions costs incurred in servicing these loans (Yunus 1999).

### *2.2 Microcredit Impact*

Even though micro credit programmes are gaining wide popularity and billions and billions of dollars are funneled into the programmes, effectiveness or impact of these programmes remain mostly un-confirmed. For an example according to Neill at el (1995) only very few solid program evaluations exist, and even those are very difficult to access. However importance of impact assessments immense in this type of environment which according to Snow & Buss (2001), to not only to stop wasting resources but also to stop from doing pure people more harm by engaging them in a debt trap.

Impact assessment is a management mechanism aimed at measuring the effects of projects on the intended beneficiaries (Afrane, 2002). Al-Mamun, et al., (2012) reviews some microcredit programs which have been effective in the socio-economic development of the poor. Hamad (2012) has examined how microcredit programs have impacted in alleviating poverty and restoring livelihoods in Bosnia and Herzegovina. Aslanbeigui et al., (2010) assessed the contribution of microcredit to the empowerment of borrowers. It is important to note that full impact of micro credit programs should be determined by assessing both direct and indirect effects of program (Shahidur et al, 1998). However, as far as this study is concerned it only examines impact towards participants of the program and also only focuses on economic impact of microcredit programs on small enterprises.

### 3. Study Design and Methods

#### 3.1 Microcredit Study variables, Questionnaire Design and Data Collection

Access to finance increases the ability of the small entrepreneurs to increase income-generating opportunities and employment opportunities, which ultimately leads to an increase in household income and reduction in poverty rate (Al-Mamun, et al., (2012). Accordingly, Table 1 gives the study variables used to assess the impact of microcredit on the economic development of the enterprises. Three in depth interviews were carried out with three specialists in order to derive the variables. These three includes two industry experts and an academic. As such, four variables were selected to assess how microcredit influences the economic development of small enterprises: with the microcredit facility to a small enterprise, it is an essential to increase the employment of the enterprise; consider new business commencement, develop the existing business, and generate considerably higher income.

Table 1: Variables of the Study

- |  |
|--|
| • Impact on employment                 |
| • New business commencement            |
| • Development of the existing business |
| • Impact on income generation          |

Interviews were conducted with a formal questionnaire to collect the data for the study. The questionnaire addressed four main areas to examine the how microcredit influences the economic development of the small enterprises. Initially the questionnaire was developed in English and then translated into Sinhalese, the main language of the Sri Lanka. This was decided as the sample of the study is not well familiar with the English language and to get the real data from the sample. Moreover the questionnaire was researcher administered to minimize perceptual differences. The questionnaire consisted of two parts: part one to address the demographic aspects of the entrepreneurs and part two to address the impact of microcredit on the economic development of the enterprises.

#### 3.2 Sample of the study

The total sample of the study consisted of 584 small entrepreneurs who have received the micro credit facility from one of the leading projects in Southern province, Sri Lanka. Table 2 shows the structure of the sample, in terms of districts. It was taken 303 small entrepreneurs from Hambanthota district, since it has evidenced that higher number of small entrepreneurs in the area have received the micro credit facility. From Matara district 153 small entrepreneurs were taken while 128 small entrepreneurs were taken from Galle districts. In addition, it should be noted that the majority of the entrepreneurs selected to sample are from rural areas (515), since it has evidenced that the majority of small entrepreneurs are from rural areas.

Table 2: Sample Structure of the Study

		No. of the respondents
Districts	Galle	128
	Matara	153
	Hambanthota	303
Total		584

#### 4. Data Analysis

Economic development of small enterprises is assessed from following aspects.

- Impact on employment
- New business commencement
- Development of the existing business
- Nature of the investment in existing business
- Impact on income generation

##### 4.1 Impact on employment

Table 3 shows that the microcredit impact on employment generation at small enterprises is at moderate level (39%). Thus, it seems that small enterprise has the potential in generating employment opportunities and initiatives are to be taken to strengthen the small enterprises. However, it shows that small enterprises have managed generating employments to a significant extent though it is not at higher level.

Table 3: Employment Increased

Increase employment	Frequency	Percent
Yes	229	39.2
No	355	60.8
Total	584	100.0

Impact of micro credit on small enterprises' employment generation might put forward more appealing insights that may be important for future applications. According to Kruskal Wallis test given in Table 4, there is statistically significant difference among the three districts in terms of the microcredit impact on the increase of employment ( $\chi^2=17.695$  (2),  $p < 0.05$ ). Thus, it reveals that though microcredit has moderately impacted on increasing employment at small businesses, there are statistically significant differences among the three districts.

Table 4: Employment Increase in three Districts

Variable	District	N	Mean Rank
Increases in the Employment	Galle	128	283.8
	Matara	153	334.0
	Hambantota	303	275.4
Test Statistics			
Chi-Square	17.695		

Variable	District	N	Mean Rank
Increases in the Employment	Galle	128	283.8
	Matara	153	334.0
	Hambantota	303	275.4
Test Statistics			
df		2	
Asymp. Sig.		0.000	

#### 4.2 New Business Commencement

Commencement of a new business is also another important aspect of small enterprise development. Table 5 shows the results of the survey. Accordingly, only 28% of the entrepreneurs could be able to commence new business with the micro credit facility while 72% of the entrepreneurs were not able to commence new businesses with micro credit.

Commencement of a new business is also another important aspect of small enterprise development. Table 5 shows the results of the survey. Accordingly, only 28% of the entrepreneurs could be able to commence new business with the micro credit facility while 72% of the entrepreneurs were not able to commence new businesses with micro credit. However, this result indicates that regardless of the district, the 161 small entrepreneurs out of 584 (28%) have been able to commence new business. This indeed is a significant contribution of microcredit facilities in the business development in the province.

Table 5: Commencement of New Business

Commencement of new business	Frequency	Percent
Yes	161	27.6
No	423	72.4
Total	584	100

According to Table 6, it was found that there is statistically significant difference among three districts in the commencement of new business by the small entrepreneurs ( $\chi^2=10.590$  (2),  $p < 0.05$ ) i.e. the effect of microcredit to commence new businesses is significantly different in three districts.

Table 6: Commencement of New Business in three Districts

Variable	District	N	Mean Rank
Commencement of New business	Galle	128	313.7
	Matara	153	308.1
	Hambantota	303	275.7
Test Statistics			
Chi-Square		10.590	
df		2	

Table 6: Commencement of New Business in three Districts

Variable	District	N	Mean Rank
Commencement of New business	Galle	128	313.7
	Matara	153	308.1
	Hambantota	303	275.7
Asymp. Sig.	0.005		

#### 4.3 Development of the Existing Business

The result on how small entrepreneurs have attempted to develop the existing business with microcredit facilities is given in Table 7. Accordingly, it shows that majority (67%) of the small entrepreneurs could not be able to develop the existing business with the provided microcredit facility. Only 33% of the small entrepreneurs have attempted to develop their existing businesses with the microcredit facility.

Table 7: Development of the Existing Business

Development of the existing business	Frequency	Percent
Yes	192	32.9
No	392	67.1
Total	584	100.0

According to Table 8, the results show that development of existing businesses is not significantly different among the three districts ( $\chi^2=5.716$  (2),  $p > 0.05$ ) i.e. the effect of microcredit to develop the existing business is almost the same in three districts. Further, it was found that the development of the existing business was done through the acquisition of new machineries, constructing new buildings and purchasing lands for the business purpose. However, it is seen that investment on new land and building has not given higher concern by small entrepreneurs. Microcredit has assisted small enterprises to get support to expand their existing businesses to a certain extent though it is not at higher level.

Table 8: Development of the Existing Business in three Districts

	District	N	Mean Rank
Development of the Existing Business	Galle	128	266.8
	Matara	153	295.4
	Hambantota	303	300.9
Test Statistics			
Chi-Square	5.716		
df	2		
Asymp. Sig.	0.057		

#### 4.4 Impact on Income Generation

According to Table 9, microcredit facilities have impacted around 84% to increasing the income of the small entrepreneurs. Only 16% entrepreneurs revealed that they were not able to increase their income level. It shows that micro credit has significantly impacted on income generation of the small entrepreneurs.

Table 9: Income Generation through Small Business

Income Generation through Small Business	Frequency	Percent
Yes	491	84
No	93	16
Total	584	100

According to Table 10, income generation of the small entrepreneurs in three districts shows that it is not significantly different in three districts ( $\chi^2=4.734$  (2),  $p> 0.05$ ) i.e. impact of microcredit on income generation is almost the same in three districts.

Table 10: Income Generation in three Districts

	District	N	Mean Rank
Increases in the Income	Galle	128	284.8
	Matara	153	309.1
	Hambantota	303	288.3
Test Statistics			
Chi-Square	4.734		
df	2		
Asymp. Sig.	.094		

## 5. Discussion and Conclusions

Microcredit schemes have significant impact on increase the households' income and assets (Al-Mamun, et al., 2012). Thus, Hamad (2012) found that microcredit clients in Bosnia and Herzegovina were satisfied with microcredit as it has impacted on their life positively. This study revealed that microcredit facilities have significantly impacted to increasing the income of the small entrepreneurs regardless of the district. This has greater impact on poverty reduction of small entrepreneurs and has a positive impact of their life styles. However, this study found that the microcredit impact on employment generation, commencement of new businesses and development of the existing business is at moderate level. The reasons behind this may be the limited credit amount, lack of motivation or reluctant to commence new businesses, training and development to business development and lack of guidance to for effective businesses management. Therefore research highlights these areas as key in order to further improve the effectiveness of micro credit programmes.

This study shows that microcredit programs have the potential to develop entrepreneurial setting in an effective manner. Thus, it is required to examine the sustainability of such impacts of microcredit programs through identifying further needs of small entrepreneurs i.e. business consultancy.

Social development of the entrepreneurs is to be inherent with the economic development of the small enterprises. Thus, further study can be conducted to examine the impact of microcredit on the social development of the entrepreneurs. This would provide a complete picture of the impact of microcredit programs on small entrepreneur development.

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