Impact of Microcredit on Micro-Enterprise Development: A Case of Gandaki Province of Nepal

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Abstract

This study examines the impact of microcredit on micro-enterprise development in the Gandaki Province of Nepal. The data is collected through a structured questionnaire from microfinance clients involved in microfinance institutions for five or more years. The explanatory research design is used to find the impact of microfinance intervention on micro-enterprise development. The study finds that microfinance intervention has made significant changes in micro-business and enterprise development with the help of microcredit. The regression results show that microcredit has increased the investment, revenue, and profits of micro-businesses and helped expand them and generate employment. Proper utilization of microcredit is critical to the success and sustainability of microcredit enterprises.

JEL classification: G20, G21, E51

Keywords: Micro-business, microcredit, micro-enterprise development, microfinance institutions

1. Introduction

We study the impact of microcredit on micro-enterprise development in terms of investment, revenue generation, return on investment, micro-business expansion, and employment generation in the Gandaki Province of Nepal. The study covers the microfinance clients who have been actively involved in microfinance institutions for a period of five or more years.

Microcredit is a small, collateral-free institutional loan encouraged for their self-employment and income generation (Rahaman, 2001). The Grameen Bank's lending approach to poor women

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We are thankful to the University Grant Commission (UGC) of Nepal for funding this research. We want to extend heartfelt appreciation to the Editorial Board and anonymous referees for their insightful suggestions and feedback that helped improve the paper's content.

has attracted international interest, making microcredit a new paradigm for thinking about economic development (Morduch, 1997). Microfinance is a popular development tool, particularly in financial inclusion and poverty reduction (Rahman, 2020). Microfinance institutions (MFIs) apply a unique credit delivery mechanism that provides loans to the marginalized and disadvantaged people under the group-based lending system. The concept of microfinance became popular when Professor Muhammad Yunus, the founder of Grameen Bank, was awarded by Nobel Peace Prize in 2006. It helps enhance the socio-economic status of the poor and low-income people through a sustainable business model (Rahman, 2001). Almost a global consensus is that microcredit to the poor is crucial for the twenty-first century's economic and social development (Microcredit Summit, 1998).

Insufficient finance is a key obstacle to firm growth (Malhotra et al., 2007). Small firms face bigger challenges in obtaining finance than larger firms (Schiffer & Weder, 2001; Beck, Demirguc-Kunt & Maksimovic, 2002). Financing is essential for firms because it helps expand operations, innovation, and investing in production facilities and new staff (OECD, 2006).

As per the Global Findex database, almost half of the population are unbanked in Nepal (World Bank, 2017). This poor access to microcredit has greatly affected enterprise development and promotion. Microfinance is considered an effective tool to access credit to the poor, marginalized, and low-income people. Most households are better off with microcredit programs. Still, its impact on income varies in magnitude and durability, and a sizeable proportion of clients finds that their post-credit incomes stagnate or fall (Copestake, Bhalotra, & Johnson, 2001; Mosley, 2001). Several studies find that microfinance helps reduce poverty, empowers women or other disadvantaged population groups, creates employment, and encourages micro-business or enterprises creation.

As per the Industrial Enterprises Act of Nepal, 2020, industries are classified into five groups: micro-enterprise, cottage industry, small industry, medium industry, and large industry. The registered (50.1%) and unregistered (49.9%) enterprises are almost equal in Nepal. Out of the unregistered enterprises, 52% are micro-enterprises, and the rest are small (5.2%), medium (3.9%), and large (2.5%) enterprises (CBS, 2019). Small and medium-sized enterprises (SMEs) are a key contributor to economic activity worldwide as an essential source of jobs, growth, and innovation. Despite their critical role, the SMEs have a low capital base, poor access to technology, and inadequate knowledge and information regarding business opportunities and marketing in Nepal (Pandey, 2004). The supply-side factor shows an inadequate flow of finance from financial institutions to MSMEs, and the demand-side element reflects insufficient business skills to MSME entrepreneurs (ADB, 2015). Therefore, SMEs suffer from poor access to finance brought about by high interest rates, large collateral requirements, inconveniences associated with the process, a lack of information, and inadequate institutional capacity, among other things (NRB, 2019).

Financial inclusion in Nepal is not satisfactory (World Bank, 2017) and demands an increased role of microfinance and microcredit to the poor and low-income people. There is a growing role of microcredit in development financing (Hazarika & Sarangi, 2005). This paper is organized into five parts: Introduction, literature review, data and methods, results and discussion, and conclusion.

2. Literature review

Advocates of microcredit believe that access to microcredit helps transform women into "entrepreneurs" (Sanyal, 2014). The most critical obstacle to greater entrepreneurship by the poor was that they were short of start-up capital. With the help of microcredit, a poor individual could establish an informal microenterprise or self-employment venture (Bateman, Blankenburg, & Kozul-Wright, 2019). Financial capital, social capital, and human capital have a significant positive relationship with women's micro-enterprise success (Hameed, Mohammad, & Shahar, 2020).

The efficiency of microcredits for small businesses can be assessed by various criteria such as firms' growth rate, productivity, profitability, income, and net assets, poverty reduction, and women's empowerment (Yang, 2018; Akhter & Cheng, 2020). Micro entrepreneurs need financing for their survival, but they do not care whether the funding comes from family, friends, or a particular financial institution (Mor et al., 2020). The role of SMEs in the development process continues to be at the forefront of policy debates in developing countries. The development of SMEs is seen as accelerating the achievement of broader economic and socio-economic objectives, including poverty alleviation (Cook & Nixson, 2000).

Microfinance has transformed the economic status of the people through the productive application of microcredit (Dhungana, 2018). Many of them have minimal networks and very little time for networking (Ozdemir et al., 2016). Microfinance institutions create self-employment opportunities, improve labor productivity, and increase wage rates (Wanjiku & Njiru, 2016). The micro-business or enterprises creation, income level, consumption expenditure, and clients' capital expenditure have been significantly improved after involvement in microfinance programs (Dhungana, 2016). Women's economic development generated self-esteem and respect for women microfinance beneficiaries. Microfinance provides finance to women to start or expand the business (Khanday et al., 2015).

Rehman, Moazzam, and Ansari (2015) find that women's involvement in business raises incomes and savings and increases their monthly family income and other household resources after microfinance intervention. Dhungana (2015) finds that the micro-business or enterprise creation, employment generation, occupational status, and income level of the people have been significantly improved after involvement in microfinance programs in Nepal.

Previous research studies indicate that the microfinance industry is effective in reaching millions of poor people, providing them with financial services, and reducing their poverty (Simanowitz & Walter, 2002). Microfinance programs help poor borrowers over time to meet their immediate needs (Khandker, 2001). There is much evidence of the positive impact of MF, mainly through increasing income (Wright, 2000; McGuire & Conroy, 2000; Khandker, 2001; Chan & Ghani, 2011), increasing consumption of household (McGuire & Conroy, 2000; Rahaman, 2010; Berhane & Gardebroek, 2011), and reducing vulnerability (Wright, 2000; Zaman, 2000; Salia & Mbwambo, 2014). Several studies have examined the relationship between access to credit and productivity. The evidence is primarily positive, and credit positively impacts enterprise productivity (Levine, 1991; Bencivenga, Smith, & Starr, 1995).

There is a positive impact of microcredit on socio-economic indicators, such as employment creation (Arinaitwe, 2006; Khandker, Samad, & Khan, 1998), income and expenditure of the target groups (Hietalahti & Linden, 2006), savings (Copestake, Bhalotra, & Johnson, 2001), asset ownership (Bhatt, Painter, & Tang, 1999), wealth and comfort of family and community (Ang,

2004), and the standard of living of the participants. Several pieces of evidence show that microcredit increased the profit rate of small enterprises (Hietalahti & Linden, 2006; Copestake, Bhalotra, & Johnson, 2001).

3. Data and methods

The study is confined to the Gandaki Province of Nepal and uses primary sources of data. The multi-stage cluster sampling method has been applied to collect the data through structured questionnaires from eight microfinance institutions. The study covers the microfinance clients who have been actively involved in microfinance institutions for five or more years. This study is cross-sectional, and the data collection period is from May 2020 to September 2020. The variables used to measure micro-enterprise development are investment, revenue, return on investment, micro-business expansion, and employment. Both correlation and chi-square tests are applied to analyze the impact of microcredit on micro-enterprise development together with regressions. The survey includes a random sample of 378 microfinance clients. The distribution of population and sample size is presented in Table 1.

Table 1

Distribution of Population and Sample Size

District	Types of MFIs	Branches or Clusters	No. of centers	Sampled Centers	Population*	Sample Size	
						Clients	%
Kaski	Dhaulagiri	1	7	2	117	34	29.6
	MBB	2	16	3	145	34	23.4
	NESDO	1	8	3	122	34	27.9
	NUBL	1	9	3	128	34	26.6
	NMBMF	1	8	2	114	34	29.8
Tanahun	Deprosc	1	7	2	125	24	19.2
	Jalpa	2	15	3	152	37	24.3
	MBB	1	8	1	75	10	13.3
	NESDO	1	7	1	134	30	22.4
	NUBL	1	8	1	110	25	22.7
	Sangrila	1	6	1	118	19	16.1
Syangja	MBB	2	17	3	178	47	26.4
	NESDO	1	6	1	85	16	18.8
		16	112	26	1,603	378	23.6

Source: Branch Office of each MFI, 2020.

Note. Population refers to the total clients of the sampled centers having at least five years of membership in MFIs. Dhaulagiri, National Educational & Social Development Organization (NESDO), Nirdhan Utthan Laghubitta Bittiya Sanstha (NUBL), NMB Microfinance (NMBMF), Deprosc, and Jalpa are D class MFIs; Muktinath Bikas Bank (MBB) and Sangrila are B class financial institutions, but they are also providing microfinance services in Nepal.

4. Results and discussion

4.1 Demographic profile of respondents

The demographic characteristics for the individual respondents are characterized through the head of the household, district (location), age, ethnicity, marital status, educational status, occupation, family size, and family members' involvement in foreign employment. The summary of the demographic characteristics of respondents is presented in Table 2.

Table 2

Respondents' Demographic Profile

Demographic Variables	Categories	Frequency	Percent
Head of Household	Male	252	66.7
	Female	126	33.3
District	Kaski	170	45.0
	Syangja	63	16.7
	Tanahun	145	38.3
Age (Years)	20-30	50	13.2
	31-40	147	38.9
	41-50	136	36.0
	More than 50	45	11.9
Ethnicity	Dalit	101	26.7
	Janajati and Adhibasi	169	44.7
	Others*	108	28.6
Marital status	Married	346	91.5
	Unmarried	6	1.6
	Divorced/separated	9	2.4
	Widow	17	4.5
Education	Illiterate	63	16.7
	Primary education	137	36.2
	Secondary education	146	38.6
	Above secondary level	32	8.5
Main Occupation	Jobs	29	7.7
	Business	136	36.0
	Agriculture and Livestock	213	56.3
Foreign Employment in family	Yes	154	40.7
	No	224	59.3
Total		378	100.0

Source: Field Survey, 2020

Note. Others include upper-caste such as Brahman and Chhetri; Dalit refers to lower caste; Janajati and Adhibasi refer to indigenous and tribal groups.

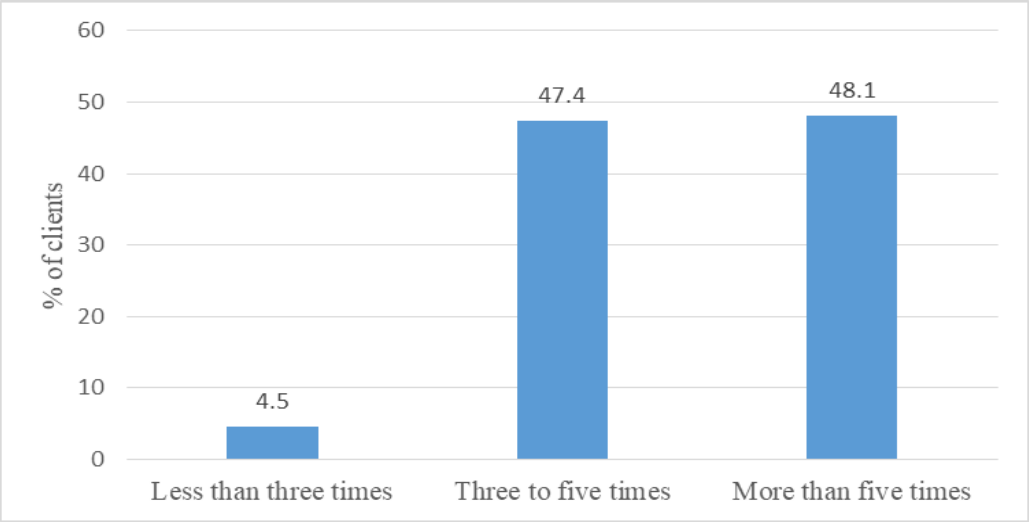
The majority of the respondents' household heads are male (66.7%), and the rest are female (33.3%). Most of the respondents are within the age category of 31- 50 years (74.9%) and married (91.5%). Likewise, most of the respondents (83.3%) are literate and have primary education (36.2%), secondary (38.6%), and above secondary level (8.5%). The illiterate respondents (16.7 percent) also reflect meaningful involvement in MFIs to initiate micro-enterprise development. The primary socio-economic transformation target is disadvantaged people such as Dalit (26.7%), Janajati, and Adhibasi (44.7%). Others include upper-caste such as Brahmin and Chhetri (28.6%). The majority of the respondents (56.3%) are involved in agriculture and livestock, and the remaining are in business (36.0%) and jobs (7.7%), respectively. The respondents who are doing the job are either indirectly involved in micro-business or have not created micro-business. Family members' involvement in foreign employment reflects the inflow of remittance income in their families.

4.2 Frequency of microcredit

The frequency of microcredit is presented in Figure 1. The survey shows that all the respondents selected for this study have taken loans in the past five years at least one time. Around half of the respondents (48.1%) have taken microcredit more than five times. Similarly, 47.4% of clients have taken three to five times, and 4.5% have taken less than three times. Most of the clients (95.5%) have taken microcredit at least three times from MFIs.

Figure 1

Frequency of Microcredit



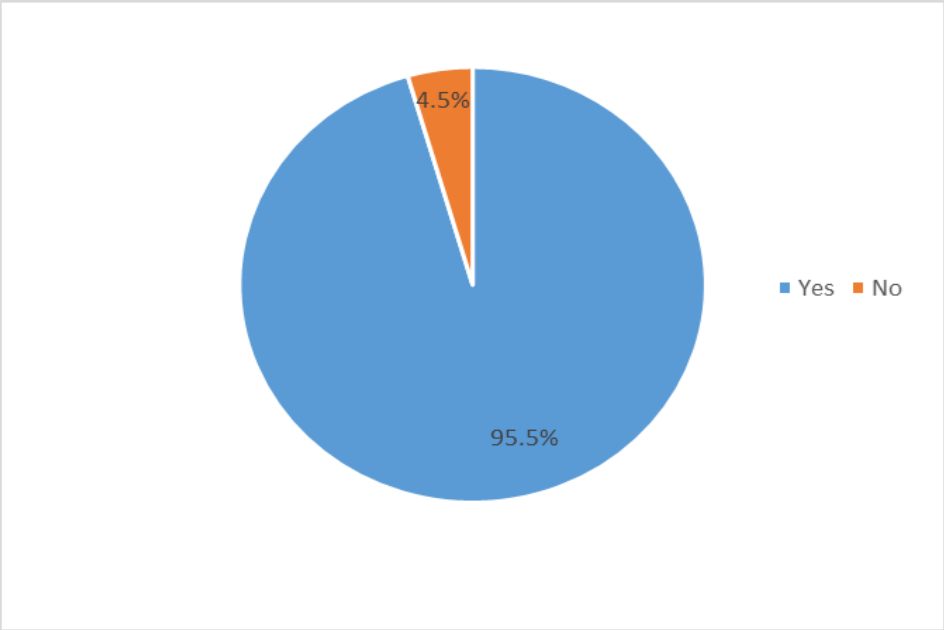
Source: Field Survey, 2020

4.3 Micro-business and enterprise creation

Next, we show the productive application of microcredit to create or expand micro-business and enterprises in Figure 2. Accordingly, most of the clients (95.5%) have created micro-business and enterprises. There is a productive application of microcredit in the form of micro-business or enterprise creation and expansion. MFIs successfully apply microcredit to micro-businesses, but the quality of operation and productivity is another crucial question.

Figure 2

Micro-business or Enterprise Creation



Source: Field Survey, 2020

4.4 Micro-business operation analysis

We measure micro-business operations in terms of investment, duration of business operations, profit, and other sources of income as presented in Table 3. Our data show that most of the clients have created micro-business and enterprises. Majority of them (53.5%) have made investments between NRs 100,000 to 300,000 and 7.8% clients have invested below NRs 100,000, 14.7% between NRs 300,000 to 500,000, and 24.1% between NRs 500,000. Most clients (93.6%) have operated micro-business or enterprises for at least three years, and only 6.4% have operated for less than three years. Furthermore, 49.3% of clients have experience in micro-enterprise operations for three to five years, whereas 44.3% have more than five years of experience. Further, almost half of the clients (49.4%) have earned monthly profits of NRs 25,001 to 50,000, and a few clients (1.4%) above NRs 75,000.

Table 3

Micro-business Operation Analysis

Amount of Investment (NR)	Frequency	Percent
Below 100,000	28	7.8
100,001 to 300,000	193	53.5
300,001 to 500,000	53	14.7
Above 500,000	87	24.1
Total	361	100.0
Duration of Business Operations (Years)	Frequency	Percent
Below three	23	6.4
Three to five	178	49.3
Above five	160	44.3
Total	361	100.0
Estimated Monthly Profit (NRs)	Frequency	Percent
Below 25,000	154	42.7
25,001 to 50,000	178	49.4
50,001 to 75,000	24	6.5
Above 75,000	5	1.4
Total	361	100.0

Source: Field survey, 2020
Note. NR is Nepali Rupee. USD = NR 117.87 on September 18, 2021.

4.5 Registration of micro-enterprises

Selected information related to the registration of micro-enterprises is presented in Table 4. Accordingly, the majority of micro-enterprises (69.5%) have not been registered; only 30.5% are registered. The ownership of all registered micro-enterprises is private. Most registered enterprises are under the municipality (56.4%), and the remaining are under the rural municipality. The registered entrepreneurs are almost equal in gender, i.e., 50.9% male and 49.1% female. Most of the clients (70.9%) have experienced that registration of micro-enterprises is easy. The reasons for not registering micro-enterprises are lack of information and ideas (47%), difficult for small businesses (28.3%), and cost/tax involvement (24.7%). MFIs should ensure the registering of micro-enterprises with the relevant authorities.

Table 4

Registration of Micro-Enterprises

	Freq.	Percent
Registration Status		
Yes	110	30.5
No	251	69.5
Total	361	100.0
Ownership		
Private	110	100.0
Total	110	100.0
Registration Entity		
Rural municipality	48	43.6
Municipality	62	56.4
Total	110	100.0
Registered Entrepreneur		
Male	56	50.9
Female	54	49.1
Total	110	100.0
Difficulty in Registration		
Easy	78	70.9
Difficult	32	29.1
Total	110	100.0
Reasons of not Registration		
Difficult for small business	71	28.3
Cost/tax involvement	62	24.7
Lack of information and ideas	118	47.0
Total	251	100.0

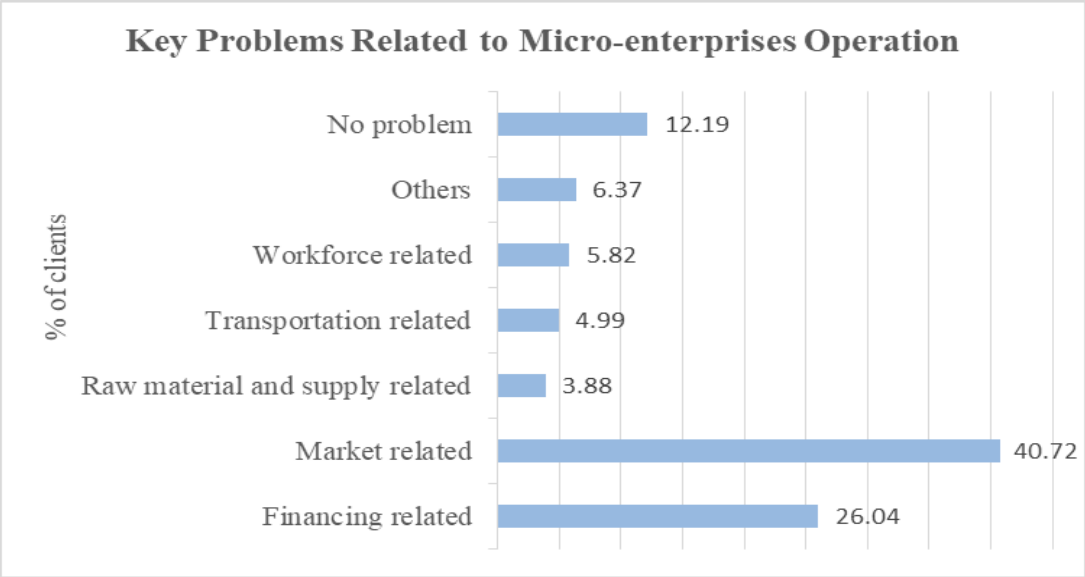
Source: Field Survey, 2020

4.6 Key problems in micro-enterprise operation

Micro-entrepreneurs may face many problems during the operation of their enterprises. The key problems in micro-enterprise operations are given in Figure 3. Around 88 percent of respondents have faced problems related to micro-enterprise operations. The key problems are related to market (40.72%), financing (26.04%), workforce (5.82%), transportation (4.99%), raw material and supply (3.88%), and others (6.37%). It is essential to provide non-financial services such as micro-entrepreneurship skills to address their issues and enable them to sustain their enterprises.

Figure 3

Key Problems Related to Micro-Enterprise Operations



Source: Field Survey, 2020

4.7 Association between demographic variables and type of micro-business

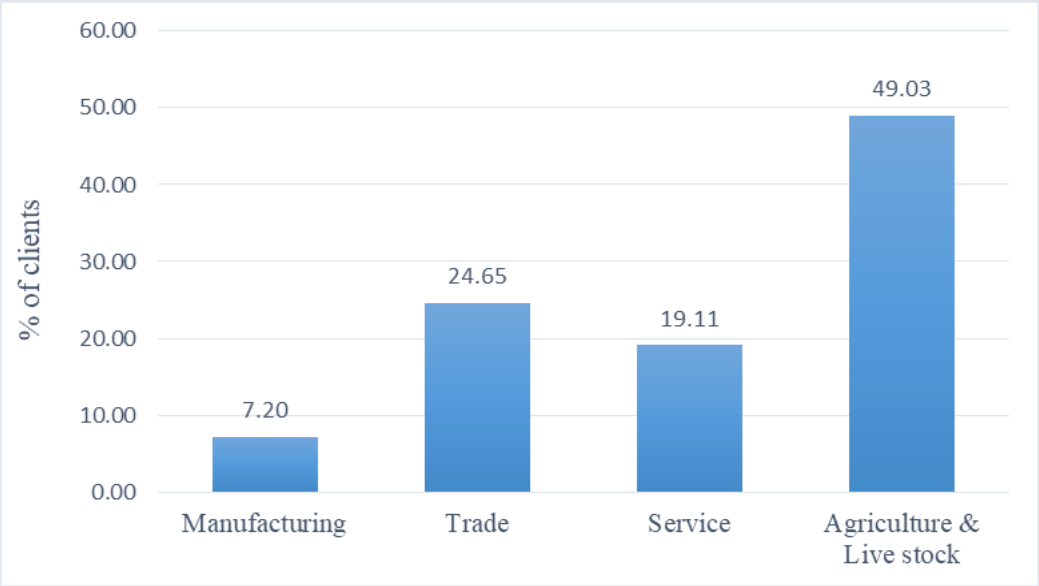
The clients have developed or expanded various types of micro-businesses. The forms of micro-businesses include manufacturing, trade, service, and agriculture & livestock, which are presented in Figure 4.

Around half of the respondents have created agriculture and livestock-related micro-business, followed by trade (24.65%), service (19.11%), and manufacturing (7.2%). The study shows that agriculture & livestock is the highly preferred sector, and manufacturing is the lowest preferred micro-business initiated by the clients.

The association between demographic variables and the nature of micro-business is presented in Table 5. The results show a significant association between the type of micro-business with the district, age, ethnicity, education status, foreign employment, and microfinance institutions. The data also showed that respondents from the age group of 31-40 years are more engaged in trade and service-related businesses than the respondents from other age groups. Respondents of Brahmin and Chhetri groups are more engaged in trade while those from Dalit are more engaged in service-related business. Illiterate respondents are primarily in agriculture and livestock-related sectors, while more educated respondents also engage in trade. However, the study shows that the lowest number of respondents are involved in manufacturing. The study finds that the nature of micro-business is affected by the respondents' age, ethnic group, education status, and location.

Figure 4

Types of Micro-Businesses



Source: Field Survey, 2020

Table 5

Association between Demographic Variables and Type of Micro-business

Variables	Chi-Square Value ($\chi 2$)	P-value
Head of Household	4.91	0.297
District	70.797	0.000***
Age	45.145	0.000***
Ethnicity	32.233	0.000***
Marital Status	10.963	0.532
Education	41.481	0.000***
Foreign Employment	26.418	0.000***
Microfinance Institutions	67.002	0.000***

Note. ***Significance at 1%.
Source: Field Survey, 2020 and authors' calculation.

4.8 Correlation between microcredit and micro-enterprise variables

The correlation between microcredit and initial investment, total sales revenue, total expenses, total profit, expansion of business, and employment is presented in Table 6. We find that the correlation between microcredit and an initial investment (r=0.3) and between microcredit and business expansion is moderate (r=0.4). Further, the correlations between microcredit and variables such as sale revenue, enterprise expenses, profit, and employment generation are low (r<0.2). However, all the variables have a significant positive correlation with microcredit from MFIs. The results imply that an increase in microcredit increases the enterprises' initial investment, sales revenue, expenses, and profit. Similarly, an increase in microcredit also helps the expansion of business and growth in employment generation. These results confirm that microfinance institutions enhance micro-enterprise development through microcredit programs.

Table 6

Correlation between Microcredit and Micro-Enterprise Variables

Variables	Microcredit	Inv	Rev	Exp	Prof	Expand
Inv	0.335***					
Rev	0.232***	0.504***				
Exp	0.212***	0.516***	0.962***			
Profit	0.211***	0.241***	0.756***	0.659***		
Expand	0.389***	0.570***	0.309***	0.290***	0.253***	
Empl	0.246***	0.413***	0.395***	0.365***	0.335***	0.306***

Source: Field Survey, 2020 and authors' calculation.
Note. Microcredit is the Size of Microcredit; Inv is Initial Investment; Rev is Total Sales Revenue; Exp is Total Enterprises Expenses; Profit is Total Profit; Expand is Expansion of Business; and Empl is Total Employment Generation. ** Significant at 1% (2-tailed).

4.9 Regression analysis of microcredit and micro-enterprise variables

The main objective of this study is to examine the impact of microfinance on micro-enterprise development in terms of investment, revenue generation, return on investment, micro-business or enterprises expansion, and employment generation due to access to microcredit. The regression analysis, which shows the impact of microcredit on micro-enterprise development variables, is presented in Table 7.

Table 7

Regression Analysis of Microcredit and Micro-Enterprise Variables

Dependent Variables	Slope Coefficient	t-stat	P-value	R-Squared	F - Statistic	P-value
Inv	0.872	6.849	0.000	0.113	46.905	0.000
Empl	0.000	4.665	0.000	0.061	21.760	0.000
Rev	0.306	4.573	0.000	0.054	20.915	0.000
Exp	0.256	4.149	0.000	0.045	17.214	0.000
Profit	0.041	4.128	0.000	0.045	17.043	0.000
Expand	0.050	8.134	0.000	0.152	66.166	0.000

Note. Microcredit is the Size of Microcredit; Inv is Initial Investment; Rev is Total Sales Revenue; Exp is Total Enterprises Expenses; Profit is Total Profit; Expand is Expansion of Business, and; Empl is Total Employment Generation.

The positive slope coefficients and the p-values less than 5 percent level of significance indicates a significant positive impact of the size of microcredit on the initial investment, total sales revenue, total enterprise expenses, total profit, expansion of business, and employment generation. Similarly, the p-value of all F-statistics less than 1% level of significance confirms that all the regression models are good. Thus, microcredit seems to have had a significant positive impact on the development of micro-enterprises.

Microenterprise credit is a broadly effective solution to poverty, although it can work well for clients close to the poverty line and live in environments with the conditions necessary to sustain high-value microenterprises (Shaw, 2004). Coleman (1999) found that microcredit programs have little impact on micro-enterprise development. The group lending focuses on its high repayment rates rather than its goal of promoting borrower welfare. Microcredit, being too small to invest productively because of economies of scale, serves primarily as consumption loans. Dhungana (2016) found that clients who have taken the small loans have mostly spent their loans on domestic purposes and found the poor application of loans in micro-business. Adams and von Pischke (1992) mentioned that debt is not an effective tool for helping most poor people enhance their economic condition.

Adusei and Adeleye (2021) observed a consistently positive and statistically significant effect of start-up microenterprise financing on MFIs' financial performance. Ghalib, Malki, and Imai (2014) found that microfinance programs positively impacted the participating households. Poverty-reducing effects were observed on several indicators, including expenditure on healthcare, clothing, household income, and specific dwelling characteristics, such as water supply and quality of roofing and walls. Dhungana (2018) found micro-business and enterprises creation of people have been significantly improved after involvement in microfinance programs in Nepal.

5. Conclusions

This study examines the impact of microcredit on micro-enterprise development in the Gandaki Province of Nepal to document the contribution of microcredit to micro-enterprise

development. We measure the impact of microcredit on micro-enterprise development in terms of investment, revenue generation, return on investment, micro-business expansion, and employment generation.

Microcredit is an anti-poverty tool to enable credit access by poor households to increase their income and livelihood status through self-employment and income generation. Microfinance institutions provide collateral-free microcredit that helps reduce poverty, empower women or other disadvantaged population groups, create employment, and encourage micro-business or enterprises creation. Many empirical studies find a positive impact of microcredit on socio-economic indicators, such as employment creation, income and expenditure of the target groups, savings, asset ownership, and the standard of living.

The study finds that clients involved in microfinance programs are using microcredit for micro-business and enterprise creation. Microcredit has impacted the positive effects on clients' micro-businesses and enterprises in terms of revenue generation, wealth creation, micro-business expansion, and employment generation. Several researchers agree that small amounts of credit to small firms could help business growth (Mead & Liedholm, 1998; Woller & Parsons, 2002; Khandker, 2005), significant impact on business outcomes, such as profits, sales, and the number of people employed by the business (Banerjeey et al., 2009), and entrepreneurs can expand their businesses through microfinance (Islam, 2019). There is a crucial question to the microfinance institutions regarding the effective use of microcredit. Since the clients' success is associated with the proper utilization of microcredit so MFIs may empower clients on building enterprise's sustainability.

This study is confined to the micro-enterprise development perspective in the Gandaki Province of Nepal. Further research can be conducted on micro-enterprise sustainability with access to micro-credit in Nepal.

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