

## **Analysis of Micro Entrepreneurs Dependency on Informal Money Lenders: Basis for Developing Micro Financing Program**

YURI WALTER D. AKIATE, Ph. D

Don Honorio Ventura Technological State University  
Bacolor, Pampanga, Philippines

### **Abstract:**

*This paper investigated the dependency of micro entrepreneurs on informal money lenders that will be a basis in developing micro financing program. The study was conducted in one of the public markets of City of San Fernando, Pampanga. Purposive sampling was used because it was only focused on the micro entrepreneurs who experienced borrowing money from the informal money lenders. The results showed that those who are less educated, married, and have large household size are more likely to borrow from the informal lenders. Moreover, loan procedure, no collateral, cost of loan, amount of loan, uses of loan, accessibility, and credibility of the lender seems to be the main factors that the borrowers consider in borrowing from the money lenders. On the other hand, results also showed that the fast release of loan is the number one reason of borrowers in borrowing money from informal money lenders. Therefore, microfinance programs focused in this underserved sector were recommended.*

**Key words:** Informal moneylending, formal moneylending, micro-entrepreneurs, micro-financing institutions, microfinance programs

### **INTRODUCTION**

Not all goods and services consumed everyday are produced by business firms legally registered with the government. These

business are just scattered in all directions like the “talipapa” and sidewalk vending. Offhand, these are unlawful in the context of underground economy (Villegas, 2002).

The informal economy is composed of entrepreneurs engaged in economic activities that typically fail to comply with the legal requirements, even as the objectives of their endeavor are perfectly lawful. They tend to violate at least one or more formal legal requirements like government’s licensing, minimum wage, tax, sanitation and reporting (Geron, 1991). According to Larson (1988), underground economy is also known as unreported economic activity. This includes otherwise legal activities not reported to the taxing authorities. The existence of this activity is due to the desire of the concerned individuals to meet their interest that they could not get when they engage in formal economic activity.

The existence of an unorganized, unregistered informal sector was recognized in the early 1970s, following observations in several developing countries that massive addition of the urban labor force failed to show up in formal modern-sector unemployment statistics (Todaro, 2001). These are the activities of economically handicapped persons who are forced to create personal income-generating activities because they simply cannot afford the cost of being formal. Being formal means having to register the business, get the requisite permits and accomplish the appropriate forms. In other words, they have to face the often complex network of the government’s bureaucracy (Floro & Ray, 1997).

It is believed that informal business existed out of the strong need of people to survive. Entrepreneurs, though they want to have their business in a formal setting, are even willing to take the risk of getting “caught” violating government laws and regulations because they cannot afford to let their business be registered due to the complexities of formal business requirements (Villegas, 2002).

Underground economy is not only confined to selling goods or items and extending services to other people. Informal money lending or informal financing is also considered part of the underground business or underground economy (Lamberte, 2003). According to the book, financial institutions by Fajardo Manasala, and Altarez (1994), the structure, objectives and functions of this business are not defined and are not based on government laws and policies. They are unregulated and unsupervised by the Bangko Sentral ng Pilipinas. They are actively engaged in the business of money lending. They provide loans mostly to the poor consumers and small producers and merchants. Such groups or individuals have no officers, employees, and other similar facilities, which the banks have.

The informal money lending has become a prime alternative source of credit because the “needy” could just borrow money easily and anytime from the informal lenders without submitting complex requirements. This borrowing activity from the informal lenders is very common to individuals whose income is not sufficient for the family and to small entrepreneurs who need additional working capital to make their business grow in order to provide the basic needs of their family (Villegas, 2002).

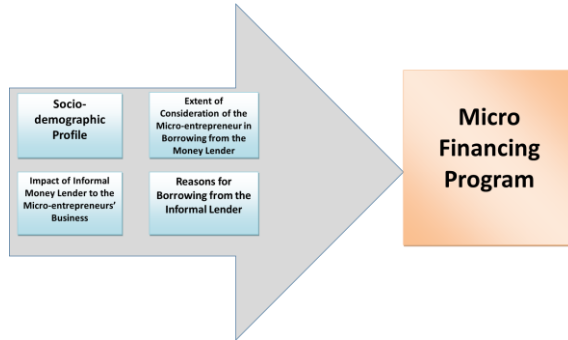
These poor and small borrowers are forced to patronize the informal money lenders because they simply do not have any asset large enough to function as collateral. If they apply for loans in formal financial sectors, they are generally ignored and considered “credit risks” and “unbankable” by the formal lending business (Atieno, 2001).

Another reason why the poor patronize informal moneylenders even if they have collateral is their unwillingness to follow difficult processes established by the formal money lenders, and their impatience to wait for the processing period (Manasala & Altarez, 1994).

Because of these, there is hardly any competition between formal and informal creditors since the commercial banks cannot do what the informal money lenders can do; informal lending individuals simply at the strength of the promise of the borrower with no collateral, and no formal transactions. Informal creditors lend in a more personal manner and they usually operate in the community where the borrowers are (Villegas, 2002). Hence, monitoring whether or not the money is being used productively which determines the borrower's ability to pay later on, becomes a lot easier. On the other hand, formal financial institutions cannot do this. The advantage of informal creditors is really on making funds available when and where they are needed (Floro & Ray, 1997). It cannot be said that informal lending rates are lower than those charged by banks, for they are not (Villegas, 2002). In fact, the lending rate is even higher, however small borrowers are still willing to borrow from these informal money lenders because what matters to them is the availability of fund and the easiness of acquiring it. (Villegas, 2002; Floro & Ray, 1997; Atieno, 2001; Manasala & Altarez, 1994) These cause the prevailing existence of "loan sharks". Formal lending institutions are security oriented; legal in almost every detail, and therefore their trust is more inclined to the collateral than to individual borrowers (Atieno, 2001). They fail to enrich the borrowers' trustworthiness because they have deposited their trust and confidence to the legal angle of "obligation and contract" between them and their borrowers, and they fail miserably to institute in public and instill in the borrowers of legacy of "obligation and character" (Villegas, 2002). This is an obvious weakness of formal lending institution. As a result, only those who "have" can borrow and those who "have not" are denied the privilege to borrow. Thus, the "rich are getting richer and the poor getting poorer" (Nolledo, 1994). It is no wonder then that poor "go-for-broke" to the informal money lenders.

In the City of San Fernando, Pampanga, money lending is numerous. To name some are banks, cooperatives, government and private insurance, lending investors as well as pawnshops. Banking industry leads the business and it is growing in number and expanding its operations. In this city, the following banks are Banco de Oro, Bank of the Philippine Islands, Philippine National Bank, Landbank of the Philippines, China Bank, Metro Bank, Allied Bank, UCPB, Robinsons Bank, Planters Bank, RCBC, Postal Bank, Bank of Commerce, PS bank, Eastwest Bank, and Security Bank. They are key players in the banking sectors, thrift and specialized government banking. Aside from banks, there are cooperatives such as Golden Group Gabay Puhunan Brotherhood Multipurpose Cooperative, Serbiz Multi-Purpose Cooperative, Apung Jose Multipurpose Cooperative, Buklod Yaman Ng Bulaon Multipurpose Cooperative, CSFP Employees Credit Cooperative, Coops for Christ Multipurpose Cooperative, Kilusang Nueve Primary Multipurpose Cooperative, Inc., and Minukyay Banua Multipurpose Cooperative, Radiant Shine Multipurpose Cooperative. Moreover, there are government and private financing institutions like Government Service Insurance System, Social Security System, Pag-ibig and some other non-bank financial institutions are also in the city as loan sources.

However, even if the number of these financing firms or entities is considered sufficient for Fernandinos to seek financial help at lower interest rates, many would still go to the informal money lenders despite higher interest rate because of fast and easier delivery of loans. These lenders are locally and popularly known as “5-6” or “loan sharks”. Their operation is underground but it has become a prime alternative source of credit due to the inability of some to borrow from the formal financing sectors. Hence, a conceptual framework (figure 1) was used in this research study.



**Figure 1. Conceptual Framework**

The aim of this study is to present an empirical analysis of micro entrepreneurs' dependency on informal money lenders that will be a basis for developing micro finance program. Most studies on this subject focused on the agricultural and the household sectors. The micro-enterprises sector of the economy relies on financial services to expand their earning capacity and in some cases meet emergency needs of the family. The respondents of the study were meat, vegetable, seafood, fruit, dry goods, sari-sari and rice vendors in one of the public markets of City of San Fernando, Pampanga who have experienced borrowing from the informal money lender. This paper will look at the extent of consideration of the borrowers in borrowing from the money lender and the reasons for borrowing from the informal money lender.

### **Statement of the Problem**

The study sought to present an empirical analysis of micro entrepreneurs' dependency on informal money lenders that will be a basis for developing micro finance program. Specifically it aimed to answer the following questions: a.) what is the profile of the borrower in terms of, age, civil status, gender, number of dependents, highest educational attainment, net earnings per month, amount borrowed, and purpose or use of the borrowed money?; b.) what is the extent of consideration of the borrower in borrowing from the lender?; c.) what is the impact of informal

money lending in terms of the borrowers' asset purchases, increase of sales, and increase on the net income of the business?; d.) what are the reasons for borrowing from the informal moneylender?

### **Scope and Delimitation**

The study was conducted on micro entrepreneurs at one of the public markets of City of San Fernando, Pampanga, Philippines. The respondents were meat, vegetable, seafood, fruit, dry goods, sari-sari and rice vendors who have experienced borrowing from the informal money lender.

## **RESEARCH DESIGN AND METHODOLOGY**

This study utilized descriptive method of research to assess the micro entrepreneurs' dependency on informal money lenders. The descriptive method was undertaken in order to ascertain, and be able to describe the relevant aspects of the phenomena of interest from an individual (Sekaran & Bougie, 2010).

The research study was conducted in one of the public markets of City of San Fernando, Pampanga, Philippines. Purposive sampling was used because it was only focused on the micro entrepreneurs who experienced borrowing money from the informal moneylenders. The samples from the borrowers included 72 respondents from a total of 192 registered retailers in the said market. The respondents of the study were meat, vegetable, seafood, fruit, dry goods, sari-sari and rice vendors.

The researchers use a set of questionnaire which they developed to gather the necessary data. Tagalog and English languages were prepared to be easily understood by the respondents.

A dry run was also conducted for this study to find out whether the instrument were clearly stated and understandable. The questionnaires were distributed to twenty

micro entrepreneurs in Angeles City Public Market. It was found out that all the survey questions were comprehensible to all respondents (see Table 1). The group was not included in the study.

In order to measure the reliability of the instrument, Cronbach’s Alpha coefficient was computed. A minimal alpha coefficient of 0.70 is required to claim that all instruments and its subscale scores are internally consistent and reliable though the alpha value between 0.80 and 0.90 is preferred (Guyatt et al., 1993).

**Table 1: Instrument Reliability Test Results**

Respondent	Cronbach’s Alpha per Subscale				
	Amount Borrowed	Purpose of Borrowed Money	Extent of Consideration in Borrowing from the Lender	Impact of Money Lending to the Borrowers	Reasons of Borrowing from the Informal Lenders
Borrowers	0.844	0.869	0.894	0.867	0.912

The researchers distributed personally the questionnaires to the respondents. Adequate care was undertaken while distributing the questionnaires to make sure that these are given to the micro entrepreneurs who experienced borrowing money from the informal lenders. The collection of data was accomplished by the researcher. Since most of the time they were busy, the researchers distributed the questionnaires and retrieved them during their free and most convenient time most likely at six o’clock in the afternoon. In all cases, verbal instructions were highlighted that there were no right or wrong responses and participants should answer questions as honestly as possible. Emphasis was also given to the confidentiality of responses since only the researchers would have direct access to them.

The gathered data were encoded, analyzed, and interpreted using the frequency and percentage distribution, and arithmetic Mean. The mean was used to determine the



extent of consideration the borrowers have in relation to the factors involved in availing credit from the lenders.

## **RESULTS AND DISCUSSIONS**

This chapter presents, analyzes and interprets the data gathered in the study. The study was conducted mainly to present an analysis of micro entrepreneurs' dependency on informal money lenders that will be a basis for developing micro finance program.

### **Profile of the Borrowers**

The bulk of borrowers are 41- 50 (36.11%) years old, followed by 31-40 (19.44%) years old. The civil status of borrowers where 45 (62.50%) are married, 16 (22.22%) are single, 8 (11.11%) are widows and widowers, and 3 (4.17%) are separated. It is rational to say that many of the borrowers are married since all of them fall under the economically productive age. This age group typically belongs to the marriageable age. Moreover, it reflected that married people have many obligations to settle, many basic needs of the family to provide, and greater responsibility to face.

A great majority of the respondents were males (52.78%). This implies that there are more male borrowers because a male, as head of the family, has greater responsibility for the provision of the needs of the family especially if married. Majority of the borrowers have one to five dependents (59.72%). This means that married individuals with large household size will have greater probability of going to informal lenders for funds. A great majority of the respondents are high school graduates (63.89%), followed by college graduates (22.22%). These findings means that entrepreneurs who have obtained more years of formal education are less likely to borrow funds from informal lenders. Educated individuals understand the concept of effective interest rate better than the less educated

individual. Accordingly, they will opt for the formal financial institutions (e.g. banks, lending institutions) that offer lower effective interest rate.

It is noteworthy to know that most of the respondents earn Php 5,001- Php 10,000 (47.22%) per month, followed by Php 10,001- Php 15,000 (29.17%). However, it is also alarming to know that some micro-entrepreneurs earn less than Php 5,000 (7 9.72%) per month. Twenty three respondents borrowed Php 20,001- Php 25,000 (31.94%), followed by fourteen respondents that borrowed Php 10,001- Php 15,000 (19.44%). It reflects that with little amount of income, it results to insufficient basic needs. The micro-entrepreneur looks for other sources of money to meet other needs of the family as a result of limited means or earnings.

All of the respondents (100%) borrowed from the informal lender for business purposes. Portion of the loaned money was used for daily subsistence with forty five and eighty three percent (45.83%), education for children with twenty seven and seventy eight percent (27.78%), and others (e.g. hospitalization/ medication of a member of the family, repayment of a previous loan, house improvements) with twelve and fifty percent (12.50 %). From these findings, it is evident then that the income of these respondents is not enough to support the basic and capital needs for their business.

### **Extent of Consideration in Borrowing Money**

It shows that the overall descriptive rating to all the factors is “Very Much Considered”. It means that micro-entrepreneurs greatly consider these factors before borrowing.

The loan procedure of the lenders in lending money is “Very Much Considered” by the borrowers with 4.75 arithmetic mean. It reflects that simple operation of the lenders is a great factor where client resorts to credit from them. There are no complex requirements just like what informal lenders are

doing. The borrowers prefer procedures of borrowing where there is no formal processing of loan papers and application.

The amount of loan is also rated “Very Much Considered” by the micro-entrepreneurs. Since most of the small borrowers need small amount of funds, they run to the informal lenders who provide immediately.

Borrowers rated purposes of loan such as business (production and trade), daily subsistence/needs, and education of children as “Very Much Considered”. It reflects that the borrowers seek loan from the lenders because of urgency of financial needs, usually for emergency like payment for inventory or asset purchases, tuition fees and some kinds of purposes. The borrower needs easy money or easy loans. If there are unplanned expenditures, the borrower does not have time in processing loan with the formal lending institutions; therefore, the preference is on the informal moneylender.

On the aspect of interest rate or cost of loan, the borrowers also rated “Very Much Considered”. The borrowers would seek a lender who would impose a lower interest rate as possible. The debtors are often taken advantage of by the informal lenders because of paying high interest rates. Since they are on financial crisis, borrowers are forced to go to the informal lenders.

The borrowers also rated “Very Much Considered” the item on accessibility of loan from the lenders. The transaction is often informal and easy processing because of the approachability and personalized services of the informal lender. This could be a good factor of informal lending that makes the operation of informal lenders successful.

Collateral serves as protection and security of the lenders in terms of unwillingness and inability of the borrower to settle obligations. On the part of the borrowers, collateral is a burden since they do not have any property or asset to serve for the purpose, so they would prefer borrowing from the informal lenders for some do not require such.

Lastly, in terms of credibility of the lender, the borrowers rated “Very Much Considered” this factor. It means that borrowers look for a trusted lender that could give the needed money immediately; a lender that could help them in some way or another, like giving consideration and grace period or extension of payment in case of failure to meet the due date.

#### *Impact of Informal Moneylending in Terms of Asset Purchases*

Majority of the respondents (68.06%) used over 80.1% up to 100% of the borrowed money for asset purchases and twenty and eight three percent (20.83%) of the respondents used 60.1% up to 80% of the money loaned for the same purpose. It is reflected that borrowers were able to procure different kinds of assets out of the borrowed money on cash basis and pay back the informal money lender through installment basis.

#### *Impact of Informal Moneylending in Terms of Increase of Sales*

Majority of the respondents (84.72%) affirmed that there is an increase of sales in their business and eleven respondents (15.28%) reported that there was no increase of sales. It reflects that the micro-entrepreneurs are expanding their operation.

#### *Impact of Informal Moneylending in Terms of Increase on the Net Income of the Business*

It is alarming to know that thirty nine respondents (54.17%) answered that there was no increase of net income generated from the business even if there was an increase in sales. This is may be due to the fact that they still need to pay for the cost of loan which is being deducted to their net income.

### **Reasons in Borrowing from the Informal Lender**

Great number of the respondents (94.44%) affirmed that the best reason in borrowing from the informal lender is the fast release of the loaned amount. It reflects on the findings of the study that informal lenders provide the money immediately

where and when the borrower needs it. The informal lenders are usually open to any kind of borrower, no business hours to follow, simple operation and personalized services to the borrowers. The formal lending institutions like banks cannot do these and therefore the informal money lending businesses boom. Formal moneylenders consider the small borrowers as credit risks and “unbankable” so the borrowers prefer to avail loan from the informal moneylenders. Other than the fast release of loan, as shown in the table, it is safe to conclude the most of the borrowers said that all of the below mentioned factors are reasons in borrowing from the informal lenders such as accessibility, no complex requirement, easy to approach and no collateral. Another reason why borrowers prefer to borrow from informal lenders is approachability and caring attitudes of the informal lenders because the borrowers do not have to be well-dressed and they may come anytime and any day for emergency loans. It reflects that borrowers prefer to borrow money from the informal money lenders with the least difficulty and least time to transact business with them.

### **Summary of Findings**

The study aimed to assess micro entrepreneurs’ dependency on informal money lenders that will be a basis for developing micro finance program.

The salient findings of the study are presented hereunder.

On the Personal Profile. Great majority of the respondents are married (62.50%) aged 41-50 years old supporting one to five dependents. Majority of the borrowers are males (52.78%). Majority of the borrowers are high school graduates. Micro entrepreneurs who have a monthly income of Php 5,000- Php 10,000 are the most common borrowers of the informal lenders. Most of them borrowed Php 20,001- Php 25,000 that was used for business purposes.

Extent of Consideration of Factors of Borrowing Money. The seven factors in borrowing money from informal money lenders were rated within the range “Very Much Considered” with a mean rating from 4.22 to 4.75, These are ranked as follows: 1.) loan procedure, 2.) no collateral, 3.) cost of loan, 4.) amount of loan, 5.) uses of loan, 6.) accessibility, and 7.) credibility.

Impact of Informal Lending to the Business. Majority of the respondents (68.06%) used over 80.1% up to 100% of the borrowed money for asset purchases and affirmed that there is an increase of sales in their business. 54.17% of the respondents claimed that there was no increase of net income generated from the business even if there was an increase in sales.

Reasons for Borrowing Money from Informal Money Lenders. A great percentage of the respondents (94.44%) affirmed that the most common reason in borrowing from the informal money lender is the fast release of loan in times of financial needs. The rest are accessibility (86.11%), no complex requirements (90.28%), approachability of the lenders (84.72%) and no need for collateral (77.78%).

## **CONCLUSION**

The following conclusions were drawn from the study:

1. As to personal profile, there are more married respondents aged 41-50 years old, more males, mostly high school graduates, with one to five dependents and an average monthly income ranging from five thousand and one pesos to ten thousand pesos (Php 5,001 – Php 10,000). Most of them borrowed Php 20,001-Php 25,000 that was used for business purposes.
2. As to the extent of consideration in borrowing from informal money lenders, the number one the respondents considered was the loan procedure.

3. On the impact of informal money lending to the business, all micro entrepreneurs used a portion of the borrowed money for asset purchases that increased sales but has not increased the net income of the business.

4. Fast release of loan is the number one reason of borrowers in borrowing money from informal money lenders.

### **RECOMMENDATIONS:**

Based on the findings and conclusions of the study, the researchers forward the following recommendations.

1. It is apparent from the study that less educated entrepreneurs are easy prey for the informal lenders. The less-educated entrepreneurs are not aware of the high effective cost implied by the nominal rate. Microfinance institutions (MFIs) should provide funds with favorable terms.

2. MFIs should encourage micro entrepreneurs to become members to their organization to avoid usurious interests demanded by informal money lenders.

3. Enterprises with increase of sales but same net business earnings is usually experienced due to exorbitant interest rates from informal lenders. It is a reason why it is more difficult for micro entrepreneurs to expand their earning capacity. Therefore, MFI should focus in empowering this underserved sector. Entrepreneurial skills enhancement by the MFIs is recommended.

4. MFIs should provide loans without collateral to small-scale borrowers, specifically microenterprises. Instead of collateral, they can use guarantors.

5. The MFIs should also be reaching borrowers who have viable businesses but have limited financial resources.

6. MFIs must be able to provide high quality, appropriate, and friendly service to its microfinance borrowers. Borrowers must feel welcomed in their office.

7. MFIs should streamline operations to simplify documentation and procedures. A simple procedure design will be easier for the borrowers to understand and for the staff to implement.

8. Loan agents of the MFIs are needed to deliver the loans at the doorsteps of micro entrepreneurs in a specific area. MFIs must clearly define geographic areas assigned to loan agents. Efficient planning of travel schedules of loan agents can reduce costs

9. Maintain inexpensive offices close to borrowers. Preferably, select staff from the communities.

10. Decentralize loan approval through a branch-level credit committee. For instance, a loan agent presents and defends his/her loan recommendation to a credit committee.

11. MFIs should reward clients who pay on time through interest rebates, bigger loans and/or longer terms.

12. MFIs should sponsor seminars and conferences that would influence the small time borrowers in their awareness on the negative effects of informal lending-borrowing activity.

13. MFIs should maintain regular contact with clients.

*Other Recommendations:*

14. The local officials of the city should provide measures to minimize the prevalence of informal money lending business in the city by implementing accessible micro-financing project to micro-entrepreneurs.

15. The Bureau of Internal Revenue should monitor and check the existence of informal money lenders and have them be formally registered so that they will also pay taxes to the government.

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