

**Micro-Finance Banking (MFB) in Pakistan and Its Impact on the Well-Being of Low Income
Individuals Living in Rural Areas of Pakistan.**

(Case Study: Peripheries of Rawalpindi / Islamabad)

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ABSTRACT

Micro-Finance Banking (MFB) in Pakistan is one of the focused channels in poverty alleviation projects undertaken by State Bank of Pakistan and Government of Pakistan in general. This study examines the procedures of Loan Processing System (LPS) of MFBs in Pakistan. The study helps in analyzing the impact of loan processing formalities with regards to emancipation of low income groups or individuals of Pakistan's rural areas, peripheries of Rawalpindi & Islamabad, in particular. The study tests the theoretical model in relation to MFBs and their impact on above-stated dimensions by using sample data on the low income individuals living in the peripheries of Rawalpindi & Islamabad cities. The data gathered from MBFs, organizations through field work and directly from the borrowers / clients of MBFs were analyzed by statistical tests of correlation and regression with a sample size of 200 out of which 190 respondents' data was appropriate to use for analyses. The conclusion drawn are significant with high positive correlation of MFBs with the well-being of low income groups / individuals living in rural areas. The results confirm the role of moderating variable indicating that the well-being of the low income groups / individuals is contingent on the easy loan processing systems / procedures of MFBs. Areas of further research have been suggested in this study report.

Keywords: Micro-Finance Bank (MFBs), Loan Processing Formalities (LPF), Well-Being of Individuals Living in Pakistan's Rural Areas located in the Peripheries of Rawalpindi / Islamabad.

Introduction

The World Bank defines two edges of poverty – the ‘extreme-poor’ who live on less than \$1.25 a day and the ‘merely poor’ who live on less than \$2 a day based on consumption per capita. In Pakistan, micro-finance businesses constitute ten “micro-finance banks”, sixteen “micro-finance institutions”, including eight “rural support programs”, nineteen “non-governmental organizations” and two “commercial financial institutions”. It is also discovered that most appropriate poverty alleviation is based on Islamic Micro-finance Institutions in Pakistan.

Micro-Finance, or the establishment of small loans to the poor with the purpose of lifting them out of poverty is a key poverty reduction strategy that has extent rapidly and widely over the last 20 years, currently operating in more than 60 countries.

Micro-Finance has played an important role in decreasing poverty and supporting economic growth. Moreover, conventional microfinance institutions were inheritors in Muslim countries but these are not proficient for overall Muslim clients in Pakistan. A focus of study is on the procedures of loan processing system that what could be the outcomes of loan processing formalities to the people of rural areas whether, these formalities are easily comprehensible to the prospective borrowers or not. An adequate loan processing formats should provide in order to achieve the goal of providing loans to the low income groups of Pakistan’s rural areas. So, Micro-Finance Banks need to simplify their loan processing formalities and systems enabling the target market to avail maximum benefit of the desired lending.

It is also observed that 80% of the respondents belonging to Lahore, Karachi and Islamabad cities of Pakistan considered loans disbursed by conventional Micro-Finance Institutions as not sharia compliant or adhere the Islamic mode of financing. Therefore, there is approximately the potential of 20 to 24 million borrowers in Pakistan for Islamic Micro-Finance market.

Agriculture is considered as an important economic sector, not only in rural areas, but also in urban areas. Moreover, farmers in rural areas in developing countries still find it difficult to access credit to enhance their productions. Financing micro-entrepreneurs with small, but collateral free loans, has emerged as a promising and effective tool for alleviating poverty, as it focuses on providing credit services to the poor, yet income generating ventures without collaterals.

Another study on Micro-Finance in Nigeria for the period (2000-2015) investigates that the impact of microfinance activities on rural economic growth and savings in not only contributed to agricultural productivity but had also assisted in increasing rural savings habits in Nigeria.

About two-third of the nation’s population lives in rural areas and a dominating portion of this population is poor. Even so, rural clients face difficulty in accessing credit due to their inability to comply with conventional loan collateral requirements, lack of credit history and high appraisal costs relative to the generally small loan size needed.

Significance of the study

In-depth study of the impact of MFBs on the wellbeing / emancipation of low income groups / individuals through easy loan processing formalities constitutes the rationale of the present research. In addition, the relevance of easy to avail small loans is an integral part of this study. Pakistan's significant population belongs to medium and low income groups. Whereas, Pakistan is also considered to be as agriculture-based and cottage industry based economy. Thus the results of the study are of paramount importance for the strategic planners, policy formulators, development sector practitioners and researchers.

Since the scope of this study is broad therefore, it is decided to restrict the scope to the specific area which revolves around the loan processing formalities of MFBs in terms of easy to avail bank's loan facility by the low income groups living in the peripheries of Rawalpindi / Islamabad. All other aspects such as training and development of MFBs staff, Directives of the regulatory framework, loan size and loan criteria have been excluded from the study enabling other researchers / practitioners to explore the possible perspectives of these areas in their future studies.

Key objectives and research questions

This study aims to find out answers to the questions by analyzing statistically the impact of MFBs on the emancipation of under-privileged / low income individuals through easy to avail small loans. The objectives of the study are to explicitly identify the following aspects:

- To assess the availability of Micro-finance Facilities in the peripheries (Rural Areas) of Rawalpindi / Islamabad
- The extent of effectiveness of Micro-finance Banks in terms of well-being / emancipation of low income groups living in the peripheries of Rawalpindi / Islamabad.
- To analyze the Micro-finance Banks' loan processing formalities in terms of convenience for the perspective borrowers.

The research questions were structured to check relationship of independent variable (IV) with the dependent variable (DV). One issue pertained to checking of the strength of relationship of IV with the DV given the likelihood of the MV to affect MFBs at various level of loan processing procedures. Following questions were formulated for testing the hypotheses in the study:

- What will be the impact of MFBs on the wellbeing of low income groups / individuals living in the peripheries (Rural Areas) of Rawalpindi / Islamabad?
- How the well-being of low income groups / individuals will get benefited by the loan facilities offered by MFBs?
- How the loan processing formalities of MFBs will moderate the wellbeing of low income groups / individuals living in the peripheries (Rural Areas) of Rawalpindi / Islamabad/

Variable of key interest.

The scope of the definition "Micro-Finance refers to small scale financial services primarily credit and savings-provided to people who farm or fish or herd; who operate small

enterprises or small business enterprises where goods are produced, recycled, repaired, or sold; who provide services; who work for wages and commissions; who gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and groups at the local levels of developing countries, both rural and urban”.

Micro-finance is often defined as financial services for poor and low-income clients. In practice, the term is often used more narrowly to refer to loans and other services from providers that identify themselves as — Micro-Finance Institutions (MFIs). These institutions commonly tend to use new methods developed over the last 30 years to deliver very small loans to unsalaried borrowers, taking little or no collateral. These methods include group lending and liability, pre-loan savings requirements, gradually increasing loan sizes, and an implicit guarantee of ready access to future loans if present loans are repaid fully and promptly”.

Micro-Finance is basically known as an establishment of a wide range of financial services such as credit, deposit, savings, insurance, and payment services to poor and low-income households who are excluded from conventional financial services for lack collateral. The logic is that by offering financial services, poor and low income people will be able to participate in economic market through forming and developing their micro and small enterprises. Consequently, they will be able to improve their households, make their decisions independently and manage their businesses.

Loan is a main and important product of Micro-Finance Banks and Institutions which refers to the small amount of credit given to poor people at reasonable interest for generating income through self-employment. The terms and policies of the given loan are important elements to the clients’ well-being and household improvement and their businesses’ performance. For example, increasing the size of the given loan is important for prolong the market and the size of micro and small enterprises. The flexibility of loan disbursement which includes the facilities of easy access to services, time responsiveness and providing suitable information about the terms of service is important determinants for improving the clients’ well-being. Furthermore, the flexibility of loan repayment policy which includes loan grace period, interest rate and repayment period all are critical factors for determining the role of micro-finance services on clients’ well-being. Micro-Financing emphasis is on the social objectives of poverty alleviation towards economic objectives of sustainable development of the local community. The potential importance of Micro-Financing is to uplift the financial inclusion and decrease the poverty alleviation.

In developing countries illiteracy rates are mostly high in rural areas. Poorly educated people face difficulty in retrieving financial services: it is difficult for them to analyze credit risks and the profitability of a loan or savings scheme, to provide all documents and information (such as a business plan) required to apply for a loan, and to understand conditions and contracts. Some institutions fail to communicate interest rates and commissions in a see-through manner, and small prints in contracts can contain more costs for borrowers. In contrast, financial institutions that want to broaden into rural areas experience difficulties in finding, hiring and keeping well-trained staff that is keen to work in a rural region. Lack of experienced staff leads to poor institutional capacity among rural financial institutions.

The challenges faced by Micro-Finance Institutions, which exterminate Poverty and empowering of women in Pakistan. Women empowerment and poverty alleviation are the

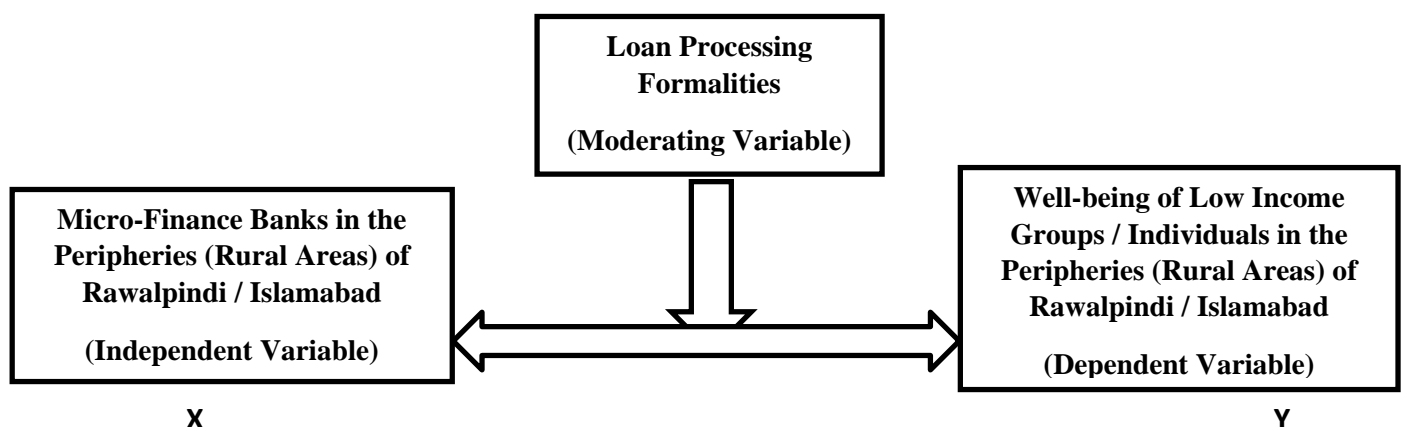
main problems in Pakistan. Some problems faced by micro-finance banks were low Literacy rate, absence to reach the financial facilities. In rural areas in Pakistan the level of credit use for agriculture inputs is high and credit for consumption is 5% more than for agriculture inputs, which is largely met through informal sources; and keep the poorer households at the level of better-off households. Without credit the former would drop below poverty line. Theoretically, credit increase income of households and as income of household increases more resources are available for expenditure, savings, and investment in assets. Studies have shown micro credit improves capacity to cope economic difficulties because there is a positive influence of micro credit on well-being of borrowers. The argument is that micro credit does not create assets of poor and very poor borrowers, but only increases income to the extent to meet daily expenditure. In certain situations, it decreases assets because the demand for repayment of loan is so intense that borrowers are get to sell assets to repay loan. At “lower levels of income there is greater risk that improvident or unlucky borrowers may be forced by their exposure to debt into selling assets which will permanently lower their income possibilities”.

Repayment of micro credit installment is burdensome for poor borrowers whose assets and income are at subsistence level. Persuasive loan staff insists on payment on time leaving no flexibility and thus rural households either further borrow or sell liquid asset in certain cases. Micro-credit loans lean to be distributed to women as well as groups of borrowers, who share the responsibility of repaying the money (social collateral); lending to both women and groups results in high micro-loan repayment/refund rates.

Micro-credit provided by micro-finance banks affects subjective well-being of low income groups in the form of overall life satisfaction with different life domains (satisfaction with financial security, standard of living, achievement in life, health, family, and community), and feelings of happiness, worry and depression. Positive and negative emotions, aspirations, social comparisons, and a sense of fulfillment, recognition and purpose are significant in how people feel about their lives; these are unlikely to be fully, or even partially, reflected in objective measures of well-being such as income. Therefore, focus on subjective well-being measures, such as life satisfaction, happiness, worry, and depression, provides a more holistic view of the well-being effects of micro-credit entrepreneurship.

Theoretical / conceptual framework

Based on the above-cited theory and extensive literature review, the following conceptual framework is developed for the study:



Hypotheses

It can be assumed that MFBs have direct and positive impact on the wellbeing / emancipation of the low income groups / individuals of Pakistan living in the rural areas. Furthermore, easy to fulfill or complete the loan processing formalities is a key to leave a positive impact on removing the poverty stigma from the low income / under-privileged groups / individuals of Pakistan's rural areas. It is therefore, hypothesized that:

H₁: Micro-Finance Banks have a positive and significant impact on the well-being / emancipation of low income groups / individuals living in the peripheries (Rural Areas) of Rawalpindi / Islamabad.

H₂: Loan Processing Formalities (LPF) moderates the impact of MFBs on the well-being / emancipation of low income groups / individuals living in the peripheries (Rural Areas) of Rawalpindi / Islamabad.

Methodology

This is a quantitative study and cross-sectional research. Survey was conducted through structured questionnaires to collect data from Banks, organizations and the borrowers / clients of MFBs. Data was collected through primary sources. Due to limited time, convenient sampling was used in this research. 200 respondents were requested to fill the questionnaire and 190 useable questionnaires were returned with response rate of 95%. 5 point Likert Summation Scale was used to measure the nature of all variables strongly disagree= 1 to strongly agree= 5. Respondent were assured of confidentiality and participation as a voluntary basis. NFMB was measured using 5 item scaled. LPF was measured using dichotomous YES NO item scale. WBLIG was measured using 5 item scaled strongly disagree= 1 to strongly agree= 5. Demographically, population was comprised of combination of both males and females, respondents belong to variety of designation, experience, age and education. The majority of the participants were single (50.9%) males (70.2%) with average ages from 21 to 25 years (30.4%). Most of were general public (63.7%) who had been not educated. Their average education was intermediates degree (59.1%).

Equation:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 M + \dots \dots \dots \mu$$

Control variable

One way ANOVA was performed to control the variation in well-being of low income groups on the basis of demographic variable used in the study. Result obtained from one way ANOVA indicated significant differences in well-being of low income groups (dependent variable) across gender (F= 2.51, p < .01), age (F= 5.42, p < .01), marital Status (F= 4.41, p < .01), qualification (F= 3.52, p < .01). While no significance differences was found in mean values of well-being of low income among group on the basis of gender, age and qualification.

Subsequently, factor identified as significant were entered as control variables in step 1 of regression analysis for dependent variable.

Table 1: One-way ANOVA

Well-being of Low Income Groups		
Sources of variation	F statistics	P value
Gender	2.51	0.00
Age	5.42	0.00
Marital status	4.41	0.54
Qualification	3.52	0.71

Results and Discussions

Mean, standard deviation and correlation matrix are presented in Table 2.

Table 2: Means, Standard Deviations, Correlations and Re-liabilities

	Mean	.D	1	2	3	4	5	6
Gender	.21	.41						
Age	.65	.82	.09**					
Marital status	.65	.82	.02*	.01**				
Qualification	.83	.86	.07*	.08**	.89***			
MFB	.56	.81	.08**	.04***	.05**	.14***	(0.84)	
WBLI	.61	.89	.28***	.27***	.19**	.27***	.35***	(0.88)
LPF	.52	.48	.15**	.12***	.05**	.13***	.19***	.06*** (0.79)

NMFB = Network Of Micro-finance Banks

LPF = loan processing formalities

WBLI = Well-being of Low Income Groups

* $p < .05$, ** $p < .01$, *** $p < .001$

n = 200;

Alpha re-liabilities are given in parentheses ()

For gender, 1, "male"; 2, "female".

Age ranges from 1, "below 18 to 25"; 2, "26 to 40"; 3, "41 to 60"; 4, "above 60".

For marital status, 1, "single"; 2, "married";

For Qualification, 1, "uneducated"; 2, "below metric"; 3, "bachelor"; 4, "master".

This table indicates that there is a strong positive significant relationship between Network of Micro-finance Banks and Well-being of Low Income Groups ($r = 0.35$, $p < 0.001$) the hypothesis 1 receives empirical support from the correlation results. On the other hand loan processing formalities exhibited a strong degree of association with Well-being of Low Income Groups ($r = 0.27$, $p < 0.001$) thus initial supported for H2.

Regression Analysis

Multiple regression analysis was used to test the main effect as well as the moderation effect of these variables. Result of regression for main effect of Network of Micro-finance Banks with Well-being of Low Income Groups is reported in Table 3.

Table: 3		Investment Decision		
Moderated Regression Analysis		B	R²	Δ R²
Predictor				
Step 1				
Control Variables			0.03	
		7		
Step 2				
MFP	0.49***			
LPF	0.35***	0.33	0.27	
Step 3				
MFP x LPF	0.21***	0.34	0.03**	

* $p < .05$, ** $p < .01$, *** $p < .001$

N=200

Control variable is gender.

The result indicates that NMFP strong significant positive relationship with WBLI having β value 0.49*** at a significance value of $p < 0.001$ thus the H1 is supported. Regression analysis further indicates that LPF have a strong positive significance relationship with investment decision having β value 0.35*** at a significance value of $p < 0.001$, therefore H2 is supported.

H2 was tested using moderated regression analysis technique developed by Cohen, Cohen, West, and Aiken (2013), where control variables were entered in step 1. In step 2 independent and moderator variables were entered. Finally, in step 3 the interaction term (product of independent and moderator variables) was entered, which if significant, verifies moderation.

In Table 3(step3) the result of moderated regression analysis show that LPF moderates the relationship of NMFP and WBLI ($\beta = 0.21^{***}$, $p < 0.001$; $\Delta R^2 = 0.03$, $p < 0.01$) and, as a result, H2 was supported.

Future directions

For future prospects of the study on this issue, it is strongly recommended that study may also be carried out covering other relevant areas such as, MFBs' role in decreasing deflation in Pakistan, empowering under privileged women in Pakistan, forecasting the agriculture industry's yield for onward conversion process from agricultural growth to industrialization prosperity. In order to further authenticate the relationship of variables which have been analyzed in this study.

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