

EFFECT OF MICRO FINANCE ON POVERTY REDUCTION OF SMALL SCALE FARMERS OF PAKISTAN

Rashid SAEED, Rab Nawaz LODHI, Zaheer Ahmad SAEED

COMSATS Institute of Information and Technology, Sahiwal Pakistan,
Email: zaheer_saeed@hotmail.com

Corresponding author: zaheer_saeed@hotmail.com

Abstract

This study revealed the impact of micro finance with regard to poverty alleviation, employment generation opportunities, upraise in the standards of living of the small farmers of Pakistan along with the access of such finances and their financial cost. Small farmers often rely on the loans and finance from the formal and informal sources of finance. There is low rate of sustainability in the micro finance sector. These schemes remain for a small time period. Another challenge is that there is a need of replicable and scalable model. There is also a requirement of formalization of informal credit source which count for higher. There is high need of reducing the ambiguities in obtaining the credit from these sources. With respect to agriculture, the proportion of finance should be increase with the proportion to its contribution to the economy. The data for this study has been collected through a self-structured questionnaire and respondents are small farmers who are availing the micro finance facility for any source; informal, formal or semi – informal. The data collected form 150 respondent from Sahiwal and Multan Region. The data has been analyzed through regression and correlation method with the use of SPSS for checking the relationship and impact of micro finance on the living of poor and employment generation. This paper also concluded that the financial cost of such finances is having significant role on the success of such schemes. The research is a contribution to the financial sector to set their focus according to the quality and quantity of micro credit to the agriculture sector.

Key words: agriculture, microfinance, Pakistan, small farmer

INTRODUCTION

Micro finance has its roots in achieving a very important objective of poverty alleviation which is the most important economic aspect of any economy and poverty is observed all over the world. Poverty is not demonstrated but practiced. Low income restricts the poor to fulfill their immediate desires. Sometimes, poor are unable to provide education, better health services and good quality food. Mostly this situation is observed in rural areas because there is seasonal employment which restricts these poor to obtain their desires because they are attached to the agriculture sector for employment.

Agriculture sector is a fundamental and very central sector and plays vital role in Pakistan's economy. It currently contributes 21% to GDP. The growth of the sector is 3.1% in 2012 as compared to 2.4% in 2011. It generates employment for 45% of the country's labor force and 60% of country side population depends upon this sector for

livelihood. It has crucial significance for food security, breeding and overall economic growth and contribute a significant role for alleviation of poverty. But unfortunately farmers have not enough finance to use innovative technology which is essential for achieving high productivity. If considering the cost of production in agriculture sector, major ingredients includes the electricity cost and the fertilizer cost, the prices of both have increased more than 100% in last two years. For the purpose, GOP and SBP provide agriculture loans at low cost to boost up this sector and all the farmers meet the needs of the crops timely and get a high level of productivity.

Currently 26 commercial and microfinance banks, with around 3,900 agriculture designated branches, are facilitating farmers by extending agriculture credit throughout the country. Following are the banks which include ABL, HBL, MCB, UBL, two specialized banks are; ZTBL, PCBL, and 14 private domestic banks. Five MFBs are also providing funding to this

farming community. Financing is provided for the purpose of growing crops, livestock, poultry, fisheries, orchards, forestry, nurseries, horticulture and sericulture.

ACAC has billed cumulative agriculture credit distribution goal of Rs. 285 billion for 2011-12; out of the over-all amount of agricultural credit distributed; Rs. 195.1 billion was distributed by Commercial Banks, Rs. 70.1 billion by ZTBL, Rs. 12.2 billion left to the Microfinance Banks and Rs. 7.6 billion was distributed to the PPCBL(Hafeez, 2012).

A large population is dependent upon the agriculture sector, while there are problems of illiteracy, poverty and seasonal employment which causes some problem and requires immediate solution, as in the economic survey 2011-12 announced that more than 60% population lived in rural areas, and literacy rate in Pakistan is 57% while in rural areas it is 48 % which is less than the national level. It requires attention so that the literacy should be increased up to the national level. This sector absorbed 45% of the employment; we have only 18 million hectares useable land, if we have ample resources, the employment level can increased more than this. Furthermore, CPI is 12.4% which decrease the purchasing power of the inhabitants that ultimately cause a decrease in the standard of living.

Today's crucial problems are unemployment, illiteracy, lower level of standard of living, low per capita income and high inflation rates in the economy. Every country either developed or underdeveloped wants to eliminate these problems from their economy because these factors affect the economy severely and destroy the whole economy because these problems decrease the economic cycle time period. As agriculture sector is very crucial and now GOP and SBP is working for the development and growth of the sector to achieve the stable economy and highly competitive raw material for the other sectors of the economy from the agriculture.

Poverty is the conditions where inhabitants of the economy are unable to meet their basic requirements. It causes afore mentioned problems along with the psychological problems and uplift the unethical behaviors in

the society (Durrani, Usman, Malik, & Ahmad, 2011). 28% of rural area population is categorized as poor (Jaffari, Saleem, Abideen, Kaleem, Malik, & Raza, 2011). Micro financing is easy because it has fewer restrictions to obtain loans from institutions e.g. farmers can easily attain this facility by providing a personal guarantee and his CNIC's copy for obtaining loan from the Khushali Bank. Micro financing is helpful in reducing poverty. SBP is not just focusing on providing the targets but also provides tools and better policies for MFIs and MFBs so that they can easily communicate to each other and provided better loaning facilities to their customers. SBP requires from these banks e.g. product innovation, MIS, usage of new technology, branding, good credit rating of MFIs, return and risk manuals, providing planning and implementing techniques and training to their employees as well the borrowers so that they can gain high profits from their investments. SBP announces the objectives of the MFIs and MFBs are training and capacity building, and enhance the literacy programs in these specialized funds are invested with the help of \$20 million by the GOP which helps in increasing the lending capacity of the banks and easy access to finance by the lower income families. Also SBP provide £ 10 for ISF from 2008 to 2012 through FIP to strengthen the micro finance institutes (SBP, 2013). How are MFIs' equity increased? The obvious answer to the question the equity investment through investing indirectly from mutual funds or directly from private investors and communication flow towards customer in better way which attracts the poor, small entrepreneurs and commercial investors (O'Brien, 2006).

The benefits of micro finance are (a) income generation prospects (b) enhanced community physical infrastructure in the underserved areas and (c) greater economic integration of women in the country (Shirazi & Khan, 2009).

“Microfinance Institution means an institution, which extends micro credit and

allied services to the poor through sources other than public savings and deposits”

“Microfinance bank means an institution licensed by State Bank under Microfinance Institutions Ordinance 2001 to establish and operate as microfinance bank” (Microfinance Institutions Ordinance 2001, 2013).

Microfinance institutes are providing loans to the poor who are unable to obtain loans from the traditional banking system (Jaffari, Saleem, Abideen, Kaleem, Malik, & Raza, 2011).

Poverty is the situation where the poor are unable to meet their basic necessities of life such as food, shelter and clothes etc. (Shirazi & Khan, 2009). The main basic element of poverty is the high population in the country. Further Kalirajan and Sing (2009) argued that the country with sustainable agriculture growth has a high degree of poverty alleviation. Because most of the population lived in rural areas all over the world, and mostly poverty is related to the rural where land lords and other giants dominate the poor, if the poverty is reduced in the rural areas means the economy is reducing a large proportion of poverty from the society.

Ahmed (2010) found that instead of having a high poverty ratio, microfinance increases the living standards and is helpful in decreasing that poverty level in Bangladesh. Although the country has high poverty but microfinancing provides support to those poor who work hard and increase their standard of living, and the most viable financier in the sector is Grameen Bank of Bangladesh. It is viable to gain loans from friends and family members easily than financial institutions in Tanzania which is helpful in increasing the business prospectus (Satta, 2004). Poverty alleviation (Adjei, Arun, & Hossain, 2009), (Aideyan, 2009), (Rahim & Rahman, 2010), (Kalirajan & Sing, 2009) and (Chirwa, Mvula, Namata, & Zgovu, 1999) is a major concern in Bangladesh through aid, foreign funding and foreign direct investment which decrease the poverty and enhance the employment which ultimately increase the standard of living of the inhabitants of the country (Mashreque, 2012). Microfinance is helpful in increasing social capital and share the economy's risk by

increasing employment and opportunities both in male and female and affects the environment by increasing education (Schrieder & Sharma, 1999). Senanayake Premaratne (2006) provided three dimensions of microfinance; (i) it affects the financial structure of the economy because it is working under the central bank of the economy and follows the rules and regulations to achieve sustainable growth in the country, (ii) it provides loans to the poor which reduce the poverty in the country, and (iii) as it becomes the part of the economy's developmental infrastructure which affects the economy so it works in such a way which is helpful in achieving growth and development in the economy. Poverty alleviation is dependent upon the per capita income, performance of the economy, foreign remittances, public administration and growth of the economy, also stated that the corporate governance is important for the well performance of the microfinance institutes (Ashta & Fall, 2012). Microfinance is an efficient way to reduce poverty through education, health and infrastructure. They also found that competition enhanced which decreases the lending to typical poor but is helpful in achieving a sustainable economic environment (Hermes & Lensink, 2007). Dusuki (2008) stated that the microfinance is an emerging trend in the traditional system and Islamic microfinancing reducing the cost of borrowing as well as the cost of processing which increases the borrowing power and effective usage of borrowed finance alleviates the poverty from the economy. Poverty alleviation is not just only a concern of the government or financial institutions but also the attitude and behavior of the society counts a lot, without the society there is no concept of economy. Most of the people has an intention to obtain a loan for non-payment which ultimately ruins the basic purpose of borrowing that amount and ultimately microfinancing meaningless because the amount is not invested, when not invested, it will never get prosperity and cause a bank default (Nkamnebe & Idemobi, 2011). Borrowers should invest the money for the

purpose they obtain which flourish the prosperity in the economy and decrease the poverty.

Muslim world faces vicious poverty cycle, low economic growth and development and high unemployment rates (Dusuki, 2008) Islamic microfinancing provides different schemes such as Musharikah, Modarabah, Qarz-e-Hasana and Ijara etc. these schemes having high potentials for small investors and poor to increase their lifestyle with high standard of living and ultimately decrease the poverty in the economy. These are very effective techniques in assets building of the economy because these are cheap sources for capitalization of assets for any firm or individual (Rahim & Rahman, 2010). This financing system resolves the problem of heavy collateral and reputation of the credit worthiness of poor but still the problem of trust exists because the lender is unable to the intentions of the borrower although he has stated the specified objective for getting the loan (Dusuki, 2008). Mushrikah resolve this problem upto maximum level because the lender become the partner in the business.

Historically in India giants provided loans to farmers and other rural inhabitants on the basis of mortgage and charge heavy interest fee on loans (Mashreque, 2012), after nationalisation the perspective changed, rural credit provided by the banks at lower cost to achieve sustainable environment (Shah, Rao, & Shankar, 2007), and (Senanayake & Premaratne, 2006). Countryside is very crucial to Indian Government and Reserve Bank of India provide heavy microfinance facility to reduce the poverty in the countryside areas of the country. For the purpose, many tools and techniques are applied to gain prosperity in rural areas which ultimately increase the living standards by reduction in poverty. Reserve Bank of India establish soft policies for the microfinance sector so that they can provide loans to the rural inhabitants of the society (Akoijam, 2013). Type of microfinance institution also affects the poverty reduction such as NGO-MFIs and Islamic Banking has high preference in this

scenerio, while MFIs and MFBs are lagged behind due to cost of capital and borrowing procedures. Recently, micro financing is an effective tool used by under developed and developing countries to reduce poverty, so in Asia it is very effective as compared to Latin America (Zeller & Johannsen, 2008).

The important factor of financial cost is not considered in evaluating the effects of microfinance in agriculture sector, it is considering because it affects the borrowing power and borrowing decision of the customer. Financial cost includes the interest rates, processing costs and hidden financial charges. This study provides an insight to MFIs and MFBs in evaluating their customers, further helpful for the academic teachers and students, and researchers.

Hypothesis:

Null Hypothesis: Micro Finance has no impact on Poverty Reduction

Alternate Hypothesis: Micro Finance has impact on Poverty Reduction

MATERIALS AND METHODS

Present study is used to check the Effect of Micro Finance on Poverty Reduction of Small Scale Farmers in Pakistan. It is considered to be a most important that we have a prior knowledge about the topic before we conduct a descriptive research. Keeping this thing in mind we have reviewed previous studies conducted related to our topic. Structured questionnaire bases on the variables selected from previous studies have been used to collect data from the respondents. The structure questionnaire distributed among 150 small scale farmers of Multan and Sahiwal regions of Pakistan. From 150 respondents 125 completely filled questionnaires returned those are further used for analysis purpose. Regression and correlation techniques used to analyze the data using SPSS 19.0.

RESULTS AND DISCUSSIONS

To check the relationship among different variables we used **regression and correlation methods**.

Results from Table 1 suggest that there is significant ($p < 0.05$) positive correlation

among micro finance and standard of life. And micro finance has a less significant correlation with the other variables like purchase power of the community and the cost factor. When we look upon the relationship among the dependent variables then we find that there is a significant

($p < 0.05$) positive correlation among purchasing power of the consumer and the standard of life. The table further suggests that there is no significant relationship among other dependent variables.

Table 1. Correlation

		Micro finance	Standard of Life	Puchasing Power	Cost
Micro finance	Pearson correlation	1			
	Sig.(2-tailed)				
	N	125			
Standard of Life	Pearson correlation	0.673**	1		
	Sig.(2-tailed)	0.000			
	N	125	125		
Purchasing Power	Pearson correlation	0.328	0.585**	1	
	Sig.(2-tailed)	0.109	0.002		
	N	125	125	125	
Cost	Pearson correlation	0.340	0.255	0.054	1
	Sig.(2-tailed)	0.096	0.220	0.799	
	N	125	125	125	125

Regression. To check the impact of independent variable on dependent variable we used regression method. Keeping in mind that there are more than one dependent variable we used multivariate tests.

Table 2. Multivariate Tests

Source	Dependent Variable	F	Sig.
Microfinance	Standard of Life	19.047	.000
	Purchasing Power	2.781	.109
	Cost	3.016	.096

To check the impact of Micro finance upon the dependent variables like standard of life, Purchasing power and the cost factor we used regression method. Results from this regression are shown in table 2. The results indicates that Microfinance have significant positive impact on standard of life. There is no significant relationship among the purchasing power but microfinance has little impact on cost factor. This indicates that if microfinance provider at lower cost to the small scale farmers in Pakistan it will help them to get more finance to invest in agriculture sector of Pakistan.

Purpose of present study is to explore the impact of micro finance on poverty reduction in Pakistani perspective. our results reveals that microfinance have a significant impact upon the peoples standard of life which shows that firstly peoples will manage their basic necessities and then they move forward toward standard of life. Results from our study shows that microfiche contributes toward maintain the standard of life for farmers. From this we can see that our null hypothesis is rejected and alternate hypothesis is accepted which shows that micro finance have positive impact on poverty reduction in Pakistan.

Shirazi& Khan, (2009) found that poverty is the situation where poor are unable to meet their basic necessities of life such as food, shelter and clothe etc. our results reveals that microfinance have a significant impact upon the peoples standard of life which shows that firstly peoples will manage their basic necessities and then they move forward toward standard of life. Results from our study shows that microfiche contributes toward maintain the standard of life for farmers in Pakistan. From this we can draw a result that with the improvement of standard

of small scale farmers in Pakistan we can reduce the level of poverty in the country. We can further say that it is an element in Pakistan economy which can positively contribute toward poverty reduction in country. Results further reveals that the cost is consider being a significant factor in micro finance. From this we can say that as firms providing micro finance to farmers decrease their cost of processing, interest and some other financial cost it will lead farmers to get more finance.

CONCLUSIONS

In concluding remarks we can say that the micro finance is significant way to reduce level of poverty in Pakistan if it is provided at lower cost. Farmers living in Pakistan will move toward micro finance if it is available to them at lower cost. When farmers get money with the help of microfinance it will improve their living standards as well as it will add significant positive results to economy.

REFERENCES

- [1]Adjei, J., Arun, T., & Hossain, F., 2009, Asset Building and Poverty Reduction in Ghana: the Case of Micro Finance. *Savings and Development* , 33 (3), 265-291.
- [2]Ahmed, S., 2010, Microfinance institutions in Bangladesh: achievements and challenges. *Managerial Finance* , 35 (12), 999-1010.
- [3]Aideyan, O.,2009, Microfinance and Poverty Reduction in Rural Nigeria. *Savings and Development* , 33 (3), 293-317.
- [4]Akoijam, L. S., 2013, Rural credit: a source of sustainable livelihood of rural India. *International Journal of Social Economics* , 40 (1), 83-97.
- [5]Ashta, A., Fall, N. S., 2012, Institutional analysis to understand the growth of microfinance institutions in West African economic and monetary union. *Corporate Governance* , 12 (4), 441-459.
- [6]Chirwa, E., Mvula, P. , Namata, L., Zgovu, E., 1999, Capacity Constraints, Management and Effectiveness of Poverty-Oriented Micro Finance Institutions in Malawi. *African Review of Money fianance and Banking* , 21-48.
- [7]Durrani, M. K., Usman, D. A., Malik, M. I., Ahmad, S. ,2011,. Role of Micro Finance in Reducing Poverty: A Look at Social and Economic Factors. *International Journal of Business and Social Science* , 2 (21), 138-144.
- [8]Dusuki, A. W. ,2008,. Banking for the poor: the role of Islamic banking in microfinance initiatives. *Humanomics* , 24 (1), 49-66.
- [9]Hafeez, D. S.,2012, *Economic Survey 2011-12 of Pakistan*. Ministry of Finance. Govt. Of Pakistan.
- [10]Hermes, N., Lensink, R.,2007, Impact of Microfinance: A Critical Survey. *Economic and Political Weekly* , 42 (6), 462-465.
- [11]Jaffari, S. I., Saleem, S., Abideen, Z. U., Kaleem, M. M., Malik, N., Raza, M. , 2011, An Examination of Challenges and Prospects of Microfinance Sector of Pakistan. *European Journal of Economics, Finance and Administrative Sciences* , 146-159.
- [12]Kalirajan, K., Sing, K., 2009, The pace of poverty reduction across the globe: an exploratory analysis. *Journal of Social Economics* , 36 (6), 692-705.
- [13]Mashreque, M. S., 2012, Paradox of rural development in Bangladesh: A focus on poverty alleviation and triangular policy manipulation. *Humanomics* , 28 (3), 187-199.
- [14]Nkamnebe, D. A., Idemobi, I. E., 2011, Recovering of micro credit in Nigeria: Implications for enterprise development and poverty alleviation. *Management Research Review* , 34 (2), 236-247.
- [15]O'Brien, B. , 2006, Valuing Microfinance Institutions. *Saving and Development* , 30 (3), 275-296.
- [16]Rahim, A., Rahman, A., 2010, Islamic microfinance: an ethical alternative to poverty alleviation. *Humanomics* , 26 (4), 284-295.
- [17]Satta, T. A., 2004, Microfinance regulation influence on small firms' financing in Tanzania. *Journal of Financial Regulation and Compliance* , 12 (1), 64-74.
- [18]SBP, 2013, March 2: http://www.sbp.org.pk/l_frame/MF_Inst_Ord_2001.pdf
- [19]SBP, 2013, March 2, State Bank of Pakistan's Website: www.sbp.org.pk/publications
- [20]Schrieder, G., Sharma, M., 1999, Impact of Finance on Poverty Reduction and Social Capital Formation: a Review and Synthesis of Empirical Evidence. *Savings and Development* , 23 (1), 67-93.
- [21]Senanayake, S., Premaratne, S., Micro Finance for Accelerated Development. *Savings and Development*, 30 (2), 143-168.
- [22]Shah, M., Rao, R., Shankar, P. V., 2007, Rural Credit in 20th Century India: Overview of History and Perspectives. *Economic and Political Weekly* , 42 (15), 1351-1364.
- [23]Shirazi, N. S., Khan, A. U., 2009, Role of Pakistan poverty alleviation fund's micro credit in poverty alleviation. A Case of Pakistan. *Pakistan Economic and Social Review* , 47 (2), 215-228.
- [24]Zeller, M., Johannsen, J. ,2008, Is there a difference in poverty outreach by type of microfinance institution? Country studies from Asia and Latin America. *Savings and Development* , 32 (3), 227-269.