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TABLE OF CONTENTS

DETERMINANTS OF INFORMAL CREDIT DEMAND BY SME HOLDERS IN THE RURAL SECTOR (WITH REFERENCE TO PAMBAHINNA, BALANGODA DS DIVISION)

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Introduction

As in most of Asia and the Pacific, Sri Lanka too, has a majority of its people living in rural areas, estimated at around 78% of its total population. The small industries in the rural areas are the major source of employment and production of food and, therefore, of the Sri Lankan villager's livelihood. The relatively labor intensive nature of this sector, coupled with regional dispersions of cottage and small scale industrial enterprises, enables them to create substantial employment opportunities particularly in the informal sector.

Small and Medium Enterprises (SMEs) have a great potential to mobilize financial resources in the economy which would otherwise have been used for consumption purposes. In rural areas', a substantial portion of the investment cost of small scale units is financed by domestic sources, mainly from their personal savings or informal borrowings (Gamage, 2000). In particular, informal sources play an important role in fulfilling the financial needs of the rural community. Even though formal financial institutions have expanded in the rural sector, many rural households still demand informal credit. Non-institutional or informal lenders are still seen as playing the major role in the provision of rural credit in Sri Lanka (Sandaratne, 2002). Better accessibility, flexibility of repayment, being less time consuming, no collateral requirements and proximity are the major reasons for a high demand for informal credit by the rural community (Karunagoda, 2007).

According to the Consumer Finance Survey (2003/2004) of the Central Bank of Sri Lanka nearly 10.7% and 89.3% of the loans were provided by the formal and informal sectors, respectively in 1978/79. When considering the value of loans the figures are 25.3% and 74.7%, respectively. Corresponding sets of figures for 2003/04 are around 45% and 55% (number of loans) and 61.1% and 38.9% (value of loans). The informal sector loan amount is lower on average than that of the formal sector.

Studies on informal/rural finance have been carried out in many countries. Essien et al (2013) examined the frequency of loan demand in the credit market among small scale agro-enterprises in Nigeria. According to their results borrowing experience, firm income, guarantor, social capital and non-agro based income significantly influenced the frequency of informal credit access.

Amjad and Hasnu (2007) in their study of smallholders' access to rural credit in Pakistan, showed that family labour, literacy status, off farm income and value of non-fixed assets were the main influential factors for accessing formal credit. Total operated area, family labor, literacy status and off farm income were important factors in accessing informal credit sources. According to their findings in Pakistan more than 90% of smallholders obtain credit from informal sources.

Messah and Wangain (2011) found demographic and socioeconomic factors affecting credit demand by small scale investors in Kenya. Gender, marital status and the number of dependents (unemployed) in a family were the most significant demographic factors while level of education and income of enterprises were important socioeconomic factors. According to their findings education, level of income were an important elements that has a positive impact on small scale enterprises demand for credit.

In comparison with studies in other countries there is a dearth of studies relating to informal credit demand in Sri Lanka. Existing studies have not paid attention to the determinants of informal credit demand by SME holders in rural sector. Accordingly, this research aims to find an answer to the question, what are the determinants of informal credit demand by SME holders in rural sector?"

The objectives of the study are (to):

- Examine the determinants of informal credit demand by SME holders in rural sector

- Identify how influencing factors impact on informal credit demand by SME holders in rural sector.

Methodology

The model is conceptualized as follows.

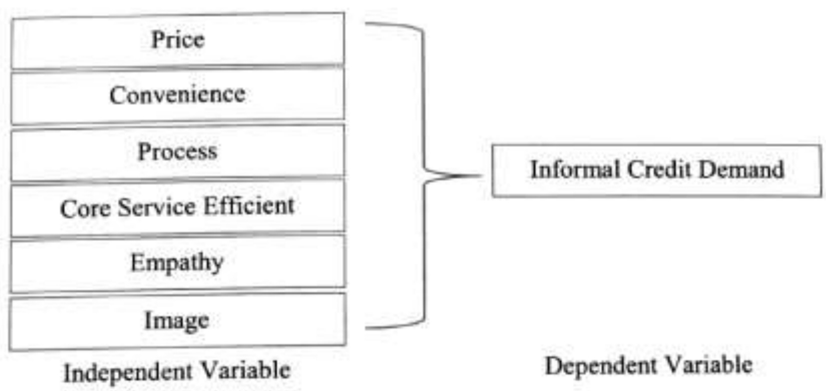

Figure 1: Conceptual Frame Work
Source: Researcher's construction

The study utilized primary data from a sample of 50 SME holders chosen from Pambahinna in the Balangoda Divisional Secretariat (DS) Division in accordance with the Morgan approach of sample selection through the purposive sampling technique, using a structured questionnaire. A multiple regression model was utilized as the main data analyzing technique.

The study was operationalized as follows.

Table 1.Operationalization

Variable	Dimension	Indicator	Measurement
Price	Price change, Interest rate charges	Low or high fees, interest rate	Five point Likert scale
Convenience	Location, Hours	Working days, Opening hours, Location convenient/inconvenient	Five point Likert scale
Process	Waiting time, complexity	Low/high Waiting time, Complexity, Documents	Five point Likert scale
Core service efficient	Mistakes, errors and conflict	Low or high mistakes, conflict of interest	Five point Likert scale
Empathy	Caring, Polite	Low or high Caring, Polite, Trustworthy	Five point Likert scale
Image	Request rejection, Response	Low/high Response, request rejection, better than formal	Five point Likert scale
Preference of Informal Finance	Informing, Recommendation, Help to access	Low/high Informing, Help to access, suit for need, recommended	Five point Likert scale

Results and Discussion

Regression results are reported in Tables 2 and 3.

According to the results, around 75% of the total variation of informal credit demand is explained by price, convenience, process, core service efficient, empathy and image (Table 2). The adjusted R square of the study is 0.737 and it indicates that the higher portion of the model (87.5%) is fit for the population. The model shows overall significance by the F test (Table 3).

Table 2.Regression results

Variable	Unstandardized coefficient		Standardized coefficient	t value	Sig.
	B	Std. Error	Beta		
Constant	0.295	0.136		2.175	0.032
Price	-0.009	0.067	-0.013	-0.128	0.899
Convenience	0.090	0.061	0.127	1.482	0.142
Process	0.271	0.095	0.299	2.847	0.005
Core service efficient	0.182	0.090	0.169	2.033	0.045
Empathy	0.075	0.073	0.095	1.029	0.306
Image	0.231	0.082	0.300	2.824	0.006
R Square 0.753 **Adjusted R Square** 0.737 **Std. error of the estimate** 0.339					

Source: Survey Data (2014)

Table 3.Analysis of Variance

Model	Sum of squares	Df	Mean Square	F	sig
Regression	32.599	6	5.433	47.340	0.000
Residual	10.674	93	0.115		
Total	43.273	99			

Source: Survey Data (2014)

From Table 2, core service efficient, process and image are the significant factors in the demand for informal finance. Omitting the insignificant variables, the regression equation can be depicted as

$$\mathbf{Y = 0.295{+}0.271\ X_1 + 0.182X_2 + 0.231X_3}$$

where

Y= Demand for informal Credit

X_1= Process

X_2= Core service efficient

X_3= Image

The constant has an unstandardized β_0 value of 0.295. It indicates the value of informal credit demand when all of the independent factors remain constant. B value of the process suggests that, if process component is increased by one unit, demand for informal credit will increase by 0.271 units when all of other variables remain constant and as same as coefficient of the core service efficient, when it is increased by one unit, demand for informal credit will also increase by 0.182 units. Further, image also leads to increase demand for informal credit by 0.231 holding other factors constant. Process has the highest β value as 0.271 and it is the most influential factor for the demand for informal credit. Further, all the explanatory variables which is in the regression equation positively influential for the informal credit demand.

Conclusion

The main purpose of this research was to identify the significant factors for informal credit demand by SME holders in rural sector. In order to achieve this objective pricing, convenience, process, core service efficiency, empathy and image were considered as explanatory variables and were tested for any association with demand for informal credit by SME holders.

According to the results of Multiple Regression Model, process, core service efficiency and image were the main variables which impacted on demand for informal finance and process was the most affected variable for informal credit demand. It has further determined that SME holders in rural areas pay a special attention on process and also for the core service efficiency and image.

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