Do Multiple Borrowing Facilities of Microfinance Lead for Over-indebtedness? Experimental Evidence from Paddy Farmers

J.A. SENEVIRATHNE[1], A.M.T.P. ATHAUDA[1], D.P.D.S. EDIRISINGHE[2] and G.H.I. ANJALEE[1]

[1]*Department of Agribusiness Management, Faculty of Agriculture and Plantation Management,*
Wayamba University of Sri Lanka, Makandura, Gonawila (NWP)

[2]*Berendina Development Services, Berendina Microfinance Institute (Gte) Limited,*
No 381/10, Swarna Place, Nawala, Sri Lanka

ABSTRACT

Even though microfinance plays a major role in any developing economy, it does not free from negative implications on socio economy of any country since microfinance involves with borrowings and lending in the low income generating rural population. Over-indebtedness of borrowers has become significant from the recent past affecting the living standard of the rural community of Sri Lanka. With the entrance of more financial organizations into microfinance industry, unethical competition and multiple barrowings became major factors which create over-indebtedness among the borrowers. This study was carried out with the objectives of finding out the level of over-indebtedness of the paddy farmers in Anuradhapura district. Primary data were collected through face-to-face interviews, from 60 respondents selected using cluster sampling technique from Madyama Nuwaragam Palatha Divisional Secretariat division with a pre-tested structured questionnaire. Both descriptive and inferential statistical analysis was carried out to analyze the data. Results indicate that gender, type of income, net monthly income, multiple borrowing have significant impact on level of over-indebtedness. A Net Indebtedness Index (NII) was developed and the impact of net monthly income was tested using Chi-square analysis. Results revealed that majority of the farmers were under the criteria of over-indebtedness or at risk of becoming over-indebted. It further highlights that over-indebtedness is influenced by education level, number of loans, and source of credit as well.

KEYWORDS: Microfinance, Net indebtedness index, Over-indebtedness, Paddy farmers

INTRODUCTION

Microfinance is considered as a powerful tool to eradicate poverty in the world. During the last decade it has been developed very rapidly throughout the world.Microfinance offers access to basic financial services such as loans, savings, money transfer services and micro insurance for people with low income (Kappel *et al.*, 2010).

As a result of the increasing trend towards the micro financing sector, some microfinance markets have become overheated. Borrowers have taken on too much credit that they eventually cannot repay. Such borrowers may end up "over-indebted" (Krishnaswamy, 2011).

The phenomenon of over-indebtedness is not new to microfinance.Microfinance literature defines over-indebtedness as the inability to repay all debts fully and on time of individuals or households (Schicks, 2010). Over-indebtedness of micro credit borrowers however can, in the first place, be harmful due to the material psychological and social consequences of being unable to respond to repayment obligations. Second, over-indebtednesscan slow downthe development of financial sector by harming the trust relationshipbetween microcredit borrowers and

micro financial institutions (MFI). Third, over-indebtednessis a great risk to the quality of the loan portfolio of micro financial institutions, and subsequently constitutes a riskfor investors in microfinance (Alam, 2012).

Sri Lanka has a very long history of microfinance. The first cooperative rural bank in the country has initiated its operations in deposits and providing small loans, in early 1900s at Menikhinna, in Kandy District. The Government has promoted microfinance from time to time through various projects and programs such as; Central Bank's Isuru Project, the Janasaviya Trust Fund (JTF) and its successor; the National Development Trust Fund (NDTF).The Lanka Microfinance Practitioners Association (LMFPA) network has a membership of 69 members. Also, there are many providers of microfinance who have not joined the LMFPA (Anon, 2012).

In Sri Lanka there is a good relationship between agriculture sector and the microfinance sector. As a developing country, agriculture represents an important, indeed major part of countries' Gross Domestic Production (Luoto *et al.*, 2007). The agricultural sector is different from other economic sectors in a number of ways. Activities are generally located in isolated

areas with low population density and poor infrastructure. They are dependent on weather and production cycles; income is seasonal and monetary income is limited. Agricultural prices are notoriously volatile and few farmers can offer guarantees that are legally or financial acceptable. Therefore majority of the farmers are looking forward for the help of microfinance sector. And as the ultimate result, most of them end up with the problem of over-indebtedness. Therefore this is a key challenge to the entire microfinanceindustry in those paddy farming areas.

With this light of shed, the specific objectives of this study were to identify the socio-economic factors affecton the over-indebtedness of paddy farmers in the Anuradhapura District and to measure the relationship between disposable family income and the over-indebtedness by means of an additive index.

METHODOLOGY

Data Collection

Several focus group discussions were carried out with the loan officers and micro financial institutes prior to the study. A preliminary survey was carried out, with a sample of 10 farmers to test the validity of the questionnaire. Primary data was collected from a sample that was selected using cluster sampling technique.

The study was carried out using 60 farmers from Palugollawa, Aluthgama, Galkadawala, Mankadawala, Gambirigaswewa and Maningamuwa areas covering Madyama Nuwaragam Palatha Divisional Sectariat Division in Anuradhapura District, from March to April 2013. Farmers were randomly selected with the help of loan officers of micro financial institutes.

The questionnaire was structured to measure the factors affecting on over-indebtedness and net income of the farmers directly as well as indirectly.

Data Analysis

Data were analyzed using both descriptive and inferential statistics. Chi-square test was used to measure relationship of gender, education level, type of income, number of loans, and source of credit of farmers with over-indebtedness using the statistical software package Minitab15.0.

Net Indebtedness Index (NII)

Net indebtedness index was developed using the net monthly income and total monthly installment on household debt. The Net monthly household income was taken as the difference between total monthly gross income of the household and the total monthly expenses of the household.

Further, Net Indebtedness Index (NII) was developed to measure the level of over-indebtedness of the paddy farmers (Schicks, 2010).

The NII was developed as follows:

NII=
Total monthly installments on household debt
Net monthly household income

Net monthly household income =
(Total monthly gross income of the household
- total monthly expenses of the household)

Based on the calculation of NII, farmers were classified as follows (Schicks, 2010):

Extremely over-indebtedness: below 0% - the farmer had negative net income of the household on debt servicing.

Insolvent: equal or exceeding 100% - the client spent all net income of the household on debt servicing.

Critical: between 75% and 100% - the client spent between 75% and 100% of the household net income on debt servicing.

At risk of becoming over indebted: between 75% and 50%-the client spent between 50% and 75% of the household net income on debt servicing.

Not over indebted: below 50%-the client spent less than 50% of the household net income on debt servicing.

RESULTS AND DISCUSSION

Descriptive Statistics

Socio-demographic status of the sample is depicted in the Table1.

Majority of the respondents were female borrowers with secondary education (above grade five) and having an income between Rs. 10,000- 50,000 per month.

Lowest percentages of respondents were with no schooling and there were only 12% was earning more than Rs. 100,000 per month.

Table 1.Socio-demographic background of respondent

Parameters	Percentage (%)
Gender	
Male	68
Female	32
Other income resources	
Farm labours	82
Carpenters	2
Drivers	3
Other	13
Education level	
No education	5
Primary education	17
Secondary education	68
Higher education	10
Income level	
Rs.10,000-50,000	65
Rs.50,000-100,000	23
Above 100,000	12

Net Indebtedness Index

The distribution of Net Indebtedness Index data are depicted in Figure 1.Sixty percentageof the microcredit borrowers are extremely over-indebted, insolvent, at the risk or at critical level. While 27% of clients exceed their household expenses over household income and only 13% of clients spend all their disposable income on debt repayment, 8% are in the critical situation spending three quarters of whatever money is left in the household after meeting all necessary expenses and 12% are regarded as being at the risk of becoming over-indebted, as the amount spent on debt servicing every month exceeds 50% of their net household income.
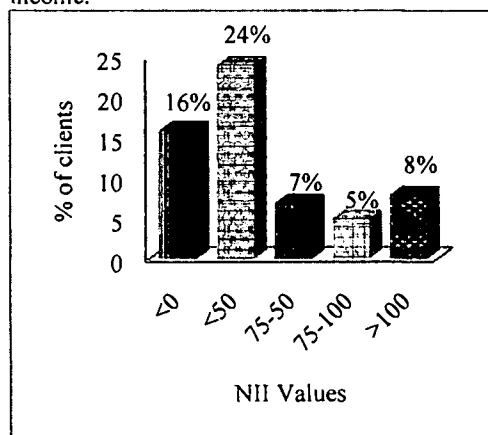
Figure 1. Levels of indebtedness

Gender of the Farmers

Gender-related differences in over-indebtedness were mixed. Men less often were found to be insolvent (15% of women versus 11% of men) but were more likely to face a critical situation or to being at the risk of becoming over-indebted.The gender distribution of the borrowers is depicted in Table 2.

Level of Education

Free education system is the key feature of higher literacy rate among the farmers in those paddy cultivating areas. When the education level increases the level of indebtedness is going to reduce.

According to the data, 10% of the farmers with higher education come under the criteria of not over-indebted. Comparatively farmers having only secondary education (68%) falls under the criteria of insolvent.

Table 2. Percentage of the farmers under the levels of over-indebtedness with respect to gender

Gender	% of clients
Male	
Extremely over-indebted	0
Insolvent	11
Critical	16
Risk	21
Not over-indebted	36
Female	
Extremely over-indebted	39
Insolvent	15
Critical	5
Risk	5
Not over-indebted	36

Source of Credit

According to the Figure 2, only 97% of microcredit borrowers are clients of both banks and MFIs.

In those areas most of the Non-Governmental Organizations play a major role in granting loans for the farmers. Majority of the banks are not going to grant loans for those who live in these areas due to low levels of net monthly income and it's highly risky for that formal institutions. Therefore most of the informal money lenders come into the play due to the above reason.
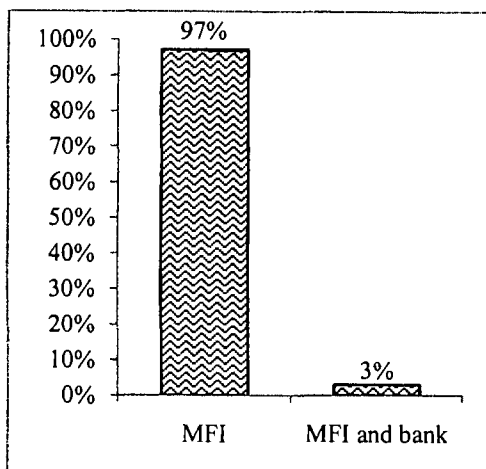
Figure 2. Source of Credit (Percentage of Clients)

Multiple Borrowings

Thirty eight percent of borrowers were having multiple loans. Credit registry data showed that 62% of microcredit clients had just one active credit contract. The distribution of clients among different borrowing resources is depicted in Figure 3.
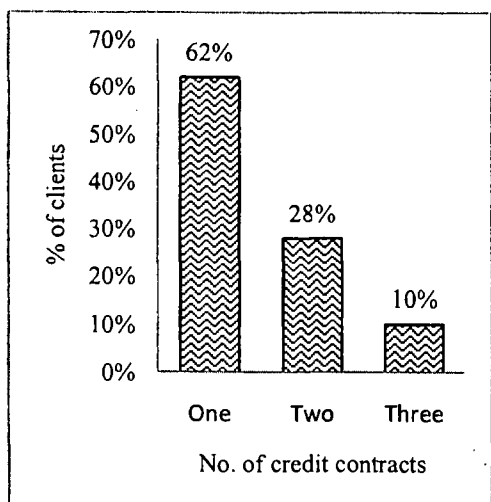

Figure 3. Multiple borrowings with client percentage

Multiple Borrowings and Over-indebtedness

Multiple borrowing and over-indebtedness go hand in hand. According to the figure 4, the level of indebtedness decreases with the number of active borrowing sources.

Among clients with a single borrowing source only 17% are insolvent compared to 9% of those who have two or more borrowing sources and 27% are extremely over-indebted with a single borrowing source with compared to 26% of those who have two or more borrowing sources.
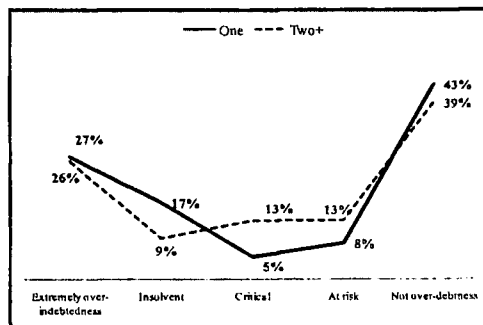

Figure 4. Multiple borrowing and over-indebtedness

Repayment Periods

Friends and relatives, moneylenders, farmer groups provide the majority of their loans without fixing a repayment date. Average repayment period of bank loans in Anuradhapura District is 12 months. NGOs, which distribute much smaller loan amounts, operate with shorter repayment periods;such as six months in those remote villages under first loan cycle.

The Prevalence of Repayment Struggles among Micro Credit Borrowers

According to the figure 5, many borrowers experience repayments as a challenge. Seventeen percent struggle regularly over the repayment of the loan but not all the time, and 83 percent permanently struggle with (almost) every single installment which means that majority of the borrowers struggle with their repayment.
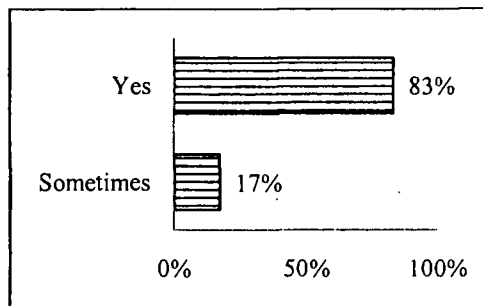

Figure 5. The prevalence of repayment Struggles among micro borrowers

Results of Chi-square Analysis

Pearson Chi-square test was done to check whether there is an association between gender, education level, number of loans, type of income, multiple borrowings, net household income, and level of over-indebtedness.

The results of Chi-square test indicate that the gender, net household income, type of income and multiple borrowings significantly

335

affects to level of over-indebtedness where it is significant at 0.05 levels.

Table3. Association between levels of over-indebtedness with variables

Variables	P values
Gender	0.002*
Education level	0.072
Type of income	0.012*
Net monthly income	0.003*
Number of loans	0.250
Source of credit	0.342
Multiple borrowing	0.006*

Significant at 0.05 level

CONCLUSIONS AND POLICY IMPLICATIONS

The outcome of the study revealed that the clients were unable to meet their loan obligations because of the harvesting failures due to rains and floods, misuse of loans, emergency situations such as weddings, funerals and illness in family member which can be identified as the socio-economic factors affecting for over-indebtedness condition.

According to the NII, a high percentage of the clients were categorized under extremely over-indebtedness condition due to the lack of their net monthly income. This was mainly occurred because; during some seasons they can't harvest their cultivations at the proper maturity level due to the natural barriers such as floods and rains. Sometimes they can't sell their harvests and even though there are buyers, those buyers are not willing to pay agood price for the harvest. Therefore a proper market chain should be developed inorder to help those farmers.

Also the study reveals that only a few portions of people get involved with different types of income resources except farming. Therefore, in order to get rid of those low income levels, those people should be encouraged to pay their attention on other income resources such as self-employment. Not only that but also they should be guided to cultivate various types of crops such as papaw, onion, brinjal which are suitable for the Dry Zone other than paddy, maize and black gram. Also, theycan get involved with the dairy industry which will help to improve their living standards. These precautions will help to dawn a new era in the microfinance industry in Anuradhapura District.

Though there are a high percentage of borrowers categorized under over-indebtedness criteria, they maintain to repay their loans at the proper time. That is the place where the multiple borrowing comes into the play. Therefore, the farmers were looking forward for two or more loans from different MFIs and informal lenders. Then the farmers will ultimately end up with over-indebtedness condition. This may occur due to the strong collection mechanisms of the MFIs. Therefore this may result in mental over-indebtedness condition in farmers which calls for a further study to investigate that as a subjective measure.

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