

## ***The Relationship between Credit Characteristics and Microenterprise***

### ***Performance: A Brief Analysis***

*by Adekunle Bamidele<sup>1</sup>*

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*This paper presents the relationship between financial institutions and microenterprise development. The impact of microfinance institutions on microenterprises and why some of them encourage entrepreneurial development is explored through the development of a conceptual framework. The paper posits that financial intermediation through an interdependent society might encourage entrepreneurial and microenterprise development.*

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### ***Introduction***

Microenterprises represent a significant portion of business activity in developing countries. The only reason why people underestimate the magnitude of microenterprise is because most of these businesses are not registered. A house-to-house survey in Zimbabwe by Liedholm and Mead (1999) indicate that the number of medium and small enterprises in developing countries is far greater than official statistics. They further state that the range of activities of microenterprise are small and mostly involve self-employment. The labour force comprises mostly the proprietors and unpaid family labour; at times hired labour is employed but this accounts for only 20 percent of the labour force of microenterprises in Zimbabwe. In some studies undertaken on microenterprise it has been argued that one-person enterprise generates the lowest return, thus an increase in the size through the increase in workers leads to significant increase in economic efficiency (Parker 1994; Cabal 1995; Liedholm and Mead 1999). A major

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barrier to enterprise performance is finance. Thus, this paper presents the implication of the source of credit on entrepreneurship and microenterprise development.

### ***Microenterprise Development***

The problems that constrain the development of microenterprises in developing countries are markets for the product they sell, access to inputs required for these products, finance and lack of incentives and norms that generate a propensity for entrepreneurial discovery (Liedholm and Mead 1999; Walker and Weigall 2001; Co 2003; Still 2005; Marlow 2005). Other barriers to continual microenterprise growth identified in the literature include structural and socioeconomic conditions, increasing competition, and lack of microentrepreneur business skills and understanding. According to Zeller *et al* (1997), member-based institutions at the community level, such as credit groups, can be built on and make use of the principles of informal finance by using locally-available information and social contacts in enforcing contracts. Thus, a good institutional framework is required to create an enabling environment for microenterprise development.

### ***Impact of Microfinance***

Capital in the form of money is crucial for entrepreneurial development. This is enunciated by Harper (2003), who contends that one way money affects entrepreneur's agency belief is through its impact on their perception of their problem situation. An entrepreneur's estimates of self-efficacy and degree of agency may include a cognitive appraisal of the situational context in which entrepreneurship occurs, including the nature of the goals to be achieved and the requirements of transactions to be carried out. The challenge is that economists have not analyzed the role of financial institutions such as

Cooperative Thrift and Credit Societies on agency belief, entrepreneurship and microenterprise development.

Zeller (1997) suggests that the success of rural finance programs can be measured using three criteria. These are i) the coverage of the poor and their demand for financial services; ii) accessibility, particularly equal gender access to the program; and iii) financial viability and sustainability in providing the service. The major microfinance institutes in sub-Saharan Africa are Commercial or Development Banks, Moneylenders, Rotatory Savings, Non-Governmental Organizations, Cooperative Thrift and Credit Societies, friends and relatives. According to Zeller (1997) these institutions have different characteristics when it comes to production credit, consumption/social credit, extension services, savings mobilization, and risk coverage, which measure the coverage of the poor. Accessibility can be measured using formal or informal institutions, gender orientation, minimum balance, membership fee, collateral requirement, and formal/informal sector linkage. Subsidization, covering administrative costs, recovery rates, year of establishment and growth can also be used to measure financial viability and sustainability. Institutional economics has gone a step further by stating that the three benchmark measures of impact are real receipt, client longevity and graduation schedule (Mercatus Centre 2003):

- **Real Receipts:** This measures the real receipts of the organization (that is payment versus loan paid out). Unlike repayment rate it takes into consideration inactive or unpaid loans from the books.
- **Client Longevity:** This reports lost clients as a percentage of total clients.

- **Graduation Schedule:** This tracks the number of clients receiving different sized loans, how many of them are first-time or repeat recipients and the number of loans at each level as a total percentage of the overall portfolio.

### ***Conceptual Framework***

Economic evaluations of enterprise development have typically focused upon resource endowments, including stocks of physical and human capital and technological knowledge. Little or no attention has been paid to the role of entrepreneurship and the capacity of institutions like Cooperative Thrift and Credit Societies to promote entrepreneurship. Entrepreneurship is the basis of economic development and growth (Schumpeter 1934; Coase 1937; Baumol 1968; Leibenstein 1968; Nafziger 1977; Kirzner 1997; Harper 2003; Van Praag 2005). It causes continuous disequilibria in the market that creates opportunity for value creation in the market and affects firms' responsiveness to new market conditions (Kirzner 1997). This paper presents the institutional context in which entrepreneurial processes are manifested. A blended-value approach was used in the development of a framework for this paper. According to the blended value approach, all investments are understood to operate simultaneously in both economic and social realms (Emerson 2000). There is no trade-off between the two rather a concurrent pursuit of value – both social and financial. A blended value approach is not about financial sufficiency or social impact per se; it is about value creation in the pursuit of both economic and social objectives (Emerson 2000). The role of Cooperative Thrift and Credit Societies as socioeconomic institution on entrepreneurial behaviour was analyzed.

This paper presents a conceptual framework that presents the relationships among financial institution characteristics, personal agency beliefs, entrepreneurial alertness and

economic performance. The institutional framework in this study is group oriented. This is so because institutions affect people's cognitive processes and entrepreneurial capacity. Institutions and economic policies that inhibit economic freedom dampen people's alertness to opportunities through their negative effect on personal agency beliefs that is internal locus of control and personal efficacy (Harper 2003). In this paper<sup>2</sup> entrepreneurship is defined as a function of agency belief (the stronger the agency belief, the higher the entrepreneurial ability of the business holder), which is affected by locus of control (LOC) and perceived self-efficacy (SE). Agency belief is a multiplicative function of locus of control (contingency) and perceived self-efficacy (competence) (Harper 2003). This is likely to be affected by the type of finance available to the business holder.

Financial institutions have different characteristics, which include their ownership structure, type of credit, savings mobilization, etc. All these characteristics affect the way the financial institutions play their role as a financial mediator and entrepreneurial developer. Financial institutions give out credit with different characteristics (Zeller *et al*, 1997). The characteristics of credit determine what a microentrepreneur can use the money for and whether it is going to be accessible to them. Fungibility is the quality of being capable of exchange or interchange, in other words a fungible credit will have the ability to be used either for consumption or production. A credit with huge paper work and heavy collateral may not be accessible to small business holders (Soyibo 1997; Audretsch, Keilbach, and Lehmann 2006) though the credit is fungible. The interest rate is another important issue (Akabueze 2002) and most authors have said that the poor

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<sup>2</sup> This paper defines entrepreneurship based on the concept developed by Harper (2003). Other factors may affect entrepreneurship (agency belief); this study measured it as a function of locus of control (LOC) and perceived self-efficacy (SE).

cannot pay the market interest rate so there should be a safety net for them. Risk is inevitable in the business world (Knight 1921) and the ability of credit to insure against unforeseen characteristics is also very important. Finally, a financial institution will be able to sustain its services if their clients pay back their loans, so the default rate as a characteristic of credit will assess the sustainability of the institutions. Wood (2006) also submits that age and source of finance affect business performance.

Microentrepreneurs have certain characteristics like age, education, gender and managerial ability, which affect their skills, knowledge and attitude (Van Praag 2005). This behaviour can be modified through the effect of credit and social support (Svendsen and Svendsen 2004; Kalantaridis 2004) on self-efficacy, locus of control and thus personal agency belief is improved. The improvement of agency belief leads to better strategies like technology adoption, quality improvement, product innovation and market expansion (Nafziger 1977; Audretsch and Keilbach 2004; Van Praag 2005). All these strategies will lead to better performance of micro, small and medium scale enterprises. Figure 1 depicts the conceptual framework.

### ***Conclusions***

This paper indicates that microenterprises are relevant for economic development though official statistics about their activities might be difficult to get. Microenterprises will contribute to economic development if they also witness growth. The development of microenterprises are affected by factors such as entrepreneurship, firm size, enterprise age, size of the firm, education, business environment and so on. Entrepreneurship has been ignored to some extent because of measurement problem and complexities of its definition. This paper adopts Harper's perspective in measuring entrepreneurship and

argues that entrepreneurship can be promoted in an interdependent society. Microfinance institutions contribute significantly to microenterprise development but the most desirable may be the ones where beneficiaries are involved in decision-making (for example, the Cooperative Thrift and Credit Societies).

Financial institutions have different characteristics, which affect the type of credit they disburse. Microentrepreneurs also have different characteristics, which might affect their performance. The interaction of these factors when there is an intervention through appropriate credit facilities will lead to adoption and development of strategies that are appropriate and desirable for growth in sales, profit, number of employees and savings. Thus, performance can be improved when entrepreneurs belong to societies that provide accessible finance and promote entrepreneurship (Adekunle 2007).

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**Figure 1**  
**Conceptual Framework**



