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# Role of microcredit on street vendors: Study on selected districts of Bangladesh

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**Abstract**
Micro credit institutions (MCI) emerged with a view to assisting unprivileged group of people. By financial inclusion MCI provides many financial services to the poor people. Street vendors are a part of financially unprivileged group of society. Their income is low and most of them are illiterate. This report shows the impact of MCI on street vendors selected district of Bangladesh. The main objectives of the research is to know whether micro credit helps people to be entrepreneur as street vendors and the positive and negative aspects of micro credit on street vendors. The study was confined in five districts namely Khulna, Jashore, Bagerhat, Pabna and Rajshahi. A questionnaire with structured, unstructured, semi-structured questions was used to collect necessary data from 200 respondents by face to face interview during October, 2019. This report revealed only 21% of people start their business with the help of MCI's fund. Majority percent people start their business with their own fund. This research also shows that the borrowed fund is used for multipurpose sector like – agriculture, rearing cattle, purchasing household utensils, build house etc. 100% respondents think that interest of MCI is very high at the same time they have to pay compensation at delay payment of installment. Average interest rate of MCI is 26.92%. High cost debt creates debt trap. For excessive burden of interest, some respondents become multiple borrowers and finally they have to make capital loss to repay the loan.

**Keywords:** street vendor, unprivileged, multiple borrower

## 1. Introduction

Microfinance institutions have been defined by different scholars in different ways. The essence of the definition, however, is usually the same in which microfinance refer to the provision of financial services generally saving and credit to low income clients [1]. Micro credit institution (MCI) is one of the fast-growing financial institutions aimed at alleviating poverty, aid economic growth and support future growth through financial inclusion of unprivileged people of society [2]. Robinson (2001) defined microfinance as small scale financial services – primarily credit and saving provided to people who farm or fish or herd; who operate small enterprises or micro enterprises where goods are produced, recycled, repaired, or sold, who provide services, who work for wages or 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 [3]. The microfinance sector, apart from being a critical component of the financial system, is also regarded as a poverty reduction strategy for developing countries [4]. There are two main systems of microcredit [5]. One is formal financial institutions, banks and co-operatives, which provide micro-credit to the poor people under different schemes for livelihood support or helping them to start micro-enterprises. The other is informal system comprising traditional moneylenders, pawnbrokers and trade specific lenders. Both the systems have their own positive and negative aspects. While there have been successful stories, numerous failures have not made to publicize highly. Micro credit institutions operate their activities informally. They don't have branch cost because they open their branch at client's village and client's house. They don't pay any space rent or electricity bill. Since MCI's operating cost is very low, it could offer loan at low cost. But reality is different. Numerous field survey reported that MCI's interest rate is very high. Moreover, they have a little loan default risk because they take social collateral. Grameen Bank in Bangladesh pioneered peer group monitoring. Grameen Bank would open a branch when a group of people (similar economic background) organized. The group is ultimately responsible (social collateral) for repayment if the individual defaults. Robinson (2001) claims that subsidized rural credit programs often do not reach the poor. The credit subsidies become transformed into political pay offs for rural elites and the programs typically have high defaults and high losses [6]. Dean Karlan of Yale University studied the impact of micro finance. The results of his study suggest that many of the benefits from microcredit are in fact loaned to people with existing businesses and not to those seeking to establish new ones. He also discovered that the increase in income that went up in business was true only for men and not for women. Robinson (2001) state that financial services are not the panacea for poverty alleviation but other strategies are needed for the very poor who need food and employment before they can make use of financial services [7]. "If financial institutions do not understand and reward sustainable behavior, progress in developing more sustainable business practices will be slow" [8]. As Banerjee *et al*. (2010) found, the effects are heterogeneous, depending on whether the household had a self-employment activity at baseline: we find a significant decrease in consumption among households who had an existing activity before Al Amana launched its program (about two thirds of the sample), while there is a positive but not significant effect on overall consumption for those without an own activity at baseline, together with a significant increase in expenditure on food, and on durable goods purchase [9].

Poor people borrow from microcredit for various and different purposes. It may be to meet the major household expenses; emergency needs or even basic livelihood support. Formal financial sector like bank has complex legal and operational procedures, involving lot of paper work. Since the process of credit disbursement is time consuming, many times credit is not available in time. Finally, there is a stigma attached to the poor people so that the bankers do not think them eligible for credit and feel that they are unable to repayment. But this may not necessarily be true. Microcredit alone is not necessarily the best way to help the poorest of the poor [10]. Datta also finds that the extremely poor are excluded from the micro credit programs by peer screening (i,e group members are not willing to take an extremely poor for fear that the loans will not be repaid). The positive aspects of micro-credit are that the credit disbursement is smooth and relatively quick. No big amount collateral is required and there is least paper work. Credit can be given for any activity, especially for livelihood support, purchasing household utensils and emergency purposes. Credit is generally given for non-productive purposes as well. But at the same time there is very high cost in micro-credit system.

For some limitations of formal sector (bank), unprivileged people would have to go MCI to meet up their financial demand. Street vendors of Bangladesh operate their business with very low capital and their income is also low. Most of them are illiterate. They are the targeted customer of MCI. Micro loans are given for a variety of purposes but frequently for micro enterprise development. Because of the industry’s focus on the poor, MFIs often use non-traditional methodologies such as group lending or other forms of collateral not employed by the formal financial sector [11].

## 2. Research Objectives

The study was carried out for the following objectives to achieve:

1. To whether micro credit helps people to be entrepreneur as street vendors
2. To know the positive and negative aspects of micro credit on street vendors

## 3. Methodology

The research is descriptive in nature. Street vendors in 5 (five) selected districts (Khulna, Jashore, Bagerhat, Pabna, Rajshahi) who borrowed money from any MCI at any level/time for their business were interviewed for data collection. Convenient sampling technique was followed for selecting the street vendors. A total of 200 street vendors, (40 street vendors from each district) were interviewed as sample size. A mixed structured questionnaire was used with trained interviewers to avoid any kind of biasness.

## 4. Data Analysis and Discussion

The study focused on several aspects like the source of startup capital whether borrowed from MCI, collateral policy, use of borrowed money, whether borrowed from single/multiple MCI, borrowed rate, repayment of loan, penalty for delayed payment of loan, and insurance premium to achieve the prescribed objectives.

### 4.1 Startup Capital for the Business

Capital is a life blood of business. At the formation stage of business, a huge amount of capital is needed. The entrepreneur faces great difficulties to arrange this capital. Moreover, working capital is also required to operate day to day expenses. To arrange this capital, the entrepreneur sometimes has to borrow money from the financial institutions. Though, street vendors requires a small amount of capital to start the business, the amount is also difficult to manage by themselves often. The study wanted to know how the street vendors sourced their initial business capital to start their existing venture.

**Table 1:** Startup Capital

| Startup Capital from MCI | No. of respondent | % of respondent |
|---|---|---|
| Yes | 42 | 21% |
| No | 158 | 79% |
| *Total* | *200* | *100%* |

***Source*:** Field survey, 2019

Though all the respondents surveyed under this study at 5 (five) different cities are currently using the fund borrowed from MCI, Table 1 revels an interesting finding which is somehow opposite of our conventional understanding. Table 1 shows that only 21% of the respondents started their business with the amount borrowed from MCI while almost fourth-fifth (79%) street vendors under the survey started their venture with their own fund which was very usual their own saving or from borrowed from any informal sources like relative/friends or from money lenders. As street ventures requires a small amount of capital, the unprivileged group of people in our society somehow can manage the fund to start the business. The finding also triggers another study to know why the majority of street vendors didn’t borrow fund from MCI at the initial stage of their business.

### 4.2 Collateral Policy for MCI Loan

Collateral is a must condition for having any business loan from formal financial institutions. A distinctive feature of micro credit is based in trust. MCI mainly maintains social collateral for their loan. Social collateral means all group members are/will be responsible when an individual become default (unable to repay his/her loan installment). In addition to this social collateral, now-a-days, some MCI insurance on MCI loan and the insurance premium is paid by borrower. MCI sometimes take mortgage assets or personal guarantor as collateral to issue loan.

**Table 2:** Collateral for MCI Loan

| Collateral Required | No. of respondent | % of respondent |
|---|---|---|
| Yes (personal/mortgage) | 26 | 13% |
| No (personal/mortgage) | 174 | 87% |
| Social Collateral | 200 | 100% |

***Source*:** Field survey, 2019

Table 2 represent that 13% respondents admitted that they required personal/mortgage collateral while majority of the respondents (87%) respondents did not require any personal/mortgage collateral for getting loan from MCI. But

100% respondents agreed that they require social collateral for having loan from MCI.

### 4.3 Use of Borrowed Money

Most of the time borrowed fund is used for multiple purposes. Street vendors use their fund for the business purpose. Since they are low income people, they sometimes use borrowed money for purchasing livelihood, farming, and purchasing household utensils. The study wanted to know how much fund is used in business and how much fund is used in other purposes.

**Table 3:** Use of Borrowed Money

| Use of Borrowed Money | No. of respondent | % of respondent |
|---|---|---|
| Business | 150 | 75% |
| Agriculture | 36 | 18% |
| Small and cottage industry | 0 | 0% |
| Purchase household items & utensils | 8 | 4% |
| Other | 6 | 3% |
| *Total* | *200* | *100* |

***Source***: Field survey, 2019

Table 3 explores that three out of four (75%) respondent borrowed money to use in their business. Almost one-fifth (18%) of the respondents have used the borrowed money in agricultural sector and very few respondents (7%) used their borrowed money for the purpose of buying household items & utensils and other purposes. In black and white, most of the respondents borrowed money to use on business vendors but real scenery is different. This research revealed that they didn't use it on business because their business capital is very small. Most of the time, they have no need to take loan to operate business. They used the borrowed money to build house, purchase household utensils, furniture, electric goods like TV, refrigerator, fan, mobile etc. It is also interesting findings that there is no use of the borrowed fund in small and cottage industry which once was a great way of self-employment and employment generation in Bangladesh.

### 4.4 Borrowing Sources of MCI

MCI generally provides small amount of fund to unprivileged people of the society. Sometimes this amount of fund is insufficient to meet up their demand. So, people simultaneously borrowing fund from various MCI and become a multiple borrower. Sometimes, people borrow one institution to repay another institution. The study wanted to know about respondents whether at a same time they borrow one MCI or more than one MCI.

**Table 4:** Borrowing Source of MCI

| Source of MCI | No. of respondent | % of respondent |
|---|---|---|
| Single Source (one MCI) | 168 | 84% |
| Multiple Sources (more than one MCI) | 32 | 16% |
| *Total* | *200* | *100%* |

***Source***: Field survey, 2019

Table 5 points outs that most of the respondents (84%) have taken loan from one MCI. It is also found that some respondents approximately one-seventh (16%) were the multiple borrowers; which means that these people have borrowed from more than one MCI. When people unable to repay the loan installment of his/her initial (first borrowing MCI), they become multiple borrowers. Most of the multiple borrowers took loan from one institution to repay another institution's loan. By this way they fall into debt trap and become more levered.

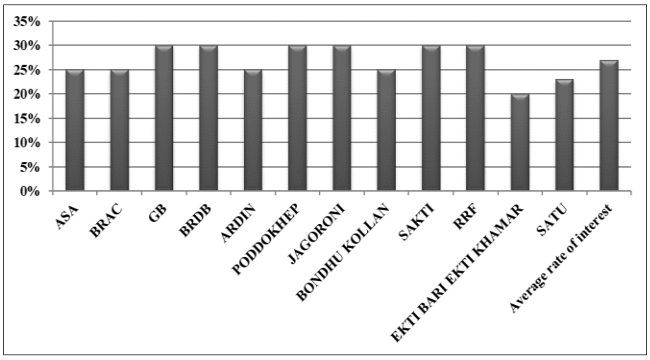
### 4.5 Borrowing Interest Rate

Interest income is the main source of income of MCI. In other financial institutions like bank has different service income besides interest income. But MCI has seldom opportunity to earn of these types of income. So, MCI focuses heavily on interest income. As a result, interest rate of MCI is higher than formal sector of financial institutions. The study attempted to find out the interest rate on borrowed fund from MCI.

**Table 5:** Borrowing Interest Rate of MCI

| MCI | No. of respondent | % of respondents | Interest Rate | Average Interest Rate |
|---|---|---|---|---|
| ASA | 70 | 35% | 25% | 26.92% |
| BRAC | 58 | 29% | 25% | |
| GB | 12 | 6% | 30% | |
| BRDB | 16 | 8% | 30% | |
| ARDIN | 4 | 2% | 25% | |
| PODDOKHEP | 8 | 4% | 30% | |
| JAGORONI | 10 | 5% | 30% | |
| BONDHU KOLLAN | 2 | 1% | 25% | |
| SAKTI | 10 | 5% | 30% | |
| RRF | 2 | 1% | 30% | |
| EKTI BARI EKTI KHAMAR | 6 | 3% | 20% | |
| SETU | 2 | 1% | 23% | |
| Total | 200 | 100% | | |

***Source***: Field survey, 2019




***Source***: Field survey, 2019

**Fig 1:** Borrowed Interest Rate

Most of the street vendors are illiterate. Even they didn't tell about the interest rate. That's why interest rate was calculated manually on the basis of their information. From Table 4, it is seen that the lending rate of MCI is very high. Average rate of interest of MCI is 26.92%. This high debt cost is a great threat to street vendors because their income is very low. To arrange this loan cost they become more levered.

### 4.6 Repayment of Loan by Capital Loss

Most of the MCI's loan recovery rate is highly satisfactory. They impose high rules and regulations to recover the loan. To avoid this unfavorable rules and regulations, sometimes people sell their assets to break the loan trap.

**Table 6:** Loan Repayment by Capital Loss

| Making Capital Loss | No. of respondent | % of respondent |
|---|---|---|
| Yes | 52 | 26% |
| No | 148 | 74% |
| Total | 200 | 100% |

***Source*:** Field survey, 2019

Table 6 shows little more than one-fourth respondents (26%) said that when they became default, were unable to pay the loan installment. Hence, they had to sell out their capital assets like cattle, furniture, ornaments etc. to repay the loan installment/loan. While a large portion of the respondents (74%) didn't experience it.

### 4.7 Penalty for Delay Loan Payment

MCI provides loan and receives a series of repayments. Often this low-income people cannot repay the loan installment on time. In this case, MCI charges a compensation for delay payment. Sometimes this compensation becomes burden to the borrower. This study wanted to know whether the borrowers were required to pay any penalty for delayed repayment of loan.

**Table 7:** Penalty for Delay Loan Payment

| Penalty for Delay Payment | No. of respondent | % of respondent |
|---|---|---|
| Yes | 200 | 100% |
| No | 0 | 0% |
| *Total* | *200* | *100%* |

***Source*:** Field survey, 2019

Table 7 reveals different types of finding which is somehow unpublicized. It is clear from the findings that 100% respondents have admitted that they required to pay penalty when they delayed the payment of loan installment. In case of irregular loan payment, the borrowers have to pay additional cost besides high interest cost.

### 4.8 Insurance Premium with Loan Repayment

MCI mainly maintains social collateral. Social collateral means all group member will be responsible when an individual become default. Besides this collateral, now a days some MCI make insurance on loan and insurance premium is paid by clients (borrower).

**Table 8:** Insurance Premium with Loan Repayment

| Payment of Insurance Premium | No. of respondent | % of respondent |
|---|---|---|
| Yes | 58 | 29% |
| No | 142 | 71% |
| Total | 200 | 100% |

***Source*:** Field survey, 2019

Table 8 reveals an unpleasant truth which is somehow opposite of our traditional understanding and not become headline yet. The analysis shows that 29% respondents paid insurance premium against loan and 71% respondents didn't pay insurance premium against loan.

## 5. Conclusion

Micro credit institutions work with unprivileged group of people of society. Street vendors are the significant part of the unprivileged people. Their income is low and lives in hand to mouth. So they are denied by the formal financial sector. So, these groups of people are bound to go to MCI to meet up their financial crisis. MCI provides financial support to these unprivileged groups without any hindrance. Besides MCI's positive role they are criticized for their interest rate and other some activities. The high rate of interest of MCI creates a debt trap for the poor. This money lending system exists everywhere in the world wherever poverty exists. The poor people need money for their survival and as a result of it they become the part of the vicious circle of poverty.

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