



## **A qualitative approach to determine the problems and challenges faced by microfinance institution with reference to poverty alleviation: A case of district Bahawal Nagar, Punjab, Pakistan**

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### **ABSTRACT**

This study aims to identify the factors that create hurdle in poverty reduction with reference to loan provided by the microfinance institutions (MFIs) to the destitute people of District Bahawalnagar. In this study questions regarding Utilization of Loan for Immediate Needs (ULIM), Miss Match of Loan Amount (MMLA), Customer Capacity for Utilizing Loan (CCUL) and Utilization of Loan by Addict Customer (ULAC) were asked to the respondent through face to face interview. After than all interview was transcript in MS Excel and important themes were identified with their percentage of frequencies. In this study 12 important themes through four questions were identified. Important themes that are identified through utilizing loan for immediate needs (ULIN) is the Spending loan amount on construction, marriages and health and education, whereas the compatibility of loan amount, high interest rate and high processing fee are the themes that are derived from MMLA. Another question that is CCLU, through this lack of business education, business experience and business skill were derived and taking loan by drugs addicts, gambler and using loan on recreational goods were identified through ULAC questions. All these factors will be shared with all MFIs that are working for poverty alleviation so that a milestone of poverty elimination will be achieved by controlling these factors through proper planning and formulating policies regarding these factors.

**Keywords:** Microfinance Institutions, Poverty Alleviation, Pakistan

**JEL Classifications:** G21, I32

### **1. INTRODUCTION**

It is fact that microfinance programs initiated by the Government of the Punjab, Pakistan fails to reduce the poverty level of people in Southern Punjab. However, it is need of time to identify the factors due to these microfinance programs fails to reduce the poverty of people situated in underdeveloped areas of Punjab. Therefore, if Government of the Punjab, Pakistan intends to reduce the poverty of people through microfinance programs, then we have to identify problems and challenges faced by Microfinance Institution (MFIs) of Pakistan. Ikechukwu (2012) claimed that business education,

business skills and business experience are the important elements for successful business but majority of MFIs customer did not have all these pre-requisite, and besides this no arrangements have been made by MFIs to provide specific business related education or training. Therefore, due to poor business aptitude majority of MFIs customers failed to established successful business and also facing problems with reference to repayment of principal amount and interest on loan as well. The rudimentary objectives of this study are to identify the factors due to these microfinance programs fails to reduce the poverty level of the people of the Southern Punjab Pakistan. After identification of these factors policy may

be formulated to eliminate these factors through the counseling of microfinance institutes and customer as well. Micro financing is one of the important element used for poverty alleviation all over the world, especially in underdeveloped countries like Pakistan, Bangladesh, India, etc. Since 2001 different programs relating to microfinance were launched by the government of Punjab to reduce the poverty level of the people of Southern Punjab. But desire results with reference to poverty alleviation remain an unfulfilled dream. For instance, in Bangladesh succeeded to reduce its poverty level at optimal level but in Pakistan desire result will not be achieved as per plan. Therefore, it is the calamitous needs of time that such factors may be identified that create hurdles in this regard. Acha (2008) assert that due to high interest rate and processing fee MFIs fails to reduce the poverty level of people as such debt service not suitable to the owner of small scale business.

Yaron (1994) observed that majority of MFIs of developing countries fails to collect the loan amount as majority of customers take loan for starting new business or extending existing business whereas used loan amount of fulfill its basic needs like construction of house, marriages of their family member, purchase of recreational goods, health and education of children and consequently fails to repay the loan amount and creating problems for MFIs as well. As per CBN (2005) due to inefficiency and capacity of MFIs employees, microfinance banks failed to achieved the desire results with reference to poverty reduction. Adeyemi (2008) refute that major problems and challenges face by MFIs is the limited product line, inadequate services, branchless banking, high processing fee, inefficiency of management and, poor government policies. Mhammed and Hassan (2009) claimed that the poor outreach and high markup is the major problems faced by the MFIs in Pakistan.

Swain (2004) steered that there is a significant difference between non-poor people and core poor people with reference to use of microfinance and poverty reduction. He added that core people used loan amount on consumable items whereas, non-poor people invest loan amount in business to generate profit. Stiglitz and Weiss (1984) stressed that major cause of non-performing loan (NPL) is the poor screening of borrowers of bank employee as bank employee was paid per borrower commission besides his/her salary and they just focused on number of customer instead of number of quality borrowers. According to Nwyanwu (2011) the major challenges and problems faced by MFIs is the misuse of government funds, limited financial produce and services, fluctuation in government policies, high processing fee, lack of technical skills, poor estimate of loan amount and, high markup. Coleman (2004) persuade that due to high interest rate and poor estimate of loan amount is one of the major problems faced by the poor people. Therefore, product and services offered by the MFIs are useless for core poor people.

Cheston et al. (1999) argue that one of the major challenges faced by the MFIs is the capacity of customers with reference to utilization of microfinance product and services designed and laid down by the MFIs. Due to smooth process and no requirement of collateral securities for loan some drugs addicts and gambler succeeded to obtain loan. Donaghue (2004) recommended that interest of customer and MFIs are not on same line, and each stakeholder has their own preference due to this microfinance

programs failed all over the world, especially in underdeveloped countries. The core objectives of MFIs are engaging poor people in small business or small enterprises or in income generating activities through the provision of small loans, credit, savings and insurance. If a customer took loan and instead of spending loan amount in income generating activities, he used loan amount to fulfill his immediate needs or purchase on recreational products that customers are creating challenges for MFIs with reference to poverty alleviation. In this study detail interview of MFIs Employees will be conducted and questions regarding Utilization of Loan for Immediate Needs (ULIM), Miss Match of Loan Amount (MMLA), Customer Capacity for Utilizing Loan (CCUL) and Utilization of Loan by Addict Customer (ULAC) were asked to the participants. Norell (2001) indicated that there are four reason including misused of loan amount for personal needs, capacity of borrower, mismatch of loan amount with business needs and lack of business education and business experience due to this ratio of non-performing loan increasing.

## 2. LITERATURE REVIEW

Maclsaac (1997) observe that normal core poor people used loan amount to fulfill their basic needs including food, shelter, clothes, education and, health, rather than making investment in small scale business. Whereas non-poor people used loan amount to purchase household assets or making investment in small scale business to generate income to meet day to day to expense. Shirazi and Khan (2008) noted that non-poor people used the loan more effectively as per policy laid down by the microfinance institutes as compare to core people. Non-poor people make investment on durable assets whereas core-poor people used loan amount to fulfill their immediate needs, day to day to expense. Anayo and Nkamnebe (2011) describe that core-poor people facing problems to repay the loan amount and interest as they did not used loan amount for investment purpose but to fulfill their day to day needs. Some others factors like inefficiency of bank employees, corrupt tendency of clients, limited product line and, lack of technology are the major problems faced by the MFIs, especially in underdeveloped country.

Gopalan (2007) sued that majority of MFIs customers applied for loan to start new business or extension of existing business but instead of investing loan amount they used loan amount to fulfill their immediate needs including matrimony ceremony of their family members, medication, education, transportation and construction work. Due to this trends large number of MFIs customers faced problems with context to repayment of principal amount of loan and interest on loan as well. As per Ikechukwu (2012) as no collateral or securities are required by MFIs for sanctioning loan therefore majority of drugs addicts, gambler, mentally retired person and non-serious people succeeded to obtain loan and loss their money and then faced problems at the time of loan maturity. Then such customer borrow money from traditional money lenders for repayment of loan and lost their personal property as they were not able to repay amount to traditional money lenders.

According to Cheston et al (1999) role of MFIs in the context of poverty alleviation not based on the MFIs customers but also on

the employee of MFIs. He found significant difference between the performance of customers who have business education and business experience and those who do not have such prerequisite. How positively a customer used loan amount up to some extent based on the client's assessment made by MFIs employees. They added that customers were properly assessed and loan will be provided to those customers who intend to start new business or intend to extend their existing business. Maclsaac (1997) mentioned that while making assessment of customers before sanctioning loan some important elements including education of clients, his business skills, business experience, his character and his criminal record may be considered as poor assessment becomes a major cause of nonperforming loans and create problems for MFIs and customer as well especially with reference to poverty alleviation.

Godquin (2004) repayment of loan and MFIs performance in the context of poverty based on various factors including previous financial condition of customers, business knowledge, business experience and required amount of loan matching with business needs. Guttman (2007) mentioned that prime reason of MFIs failure with reference to poverty alleviation that majority of customers misused the loan amount to fulfill their basic needs like construction of house, marriages, education, health and on recreational products like cell phone, bikes and electric appliances as well. According to Woolcock (1999) providing loan to poor people without any collateral or securities is a key factor and repayment of loan depends on the capacity of borrowers especially with reference to business education and business experience of borrowers. Silwal (2003) mentioned that due to poor assessment of microfinance employee before sanctioning loan became a cause of failure of MFIs with reference to poverty alleviation.

Awoke (2004) indicated that one of the basic problems that MFIs faced with reference to poverty alleviation is the willingness for repayment of loan of customers as well. Some customer not paid loan due to some political links. While, Greenbaum and Thakor (1995) suggested that past track record and history of borrower must be considered while sanctioning loan and its past record indicated the future behavior of borrower and factors like personal character of borrower, capital required, business education, business experience, collateral requirements, business proposal and connection with other vendors. Hulme and Mosley (1996) argue that one of the most important elements is the design or features of credit products offered by the MFIs. It means that product must be designed to keep in view the capital requirement of borrowers and its personal capacity and terms and conditions of loan like period, interest rate and amount of installment must be considered and designed borrower to borrower besides the standardized term and conditions for each borrower.

### 3. RESEARCH METHODOLOGY

Qualitative techniques are a multimethod approach that focused various things in the natural environment of respondents and researcher try to get maximum input regarding subject matters as well. Researcher used various tools in qualitative techniques for data collection like case study, personal experience sharing, interview, observations, life story and visual texts (Denzin and

Lincoln, 2005). In this study face to face interview of MFIs employee will be conducted to identify the problems and challenges faced by MFIs with reference to poverty alleviation. According to Bryman and Bell (2007) mentioned that interview is one of the most important tools used by various researchers for data collection in qualitative nature research, whereas some different methods of interview like telephone, video call and internet interview are easier but face to face interview are more convenient for both interviewee and interviewer because interviewer can probe or ask follow up questions and can also observe the expression of respondent during interview on various interview protocols. In this study total 3 interviews of branch manager will be conducted including the Branch Manager of NRSP Bank Limited, Khushhali Microfinance Bank Limited and FINCA Microfinance Bank Limited. The reason for only three interviews is that because qualitative is the game of meaning in which we do not make generalized hypothesis statement and selecting large sample size will be time consuming as well (Crouch and McKenzie, 2006).

#### 3.1. Data Collection

For data collection in-depth interview of branch manager will be conducted and keeping in view the literature regarding this research following four questions will be asked to each respondent and detailed information regarding subject matter will be collected and major problems and challenges that are facing by the MFIs with reference to poverty alleviation will be identified.

#### 3.2. Research Question

On the basis of previous studies and available literature following research questions have been derived for this study.

Q. No. 3.2.1.

Does the Utilization of loan amount to fulfill his immediate needs (ULIN) instead of investing loan amount in income generating activities is the major problem or challenge with reference to poverty alleviation, if your answer is yes then describe how this act of borrower affects overall goal of poverty alleviation of MFIs?

Q. No. 3.2.2.

Does Mismatch of Loan Amount (MMLA) is the major problem or challenge faced by MFIs with reference to poverty alleviation, if your answer is yes then describe how this element affects the goal of poverty alleviation of MFIs?

Q. No. 3.2.3.

Does Customer Capacity for Utilization Loan (CCUL) is the major problem or challenge faced by MFIs with reference to poverty alleviation, if your answer is yes then describe how this element will affect the goal of poverty alleviation of MFIs?

Q. No. 3.2.4.

Does ULAC is the major problem or challenge faced by MFIs with reference to poverty alleviation, if your answer is yes then

describe how this element will affect the goal of poverty alleviation of MFIs?

### 3.3. Data Analysis

In this study content analysis techniques will be used for data analysis and through this study major problems and challenges faced by MFIs will be identified through the themes that will be derived from the interview transcription. According to Hsieh and Shannon (2005) content of the textual data can be derived through content analysis that a qualitative approach.

As per Figure 1 respondent identified the construction of house, spending loan amount on family member’s marriages and using loan amount on health and education of family members as the factor of question 1 that are related to (ULIN) whereas non compatibility of loan amount, high processing fee and high interest rate are the factors of second questions (MMLA). Against the response of third question three factors identified including lack of business education, lack of business skills and lack of business experience whereas misused of loan by drugs addicts, gambler and using loan amount on recreational goods is the factor of four question (ULAC).

## 4. CONCLUSION AND DISCUSSION

Findings of study regarding four question and 12 themes that are derived from these four question are given as under.

### 4.1. Themes Categories and Percentage (%) of Frequencies of ULIN

Figure 2 indicated that majority of microfinance customers take loan for business purposes and spend loan amount to fulfill their

immediate needs instead investing this amount on starting new business or extending existing business. As per Figure 2 41% respondent indicate that borrowers spend loan amount on health and education of their family members, 35% spends loan on matrimony ceremonies of their family members and 24% spends loan amount on construction of houses and renovation of house. All above mentioned factors create hurdle for MFIs with reference to the poverty alleviation objectives and borrowers used loan amount to fulfill their immediate needs and at the end they were unable to pay the principal amount and interest as well as they don’t invest loan amount on income generating activities.

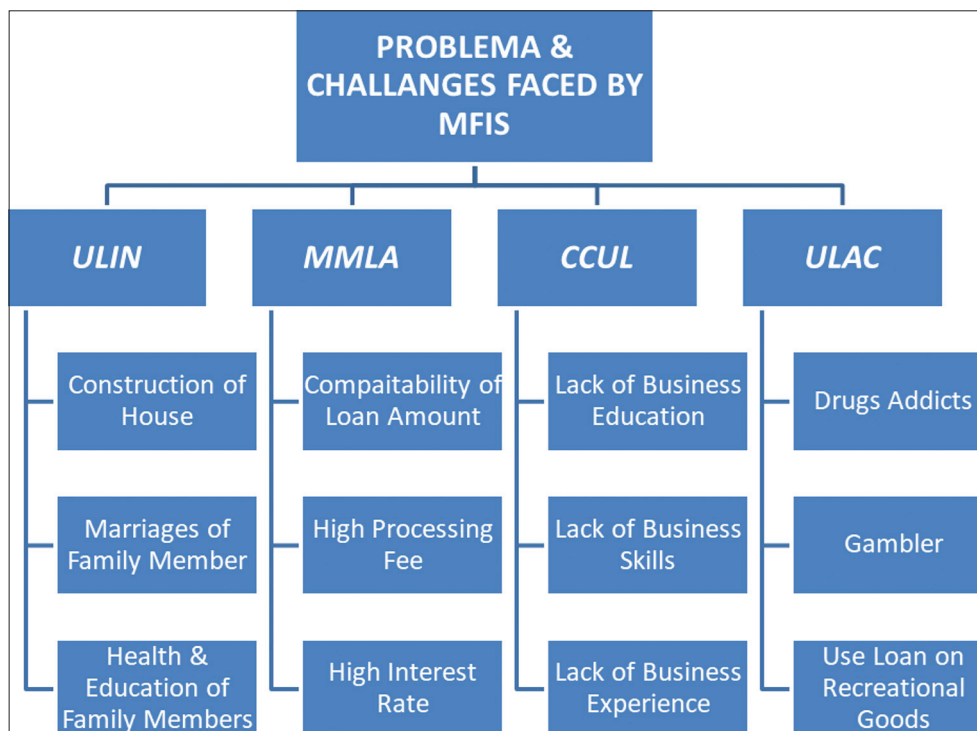
### 4.2. Themes Categories and Percentage (%) Frequencies of Themes Regarding Mismatch of Loan Amount (MMLA)

Figure 3 pinpoint the themes regarding Mismatch of Loan Amount with the capital requirement of business. One of the basis themes is the compatibility of loan amount with business needs. As per respondents MFIs has standardized products containing fixed amount of loan, sometime loan amount exceeds from the required amount and that may be misused by the borrowers and sometime capital required exceeds from the amount of loan and that becomes a cause of business failure as well. As per Figure 3 58% respondent highlighted this issue whereas 28% respondent feel that borrowers unable to pay the high interest rate and 14% respondent identify that high processing fee is also an important factors in this regard.

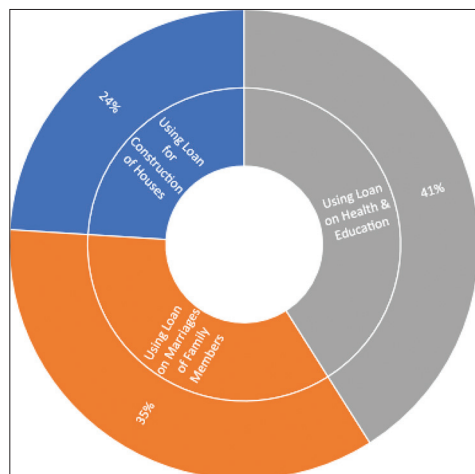
### 4.3. Themes Categories and Percentage (%) of Frequencies Regarding Customer Capacity for Utilizing Loan (CCLU)

Figure 4 highlighted the themes regarding customer capacity for loan utilization (CCLU) and respondent indentified three factors in this regard including business experience, business skills and

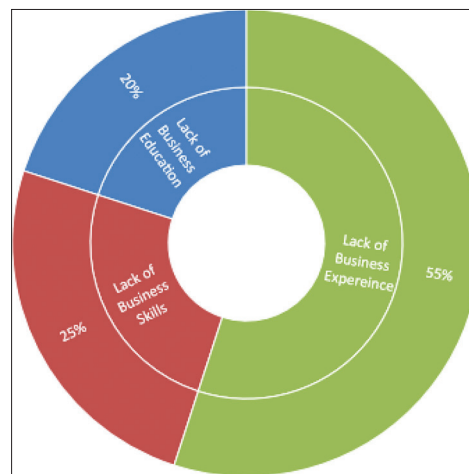
Figure 1: Problem and challenges faced by microfinance institutions



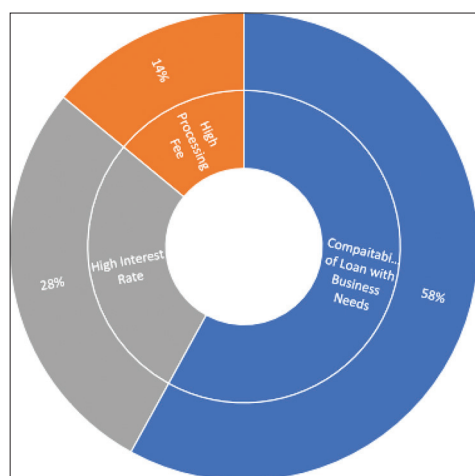
**Figure 2:** Themes and percentage frequencies of utilizing loan for immediate needs



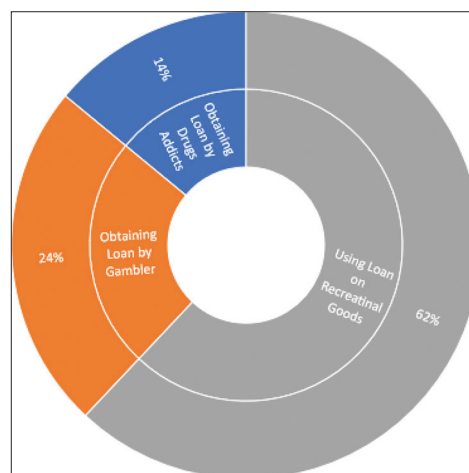
**Figure 4:** Themes and percentage frequencies of CCLU



**Figure 3:** Themes and percentage frequencies of miss match of loan amount



**Figure 5:** Themes and percentage frequencies of utilizing loan by addicts customers



business education. Findings in this regard indicating that one of the basis challenges faced by MFIs is that 55% respondent raised the issue of lack of business experience by the borrowers, 25% respondent give indication of lack of business skills and 20% respondent pinpoint that MFIs borrowers don't have business education. Due to all said factors majority of borrows take loans and unable to pay the principal amount and interest as well due to lack of necessary business experience, business skills and business educations.

#### 4.4. Themes Categories and Percentage (%) of Frequencies of Utilizing Loan by Addicts Customers (ULAC)

Figure 5 showing an others important themes that create hurdle in way of poverty alleviation goals of MFIs. As MFIs provide loan to their borrowers without any collateral or securities therefore the MFIs loan becomes a soft target for drugs addict's persons and gambler as well. Besides this some borrowers take the benefits of this policy and took loan for purchase of recreational goods like motor bikes, costly cell phones, clothes, air conditioners and also for travelling of different hill station. Figure 5 also indicating that 62% respondent replied that borrowers used loan amount on

recreational goods, 24% respondent indicated that some gambler also took loan from MFIs and 14% respondent highlighted that drugs addicts person tool loan from MFIs and all these factors creating problems for MFIs as they failed to pay to the loan amount and goal of poverty alleviation of MFIs sometime not achieved due to this reasons.

Findings of the said study will be share with the all microfinance banks, microfinance trust and NGOs working in Southern Punjab so that keeping in view the findings of this study policies may be formulated and implemented in Pakistan to reduce the poverty of people of the underdeveloped area through the effective utilization of microfinance programs.

## 5. RECOMMENDATIONS

Majority of MFIs customers fails to achieve its objectives as the capital requirements of customer will not be considered by MFIs. Therefore, customized products may be developed and each customer's capital needs must be considered before sanctioning loan. Majority of MFIs customers applied loan for business commencement or extension but instead of making investment in business they used loan amount to fulfill their immediate needs.

Therefore, to handle this problems loan may not be provided in form of cash and required material or items will be provided to clients so that they will not be able to misused the loan amount. Medical examination of clients will be conducted so that drugs addict persons will not be able to becomes a MFIs customer. Customer character assessment must be made from their neighbor and customer criminal record may be verified from concerned police station so that criminal or gambler will not be able to received loan from MFIs. To minimize the cost of debt of MFIs some new branches may be opened in rural areas. Interest rate and processing fee of MFIs are high as compare to others conventional and Islamic Banks, therefore interest rate and processing fee may be reduced so that people will be able to reduce its poverty level through the provision of MFIs loans. Majority of MFIs customers are illiterate and don't have any business experience, business skills and business education. Therefore, MFIs may launch some training programs and operational assistance in this regard must be provided to its clients. New product may be developed to keep in mind the unique needs of each MFIs customers.

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