



Informal businesses and micro-credit – Evidence from financial diaries: A study in Ramanagaram, India



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Abstract Combining quantitative with qualitative data, through a unique methodology of financial diaries, we generate thick descriptions of the informal business involving peddling of vessels and other products in Ramanagaram, Karnataka, India. By dovetailing the cash inflows from the businesses to loan repayments, we show that a standardized microfinance loan is unsuited to their business cash flows. Informal businesses are marked by seasonality and volatility springing from the contextual and socio-demographic circumstances of households running them. A keen understanding of such businesses is imperative for making the informal sector vibrant enough to support the economic lives of the poor.

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Introduction

A substantial portion of the economic activity in developing economies takes place in the informal sector. As an example, more than 90 percent of the total labour force in India works in the informal sector (Gol, 2004). Today, developed economies are also seeing an increase in informal sector activity and there is an urgent realization that very little is known about this sector and that this lapse is too glaring to be ignored (Godfrey, 2012). It is now recognized that this sector can

no longer be labelled as “economic activity that [is] conducted by unregistered firms or by registered firms but hidden from taxation” (Porta & Shleifer, 2008) and it has a key role to play in tackling questions of growth, employment, and poverty alleviation (Kar & Marjit, 2009). To understand this sector we must come to grips with some basic questions: Who participates in the informal sector? What are the activities carried out in the sector? Why do people participate in it? Where are such activities predominant and how are they carried out? Answering these questions is not easy as there is no consistent data on these enterprises. Information on informal enterprises gets captured largely as part of household level surveys which are not designed with the specific goal of understanding these ventures as business enterprises. The lacunae in understanding informal enterprises as business enterprises hampers efforts to help these businesses. This is seen starkly in the big thrust given to

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providing micro-credit to such enterprises, to enable micro-entrepreneurs to boot-strap their way out of poverty. One of the premises of the microfinance movement was providing needed, timely, and hassle-free credit to the informal enterprises of the poor, to those excluded from the mainstream financial sector (Yunus, 1998). However, this has largely been done in a routine, "cookie-cutter" manner, without truly understanding the dynamics of the informal businesses or their cash flows (Woller, 2002). The disconnect between the financial services that the informal businesses require and what they receive implies that the microfinance sector today has still to move towards a more client-centred growth (Cohen, 2002). Against this background, this paper studies the weekly cash-flows of informal business units over a period of eleven months from September 2008 to August 2009, operating in the peri-urban area of Ramanagaram, in the southern state of Karnataka, India. These informal units would be a part of what the National Commission for Enterprises in the Unorganized Sector (NCEUS)¹ describes as consisting of "all unincorporated private enterprises owned by individuals or households engaged in the same and production of goods and services operated on a proprietary or partnership basis and with less than 10 workers". Information on the cash-flows of these enterprises was collected as a part of the larger project of collating household financial diaries of 90 poor, urban households, most of them clients of microfinance institutions (MFIs). In this process, a deliberate attempt was made to collect the cash flows of informal businesses among the sample of 90 households by having them separate out the household cash flows from the business cash flows in their diaries. We attempt to make an in-depth analysis of their cash flows which would illustrate the issues faced by the informal sector today pertaining to their modes of business, their credit-needs, the reasons they cannot expand, and how and why this sector persists. Through the analysis of these cash flows we endeavour to add to the bigger debate surrounding the informal sector today – on whether this sector could be the engine bearer of growth in developing economies, or it points to the growth story being exclusionary and divisive. The paper plans to do this in the following sections. In the next section, we lay down the context of the Ramanagaram Financial Diaries project of which this study was a part; we also clarify why we chose to concentrate on seven business families in our sample of 90 households. The third section details the businesses run by the households and the issues they face with financing their businesses. The fourth section contains the data that we culled from the financial diaries kept by the households. On analysing this data we find that a major reason the informal businesses remain small is that the financial services and products sold to them are unsuited to the cash-flows of their businesses. Microfinance institutions offer standardized loan products and would do better if they designed products taking into consideration the requirements of the businesses who are their clients.

These aspects are discussed in the fifth section and in the sixth section, we conclude the paper.

Context: Ramanagaram Financial Diaries

The Ramanagaram Financial Diaries was a yearlong study carried out in Ramanagaram town in Karnataka, India. Ramanagaram is 60 kms away from the city of Bangalore, on the Bangalore-Mysore highway in Karnataka. As part of the project 90 poor families in two contiguous areas of Ramanagaram town maintained financial diaries between September 2008 and August 2009, with details of their daily financial inflows and outflows. This project was initiated to understand (a) the cash flows of the urban poor who had borrowed moneys from MFIs and (b) the actual use made of these loans, as opposed to the stated purpose. The methodology of keeping track of the financial inflows and outflows of people through financial diaries was initiated by Stuart Rutherford in Bangladesh (Rutherford, 2003); details of such financial diaries were tracked by Orlanda Ruthven in India (Ruthven, 2002) and by Daryl Collins in South Africa (Collins, Murdoch, Rutherford, & Ruthven, 2009). We departed from the original financial diary methodology by asking all our 90 respondents (all of them women) to log-in the diaries themselves. To the best of our knowledge, this method was being tried out for the first time, especially among the urban poor. A pilot study was conducted for three months from September 2007 to December 2007 in the same area to check the efficacy of this departure from the original financial diary methodology. Based on the findings (Kamath, Mukherji, & Ramanathan, 2010), this change was retained for the final yearlong study. The women of the households maintained the diaries, with their children writing the diary if the women were illiterate or unable to write. Any study conducted using the methodology of financial diaries requires fairly intensive contact of the field assistants with the households maintaining these diaries. Fine grained information on the cash flows of the poor such as the one obtained from financial diaries is therefore difficult to collect (Collins et al., 2009). This methodology enables one to go beyond quantitative data collection. While we did get large amounts of quantitative data regarding daily outflows and inflows, the basic advantage of this methodology was that it became an excellent tool for qualitative analysis through interactions with our participants. Every occasion of recording the diary entries of the participants was an occasion to understand how the participants lived and dealt with their specific situations. Our field investigators were also asked to make detailed field notes during the process of data-collection and we were also able to conduct in-depth interviews clarifying the nature of cash flows. Thus, this study also obtained rich, in-depth qualitative data on some of the 90 odd families living in the Hajinagar and Ambedkarnagar areas of Ramanagaram whose financial diaries we were recording. As researchers we were able to interact closely with the households whose data we were analysing. This also helped in verification and triangulation of the data from various other sources. Before the diaries were written, all households participated in a baseline survey giving details of their occupation, education status, housing status, assets, income and borrowings, savings in the previous one year (i.e. in the year prior to the period in which the diaries were written). Close

¹ The National Commission for Enterprises in the Unorganized Sector (NCEUS) is a national body commissioned by the Indian government to address the issues faced by enterprises in relation to the unorganized sector. The Commission was established in 2004 to act as an advisory board for matters regarding informal employment sector.

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