A Perspective on Informal Entrepreneurs who have never used Micro Financing: An Exploratory Study in the Informal Footwear Bogotanian Industry

Patiño, Omar
Professor
School of Administration, Finance and Economic Sciences
Universidad EAN
Bogota, Colombia

Salcedo-Pérez, Carlos
Professor
School of Administration, Finance and Economic Sciences
Universidad EAN
Bogotá-Colombia

Abstract

This article is based on the results of an exploratory study about financial behaviors of informal footwear entrepreneurs in Bogota, Colombia. It contains an analysis of entrepreneurs who specifically have never had a loan with a micro financing institution. The article contains the analysis of their answers related characteristics they prefer in a financing institution and, in case they have an informal loan, why they decided to use informal credit instead of other type of formal loan.

Keywords: informal economy, informal footwear sector, micro financing, informal lending

1. Introduction

Financial inclusiveness has become a key factor when it comes to economic development, therefore, governments and international organizations have formulated policies to boost it. Emerging economies want to increase the number of people in their formal financial systems as a way to increase financial services, boost savings and thus, increase and improve opportunities for micro and small enterprises, improving quality of life. What is known now as microcredit was born in Bangladesh, but then it spread to other countries (Attanasio et al, 2011). Augsburg, de Haas, Harmgart y Meghir (2012) stated that access to credit (in a study about micro financing in Bosnia-Herzegovina) allowed borrowers to expand their small size businesses. Better, "*more developed financial systems ease external financing constraints racing firms*" (Levine, 2005), which helps economic development. At this point, microfinance plays an important role, since it can become a way for entrepreneurs to start their formal financing life, therefore increasing their possibilities to increase their production, grow, and achieve a better quality of life. In 2011, it was estimated that 155 million people worldwide used microcredit (Gubert and Roubaud, May 2011). Therefore, studying the use of microfinance by informal entrepreneurs becomes important to understand their behavior and to design possible new financial services for them.

2. Microfinance

Microfinance has played an important role in the development of small entrepreneurships in countries where it has been implemented; it has become a strategy to create jobs and improve the quality of life of people who has used it (Patiño, 2010). Microfinance has had an important development lately; therefore, financial institutions have increased their services. Insurances, payments and mobile money have become part of the strategy to facilitate the access of more people to the financial market, bringing as result reduction of transaction's costs, economical acceleration and better quality of social benefits (Jack and Suri, 2014). However, regardless of the efforts to take financial services to more people, the percentage of people who do not use financial services is still high.

According to the World Bank (2015), in the year 2014, 62% of people worldwide had an account (it was 51% in 2011), meaning 2 billion people still unbanked, 54% of people in developing countries do not have an account. Global Findex Database 2014 states reasons that limit financial inclusiveness growth; globally, when people were asked about the reasons to be unbanked, the five most named answers were: not having enough money, not needing and account, a family member already having an account, accounts being too expensive, and financial institutions being too far away (World Bank, 2015); When it comes to Latin America and the Caribbean, the order of importance is not having enough money, accounts being too expensive, and not needing an account. Informal financial services appear as an alternative to eliminate the requirements of formal banking, including formal micro financing institutions. Some characteristics of informal financial services are that their procedures are simple and straightforward, operate at times and days that are convenient for their members, access to credit is simple, prompt approvals, transactions costs are low, and repayments rates are high (Global Development Research Center, GDRC, n.d.).

In 2014 micro financing in Colombia had a real increase of 8.3%, being the total amount lent 12.4 trillion pesos (around 5.18 billion dollars[1]); of this amount, 69% corresponded to banks, 19% NGO's, 8% credit unions, and 4% other financing companies (Superintendencia Financiera de Colombia, 2014). Quarterly, the Banco de la Republica (Colombian Central Bank) performs a survey to micro financing institutions in order to know their perception about the micro financing market in the country. The five most important factors that micro financing institutions mention as reasons that stop them from providing a higher number of loans are: customers' payment capacity (20.3%), customer's over debt (19%), customer in debt with more than three financial institutions (14%), credit history (10.8%), and geographic location (6%) (Banco de la Republica, Sept 2015).

3. Colombia: possibilities for financial inclusiveness

Colombia was one of the first countries where micro financing tried to be implemented; however, its evolution at the beginning was not very successful. Since 2007, micro financing grew in Colombia, achieving important levels of coverage; in such year, micro financing was strengthened by government policies and the creation of the "Banca de Oportunidades", as an investment program operated by BANCOLDEX, to promote access of low income families, non-banking people and small business entrepreneurs to financial services.

In Colombia, according to the law 590 of year 2000, micro financing is "the financing system to small businesses, with a maximum amount to be lend of twenty five (25) minimum legal monthly salaries, with the condition that at no moment the balance for a single debtor goes above such amount" (Congreso de la Republica de Colombia, 2000). Such law also authorizes financial intermediaries to charge commissions as long as they fulfill the requirements established by the Consejo Superior de Microempresa. On November 19, 2015, the maximum authorized maximum interest rate for a micro financing loan is 35.42%, exceeding 16.11 percent the regular banking interest rate, and over 24.13 percent the maximum legal rate to charge in case of late payments (Superintendencia Financiera de Colombia, 2015).

In Colombia, according to Cano et al (2013), financial inclusiveness is valid if it helps poor people to accumulate capital, thus bringing wealth redistribution. The former leads to conclude that a policy of financial inclusiveness must have as an ultimate goal to help poor people to increase their quality of life, to increase their levels of savings, to create more options for their entrepreneurial development, by means of getting access to saving and credit products of the formal financial system.

Colombia has made important advances in the matter. According to the Microscopio Global 2014, Colombia ranks second out of 55 countries (first in the rank being Peru) in terms of creating a favorable environment for financial inclusiveness (The Economist Intelligence Unit, 2014). Among the factors taking into consideration in the ranking, Colombia excels in the fact that financial inclusiveness is a key policy for the government, which includes the participation of various government organizations; another highlighted factor is the support that Superintendencia Financierade Colombia (Colombian government organization in charge of surveillance of the financial system)is providing in order to increase transparency, competitiveness and formality to the financial system (The Economist Intelligence Unit, 2014).

[1]The amount in USD was calculated using the official exchange rate of the Banco de la Republica (Colombian Central Bank) of 2,392.40 COP per USD of December 31, 2014, which was taken from www.banrep.org/es/trm Serie Historica

In Colombia, in 2011, only 30% of people above 15 had banking account, in 2013 71.5% had at least one financial product, and between December 2012 and December 2013 1.1 million people used accounts for electronic deposits according to Global Findex of the World Bank, cited by The Economist Intelligence Unit (2014). Even though such numbers are promising, a closer look shows that there is over debt especially in people of lowest income, and over 33% of adults have saving accounts but they do not use them, consequently such accounts have been declared inactive (Banca de las Oportunidades, 2013), which has an impact on the data on financial inclusiveness.

The growth in the numbers of financial inclusiveness is the result of the increase in the number of people who use financial saving products (more than those who use credit products). By December 2013, 20,780,234 people had savings accounts, while the total number of people who had personal credits, mortgages, microcredit and credit cards combined was 14,467,657, of which 46% had credit cards. (ASOBANCARIA, 2014). The same source shows that 3,257,460 people had a portfolio of one saving product and a credit product different to a credit card (ASOBANCARIA, 2014). Microcredit grew only 3.4% during 2013 (ASOBANCARIA, 2014).

In terms of elimination of barriers, Colombia has advances in many fields associated to opening accounts as well as the fact that a new law that allows card issuers to receive deposits and to offer electronic payment services (Karpowicz, 2014).

4. Informal Economy in Colombia

Before considering the topic of informal or shadow economy, it is important to understand that it should not be confused with illegal activities; informal business performs legal activities even though such companies are not formally registered, while illegal activities are banned by law (Schneider and Enste, 2002). Informal footwear entrepreneurs are performing a legal activity (production and/or commercialization of shoes), therefore, they cannot be confused with illegal actors of the economy who perform activities that are banned by the government.

It is difficult to measure the size of the informal economy, since the mere fact that a company is formally registered before a chamber of commerce does not immediately makes it formal. There are four levels of informality recognized in Colombia, depending on the level a company fulfills the regulations, that go from the first level that include all companies not registered at all, to the fourth that include companies that are registered, have accounting books, pay taxes but do not pay legal benefits to their employees (Camara de Comercio de Bogota, 2009). The fourth level then is more useful to calculate the size of the informal economy when it is measured by number of workers who work informally.

Salcedo (2012) considers two sides of the informality, which are Informality of creation (a company whose informality arises from the beginning, since they are not even registered or created before a Chamber of Commerce) and Informality of operation (a company legally created but whose operation is informal at different levels).

Based on the number of workers employed in the informal sector, the percentage of informal workers in Colombia in the quarter July-September 2015 was 48.0%; of this percentage, 59.1% were independent workers (DANE, November 10, 2015). This numbers show the importance the informal sector of the economy has as employer in Colombia, therefore, the importance to study this phenomenon in order to understand it better and create solutions for informal entrepreneurs to join the formal sector of the economy.

Salcedo (2012) states that access to formal credit is one the most important advantage informal entrepreneurs perceive formal entrepreneurs have for being formal. Of course, access to formal lending implies requirements, paperwork and income that might be difficult to fulfill by a small informal entrepreneur, being this opportunity for micro financing institutions.

5. Leather and footwear industry

Traditionally the footwear production industry has been important for Colombia, however, in the period August 2014-August 2015, its real contribution to the production of the economy of the country decreased by 2,029% (DANE, 2015). Between January and December 2014, its production increased 5.8%, and total sales increased 7.0%, and sales only at national level increased 8.8% (Asociación Nacional de industrials ANDI, December 2014).Regardless those numbers, problems in the industry are the same as before. In 2014, industrials considered contraband as one of their main problems. Many small producers have entered the industry because of family tradition (Salcedo, 2012). This reduces the opportunities to access technological developments.

The former situations lead to believe that entrepreneurs usually work in the informal sector of the economy. Being informal limits their chances to acquire formal financial credits, one of the main advantages they find by doing business formally (Salcedo, 2012). Nowadays, generally speaking, young people do not find the industry appealing as employer; such condition is a risk for the existence of the industry itself, because it is in jeopardy of not finding the required labor that adds value to its products (Salcedo, 2012). A vicious circle then appears, in which the industry does not create a competitive attractive product because it does not have the qualified labor that produce such product, and at the same time, qualified labor do not see the industry as attractive, therefore, prefer to find jobs in other industries.

Industrials must work towards improving their image as employers and invest in getting the qualified labor necessary to become more competitive. If they do not act, the industry might face a complicated future, with lower participation in the total economic output of the country, producing low added value products.

6. Methodology

In order to determine the financial behavior of informal entrepreneurs, the researchers decided to design a survey containing 39 questions regarding their preferences in terms of banking services, products, use of financial resources among others, including micro financing.

The survey was applied during the second semester of 2014, specifically during the months of October and November. The researchers chose the area of Bogota known as “El Restrepo” as the place to conduct the field work. El Restrepo is an area in the southern side of Bogota, known for being home to a large number of informal footwear producers and vendors. Over 100 informal entrepreneurs were randomly selected to answer the survey, of which only 27 finally responded it. The fact of being performing a legal activity in the informal sector is a factor to consider when analyzing the low rates of respond by the entrepreneurs. Lack of trust is almost a prime condition to survive and stay in the market, and that was a difficulty when trying to get help from the entrepreneurs to participate in the study. Entrepreneurs in general were not very confident about responding the survey and in most cases they simply said no, with reasons such as the owner of the shop not being there, not having time, being busy, asking to come back later, and in many cases just with a plain no. However, twenty seven answered the survey, being very collaborative and providing helpful information for the research.

Since the entrepreneurs work in the informal sector, it was difficult to get an exact number of informal entrepreneurs in the area. However, it was possible to made an estimation based on the estimated number of blocks of the area studied (20) and a counting of an average of sixteen visible informal entrepreneurs per block, performed in November, 2014. There are four levels of informality, from those entrepreneurs who are not even registered to a chamber of commerce, to those who fulfill all legal requirements of creation and taxation but keep their workers in the informality by not paying them all payments required by law (Salcedo, 2012). For this study, informal entrepreneurs who took only cash as a method of payment were considered as informal.

7. Results

For the purpose of this article, the issues related to micro financing were chosen. Of the 27 entrepreneurs interviewed, 66% have never had microcredit and 11.11% have had microcredits before but did not have them at the moment of the research. Entrepreneurs were asked about the importance that certain factors have when they bank with the formal banking system. Entrepreneurs were asked to rate from 1 to 5 (being 1 not important at all and 5 totally important) the importance that they find in selected factors related to relations with formal banks. For this article, only results of those entrepreneurs who have never had microcredit are shown. The Table 1: Percentages of importance given by informal entrepreneurs who have never had microcredit to selected formal banking variables, shows the percentages of importance that entrepreneurs who never have had microcredit give to selected factors related to the use of a formal bank.

The tables shows that informal entrepreneurs who have never had microcredit place high importance on having a kind staffin a bank. It was the factor to which these entrepreneurs gave the highest percentage of completely important with 72.22%. Combining the two highest possible answers, 94.44% consider it an important factor.
It is important to notice that a comfortable branch was the second factor ranked as completely important. A quick approval, long times to repay, low fees were not considered that important with only 50% of respondents considering them as completely important, and gifts were considered completely important by only 27.78% of respondents.

Of those entrepreneurs who have never had microcredit, 44.4% of them had informal loans at the moment of the research. The Table 2: Reasons why informal entrepreneurs who have never had microcredit use informal lending, shows the reasons why such entrepreneurs use informal credit.

These entrepreneurs did not give conclusive answers related why they use informal lending instead of microcredit; however, it is interesting to notice that the factor most mentioned was that they did not know how to make the process to ask for a formal loan and therefore asked for an informal loan (50% of respondents); the second factor was related to the requirements of formal banking (25%) and the immediate need of resources in third place by 12.5% of respondents.

A co relational study was performed to find relations between the use of microcredit and variables related to importance of factors taken into consideration when banking with formal banks. A Pearson co relational test, with values between 1 and -1 to show the strength of relation between variables was conducted. The P-value is used to test the statistical significance of the correlation. The authors consider a P-value of 0.05 or less to show correlations significantly different to 0. The statistical results for correlations between use of microcredit and factors considered when banking with formal banks are shown in Table 3: Correlations between microcredit and factors taken into consideration when banking with formal banks.

The results are interesting. There is statistical significance for the correlations between use of microcredit and low rates and between use of microcredit and paperwork easiness, showing dependency among those variables. Such variables are important because they show first, a relation between the use of microcredit and the cost of loans and second, a relation between use of microcredit and the easiness of the paperwork that, in some cases, is complicated for entrepreneurs when they try to fulfill requirements in formal banking. This is an important factor for microcredit institutions to promote their services to informal entrepreneurs in Colombia.

8. Conclusion

Micro financing has a room to grow in Colombia. In order to reach more informal entrepreneurs, micro financing institutions need to tailor products to their specific needs and expectations. Factors such as having a kind staff and comfortable branches are considered important by such entrepreneurs who have never had microcredit. Informal entrepreneurs who have never use micro financing and have instead decided to use informal lending mention as a prime factor to do so the fact that they did not know about the process to get a formal loan with a formal established banking institution. Such factors must be understood by micro financing institutions. Informal entrepreneurs are not just looking primarily for low rates or fees; they are also looking for an upgraded service. Also, making processes easy can become a factor that makes a difference when attracting informal entrepreneurs. Formal institutions (whether they provide micro financing or not) compete not only among themselves but with informal lenders. Understanding what informal entrepreneurs look for in financial institutions then becomes a must for microcredit institutions in order to increase their operations and cover a broader part of the market.

Tables

Table 1: Percentages of importance given by informal entrepreneurs who have never had microcredit to selected formal banking variables

Factor/Ranking	**5**	**4**	**3**	**2**	**1**
Low rates	61.11	33.33	0	5.56	0
Low fees	50	22.22	5.56	16.67	5.56
Personalized attention	61.11	22.22	16.67	0	0
Near-by branch	44.44	27.78	11.11	16.67	0
Banking hours	55.56	27.78	5.56	11.11	0
Access to branches	55.56	22.22	0	16.67	5.56
Paperwork easiness	61.11	27.78	5.56	0	5.56
Kind staff	72.22	22.22	0	0	5.56
Close to ATM	61.11	16.67	0	11.11	11.11
Time to repay	50	38.89	11.11	0	0
Comfortable branch	66.67	22.22	5.56	0	5.56
Gifts	27.78	11.11	0	16.67	44.44
Quick approval	50	16.67	11.11	16.67	5.56

Source: the authors

Table 2: Reasons why informal entrepreneurs who have never had microcredit use informal lending

Reason to use informal lending/Answer	Yes	No
Rejected by formal bank	0	100
Do not fulfill requirements required by formal credit institutions	25	75
Reported to credit agencies	0	100
Do not know the process of formal lending	50	50
Needed resources immediately	12.5	87.5
Others (not mentioned)	0	100

Source: the authors

Table 3: Correlations between microcredit and factors taken into consideration when banking with formal banks

Variables tested	Pearson	P-value
Low rates	0.5140	0.0060
Low fees	-0.0110	0.9562
Personalized attention	0.2146	0.2823
Near-by branch	-0.6070	0.7635
Banking hours	0.1933	0,3339
Access to branches	0.1921	0.3372
Paperwork easiness	0.3926	0.0428
Kind staff	0.2414	0.2250
Close to ATM	0.9757	0.6282
Time to repay	0.3213	0.1021
Comfortable branch	0.1921	0.3370
Gifts	-0.1241	0.5374
Quick approval	-0.0697	0.7294

Source: the authors

9. References

Asociación Bancaria y de Instituciones Financieras – ANIF (2014). Reporte Trimestral de Inclusión Financiera – Cifras a Diciembre de 2013. Retrieved from: http://www.asobancaria.com/portal/pls/portal/docs/1/4394197.PDF Retrieved on June 28, 2015

Asociacion Nacional de Industriales ANDI (December, 2014). Informe de Encuesta de Opinión Industrial Conjunta. Retrieved from http://www.andi.com.co/SitEco/Documentos%202014/Informe%20EOIC%20Diciembre%202014.pdf Retrieved on April 28, 2015

Attanasio, O., Augsburg, B., De Haas, R., Fitzsimons, E., and Harmgart, H. (2011). Group lending or individual lending? Evidence from a randomised field experiment in Mongolia, Working Paper. Institute for Fiscal Studies. Retrieved from: http://www.ifs.org.uk/wps/wp1120.pdf Retrieved on: August 10, 2015

Augsburg, B., De Haas, R., Harmgart, H., and Meghir, C. (2012). Microfinance at the Margin: Experimental Evidence from Bosnia and Herzegovina, *Working Paper*. European Bank for Reconstruction and Development.Retrievedfrom:http://www.ebrd.com/downloads/research/economics/workingpapers/wp0146.pdf Retrieved on: August 20, 2015

Banca de las Oportunidades (2013). Reporte de Inclusión Financiera 2013. Recovered from: http://www.bancadelasoportunidades.gov.co/documentos/Reporte%20Inclusion%20Financiera/3er_reporte/reporte_web.pdf Recovered on June 12, 2015

Banco de la Republica (Sept 2015). Reporte de la situación actual del microcrédito en Colombia. Retrieved from: http://www.banrep.gov.co/sites/default/files/publicaciones/archivos/rem_sep_2015.pdf Retrieved on: October 31, 2015

Cámara de Comercio de Bogotá (2009). El mercado de trabajo en Bogotá 2006-2008. Informe de mercado de trabajo número 5.

Cano, C. (2006). Microfinanzas. Banco de la República. Retrieved from http://www.banrep.gov.co/sites/default/files/publicaciones/archivos/microfinanzas.pdf?__utma=1.915942487.1432946900.1432946900.1432946900.1&__utmb=1.2.10.1432946900&__utmc=1&__utmx=-&__utmz=1.1432946900.1.1.utmcsr=google|utmccn=(organic)|utmcmd=organic|utmctr=(not%20provided)&__utmv=-&__utmk=207134099Retrieved on February 22, 2015

Congreso de la Republica de Colombia, (2000). Ley 590 de 2000. Retrieved from http://www.colciencias.gov.co/sites/default/files/upload/reglamentacion/ley_590_de_2000.pdf Retrieved on May 12, 2015

Departamento Administrativo Nacional de Estadística – DANE (November 10, 2015). Medición del Empleo Informal y Seguridad Social: Trimestre julio-septiembre de 2015. Retrieved from http://www.dane.gov.co/index.php/mercado-laboral/informalidad-y-seguridad-social Retrieved on November 11, 2015

Departamento Administrativo Nacional de Estadística – DANE (2015). Encuesta Mensual Manufacturera. Retrieved from: http://www.dane.gov.co/index.php/construccion-en-industria/industria/muestra-mensual-manufacturera-mmm in Anexos A1Sheet Var y Cont Annual. Retrieved on: October 31, 2015.

Global Development Research Center GDRC (n.d.) Comparing Formal and Informal Financial Sectors. Retrieved from: http://www.gdrc.org/icm/formal-informal.html Retrieved on: October 30, 2015

Gubert F. Roubaud, F (May, 2011). The Impact of Microfinance Loans on Small Informal Enterprises in Madagascar. A Panel Data Analysis. Retrieved from: http://www.iss.nl/fileadmin/ASSETS/iss/Documents/Research_and_projects/Unlocking_potential_Microfinance.pdf Retrieved on: September 12, 2015

Hernandez Sampieri, R (2014) Metodologia de la investigación. 6th Ed. McGrawHill. Mexico.

Jack, W. and Suri, T. (2014). Risk Sharing and Transactions Costs: Evidence from Kenya's Mobile Money Revolution. *Massachusetts Institute of Technology*. Retrieved from http://www.mit.edu/~tavneet/Jack_Suri.pdfRetrieved on May 2, 2015

Karpowicz, I (2014). Financial Inclusion, Growth and Inequality: A Model Application to Colombia. International Monetary Fund. Working Paper WP/14/166

Levine, R. (2005). Finance and Growth: Theory and Evidence. Retrieved from: http://faculty.haas.berkeley.edu/ross_levine/papers/forth_book_durlauf_finngrowth.pdf Retrieved on July 22, 2015

Patiño, O., (2013). *El Modelo MIFE como instrumento para la formalización del empresariado,* Bogotá, Ediciones EAN.

Salcedo Pérez, Carlos (2012) Propuesta de Formalización del Sector Calzado en Bogotá: Análisis y Prospectiva. PhD. Thesis. Bogota. Ediciones EAN

Schneider and Enste (2002). Ocultandose en las sombras: el crecimiento de la economía subterránea. Washington. International Monetary Fund.

Superintendencia Financiera de Colombia (2014) Reporte de Inclusión Financiera.

Superintendencia Financiera de Colombia, (2015). Interes Bancario Corriente (Microcredito) Retrieved from https://www.superfinanciera.gov.co/jsp/index.jsf Retrieved on November 19, 2015

The Economist Intelligence Unit Limited (2014). Global Microscope 2014 The enabling environment for financial inclusion. Retrieved from: http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=39207364 Retrieved on June 30, 2015

World Bank (2015). The Global Findex Database 2014 Measuring Financial Inclusion around the World Retrieved from:http://www.wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/10/19/090224b08315413c/2_0/Rendered/PDF/The0Global0Fin0ion0around0the0world.pdf#page=3Retrieved on April 30, 2015