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## INFORMAL LENDING PRACTICES AND PROFITABILITY OF RICE RETAILERS IN BORONGAN CITY

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### ABSTRACT

This correlational study explored the relationship between informal lender's practices and profitability of fifty-three (53) rice retailers in city of Borongan using a researcher-made-three part questionnaire on the business profile, level of practices among informal lenders and weekly income of the respondents. Data were sourced out from rice retailers who lent sum of money from "5-6" informal lenders, and were utilized using descriptive and inferential analysis test at .05 level of significance. Findings revealed that Majority of the respondents had been in the middle years of retailing business, used an average initial capital sourced out from their personal savings and are earning an average weekly income. The respondents' perceived that informal lenders assess clients' financial needs and willingness to pay without requiring collateral from them and that rice-retailers reloan due to fast processing of funds and the great customer service. Using regression analysis, year in business was found to be a significant predictor of increase in the profitability of rice retailing services. While, no significant relationship was seen between the rice retailers' weekly net income and the level of practice among informal lenders. The researcher recommends that government and non-government agencies to provide intervention that will improve the microbusiness enterprise in the market using the help of informal and formal lending institutions and that wider scope of the study should be made to include other small business sectors that are affected by informal lenders.

**Keywords:** Lending practices, profitability, rice retailing.

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## **INTRODUCTION**

Micro-entrepreneurship has become a large proportion of business enterprises in most countries in Asia. According to Monica (2020), “the establishment of micro-businesses has had a strong impact on the quality of life among individuals in developing nations” p.4 ... thereby allowing low-income families to begin a business of their own. A survey conducted in nine Sub-Saharan African countries and findings showed that the labor force and low-income groups are more engaged in micro-enterprises (Fox & Sohnesen, 2012). It cannot be denied that this kind of market requires finances, given low business capital among micro-entrepreneurs. For instance, a small store owner might be needing a quick source of temporary capital when business is slow or when there is a need to invest in additional goods or services that sell out quickly and yield decent profits during peak-seasons like Christmas; here intervenes, the lending institutions. Money lending has been a prominent activity and has flourished through time in the Philippines because of the country’s economic condition. However, with the demanding grounds for lending set by banks and other formal lending institutions, these people usually settle for less paper/requirement crediting system called informal lending institutions. The informal credit market, also known as alternative lending, has always been active in servicing the rural population in the Philippines. The Philippine Association of Service Exporters (PASE, 2015) revealed that 38% of Filipinos still prefer informal lending over banks for both savings and financing. This can be attributed to the fact that 95% of all borrowers are living below minimum wage access to informal sources even when banks are present (Banerjee & Duflo, 2007). Moreover, Atieno (2001) suggested that formal lending institutions’ complex lending terms and conditions cause them failure to cater to the credit needs of small-holders.

Nowadays, traditional money lenders and landlords have been replaced by a specialized farmer and trader lenders (Nagarajan, 1992). Currently, farmer lenders are the primary sources of credit in rice-growing areas in the country offering differentiated credit contracts, usually involving linkages of credit with labor, land, and product markets. The presence of many different credit contracts from various types of lenders implies a competitive credit market (Floro & Yotopoulos, 2011). It has been an observation by the researcher that trader lenders who specialize in trading tend to offer loan contracts to large and asset-rich farmers, while farmer lenders who specialize in farming tend to lend to small-asset poor farmers and landless laborers. Academicians’ with the likes of Muscettola (2014) presented a positive relationship between leverage and profitability, while Cassar and Holmes (2003) who studied debt’s impact on the capital structure of small and medium enterprises (SMEs) found a

negative relationship between profitability and debt ratios, demonstrating that firms with high-profit levels would preserve moderately lower debt intensities. All this information leads to existing lending patterns indicating a segmented loan market in which borrowers and lenders are matched based on the occupational specializations of the contracting parties.

Indeed, micro-entrepreneurs are the most prominent patrons of the 5-6 business, aka loan sharks, since they are the ones who need financial capital for the daily financing activities of their businesses. During hard times, many micro-entrepreneurs, especially rice retailers here in Borongan City, would seek the help of those engaged in the money lending business as a way to support their family's financial needs and to ease poverty. Specifically, this paper concentrated on the level of practices among informal lenders because they are the primary credit sources and to analyze the culture of informal lending among rice retailers of Borongan City public market.

## **LITERATURE REVIEW**

There are three essential theories which highlight the relation between debt and profitability, namely: signaling theory, the agency costs theory, and tax theory (Kebewar, 2012). According to signaling theory, debt, in the presence of asymmetric information, should be correlated positively to the profitability of the company. According to the agency costs theory, there are two different effects of debt on the profitability of companies: firstly, it is positive in the case of agency costs of equity between shareholders and managers; secondly, its effect is negative, resulting from the agency costs of debt between shareholders and lenders. Finally, the tax theory shows its complexity in the sense that the ratio of debt and profitability depends on the tax treatment of interest and income (interest and income tax). According to Scott (2010), there are pros and cons in borrowing money as business capital. Borrowing money ensures the institution has sufficient capital to open the doors for growth and stay afloat until realizing a profit. A firm business credit profile is advantageous startups because it builds credibility and the business's ability to attract new creditors and partners in the future. This also allows flexibility in paying loans and personalizes payment options. On the other side, there are also disadvantages in engaging loans such as high-interest rates that can deduct to the business income. There is also a risk in the credit score of the business if the loan will not be paid. As stated by LaMarco (2019), one is also risking the entire business if they will not be able to pay the loan. Most business loans are secured and require collateral before they will be allowed to borrow.

The relationship between debt and profitability cannot be ignored because the improvement in the net income is necessary for the long-term survivability of a firm. Because interest payment on a debt is tax-deductible, the addition of debt in the capital structure will improve the profitability of the firm. Therefore, to Shubita and Alsawalhah (2012), it is essential to test the relationship between capital structure and profitability of the firm to make sound capital structure decisions. Micro-entrepreneurs are the most patronizing party to informal lending because of many reasons. Low sales and financial difficulty urge them to borrow money from informal lenders. Sales change and market instability is also a factor that drives them to borrow. Profit, on the other hand, relies on the financial handling of the owner of the business. Also, the interest rate is depending on the preference of the lender. Thus, debts affect the net income of business because of the interest to be paid. Informal lending.

Hence, the researcher developed and working research framework with three variables, namely, predictive variables, criterion variable, and a mediating variable. The predictive variable includes rice retailing business owners' profile on years in business, initial capital, and source of capital. The mediating variable is the level of practice among lending institutions in terms of loan requirement, re-availment, and mode of collection, while the criterion variable is the weekly net income of the rice retailers in the city of Borongan.

## **MATERIALS AND METHODS**

### **Research design**

This study employed a correlation research design. A correlational study aims to find out the direction and extent of the relationship between different determinants of the population under study (Calderon and Gonzales, 2006). This research approach was used in determining the relationship between profitability measure via respondents' weekly net-income and the level of practices of informal lending institutions as perceived by rice retailer-respondents using a researcher-developed survey questionnaire.

### **Respondents of the study**

The target respondents of this study included rice retailers in the public market of Borongan City, Eastern Samar. Respondents shall satisfy the following criteria for inclusion: 1) must have experience in engaging with loan sharks. 2) must own a store in the public market of Borongan City. 3) must be a rice retailer, 4) must be willing to participate and share facts regarding the study. Due to the unique and limited characteristics of the present study, a total of fifty-three rice-retailers was enticed to be part of this endeavor.

### **Research Instrument**

A researcher-made survey instrument was used to gather data for the study. The instrument was designed according to the respondents' knowledge to elicit responses to the questions related to informal lending activities. The instrument was composed of three parts; part I focused on the business profile of rice retailers while part II dealt on the practices of informal lending in the city of Borongan. The last part (III) asked for participants' weekly-net income.

### **Data Gathering Procedure**

The study was conducted at Borongan City, Eastern Samar. The researcher secured informed consent from the respondents, and upon approval, assisted interview commenced. The questionnaire was explained, and responses from the respondents were solicited.

### **Data analysis**

In order to yield meaningful information of the data gathered from the survey, statistical analysis was employed, particularly the descriptive and correlational statistics using Statistical Packages for Social Science computer software version 24. Furthermore, all tests for relationship and association were run at 0.05 level of significance.

### **Ethical Consideration**

For ethical consideration, the confidentiality of the research outputs was placed in anonymity, and that the respondents were informed on the purpose of the data gathering. The giving of rewards was employed to avoid instances where students will withdraw from the conduct of the research and that no force was made to compel them to participate.

## **RESULTS AND DISCUSSION**

### **Rice retailers' business profiles**

Table 1 presents the business profile of fifty-three respondents who are rice retailers in the City of Borongan City. The table is subdivided into three business profiles, namely, years in the retailing business, initial capital, and source of capital; all described using frequency count and percentage. It can be noted in the table that twenty-four (24) or 45.3% of the retailers have been in the business for 4 to 6 years. This was followed by those twenty (20) respondents who have been for 7 to 10 years. While there are five (5) or 9.4% who are young (1-3 years) in the business and only one three (3) or 5.7% who have been for 11 to 13 years, likewise, it can be seen in the data in Table 1 that none of the respondents has reached more than thirteen years in the rice retailing services. The data revealed that the majority of the respondents reached the middle years in the market. A similar finding of Zainol (2017)

stated that the majority of micro-businesses reached six years on the run, which is nearest to the lowest (5 years) as concluded by Miranda and Miranda (2018). These findings imply that the rice retailing business enterprises in the city of Borongan are still in their young years in the market.

There are forty-two (42) or 79.2% of the respondents whose investment ranges from ₱101,000 to ₱175,000. About 17% of total respondent invested an amount between ₱50, 000 to ₱100, 000, while only two (2) had invested ₱175, 001 to ₱250, 000. This result is supported by Meyers (2015) that many entrepreneurs choose to start a business with higher capital than usual to ensure enough funding. Also, Ageba and Ahma (2006) highlighted this aspect as the higher capital build-up is needed in developing and reach out to new markets and products that, in one way or another, improve trade performance. On the other hand, according to Sakinah et al. (2004), some businesses prefer lower or just enough start-up capital because they choose to start with a lesser scope and fewer initial inventories and plans to upgrade operations as soon as profit comes, while Janssen (2009) stated that entrepreneurs highly consider the seasonality of the business. These findings imply that the majority of the respondents are risk-takers, having been investing a large amount of money for a business starter.

In terms of the source of initial investment, there were thirty (30) or 56.6% of the respondents who are claiming that their capital comes from their savings, while twenty-two (22) or 45.1% comes from members of the family and only one (1) or 1.9% loan from friends. According to Farley (2019), investing (in any way) hard-earned money can reach one's financial objectives in life. Data on the family-originated funds is related to the World Bank's (2011) observation that the majority of active enterprises use external sources to finance fixed investments and working capital. On the other hand, Denike (2012) claimed that taking money from a business for other expenses aside from the single business operation gives negative cash flow to the business. In addition, Wright and Stigliani, (2012) opined that the presence of external investors might be a source of conflict with the entrepreneurs' growth expectations. This scenario is affirmed as only one of the investors took capital from a friend. The results imply that people with savings are bent on business investing with the belief that their savings will grow bigger, and a higher return of investment.



**Table 1. Business profile of rice retailers in the city of Borongan Informal lending institutions level of practice on loan requirements, loan re-availment, and mode of payment/collection**

Business Profiles	Frequency (N = 53)	Percent (N = 100)
<b>Years in the business</b>		
1-3 years	5	9.4
4-6 years	24	45.3
7-10 years	21	39.6
11-13 years	3	5.7
More than 13 years	0	0
<b>Initial Capital</b>		
₱50, 000 - ₱100, 000	9	17.0
₱100, 001 - ₱175, 000	42	79.2
₱175, 001 - ₱250, 000	2	3.8
<b>Source of Capital</b>		
Savings	30	56.6
Family funded	22	41.5
Loan from a friend	1	1.9

Table 2 shows the level of practice among informal lending institutions among rice retailer-respondents in the city of Borongan. The data were described using one of the measures of central tendency: mode in interpreting the derived data per indicator. It can be observed in the table that most of the informal lenders are assessing the urgent needs and willingness to pay. However, they do not provide at all the desired amount of the clients. Also, lendee-respondents re-avail/loan from informal lending institutions due to the great service they provide and the fast processing of the needed sum of money. However, the majority of lending institutions do not offer low-interest rates. Unlike formal and legitimized microfinancing institutions such as banks and cooperatives, informal lending institutions do not provide saving options for the clients. Moving closer, most of the informal lenders set up a meeting place for receiving payments. The data also reveals that informal lending institutions are yet using the traditional way of lending since they do not provide sending of payments via remittance centers and hiring of collectors, nor establishing lending offices. In an informal interview conducted by the researcher, he found out that there is a uniform requirement for a borrower to be eligible to borrow money from the lenders. Also, the respondents are forced to agree on terms and requirements because they do not have other means of borrowing or source of capital to operate their business continuously. This occurs mainly for short-term borrowers who promise to pay at the next payday, whether this is weekly, fortnightly, or monthly (FIAS, 2009).

The findings are related to Fajardo (2005) and Ekpo and Umin (2014) findings that informal money lenders charged much higher interest rates than banks and other lending institutions. Also, Aleem (1990) explained high-interest rates since lenders have less information on the borrower's ability to repay a loan. Also, Cuevas and Sumalde (2015) found that most informal lenders offer a smaller average percentage of time compared to formal lenders. It can also be inferred from the data and

related findings that the success of a borrower's business and loan repayment history provide a gauge of the borrower's credibility. Over-all, the findings imply that informal lending institutions are yet using the the traditional way of lending and that they charged high-interest rates despite the fact that they are not paying taxes to the government.

**Table 2. Level of practices of Informal lending institutions in the city of Borongan**  
**Weekly-based net income of rice retailers in the city of Borongan**

Indicators	Mode	Interpretation
<b>Loan Requirement</b>		
The lender assesses the lendees' urgent need and willingness to pay	1	Practiced
Requires voluminous documents and co-maker.	2	Not Practiced
The lender analyzes credit status of clients	2	Not Practiced
The lender requires collaterals from the lende.	2	Not Practiced
The lender provides desired amount to the lende	2	Not Practiced
<b>Aggregate Mode</b>	<b>2</b>	<b>Not Practiced</b>
<b>Re-availment</b>		
The lende re-avails due to great costumer service	1	Practiced
The lender offers lower interest rate for re-availing clients	2	Not Practiced
The lender has fast-tracked the processing of loans for re-availing clients	1	Practiced
The lender offers a membership discount to re-availing clients.	2	Not Practiced
The lending institution offers saving options for old clients.	2	Not Practiced
<b>Aggregate Mode</b>	<b>2</b>	<b>Not Practiced</b>
<b>Mode of Collection/Payments</b>		
The lending institutions hire collectors	2	Not Practiced
The lende visits the lending office for payment	2	Not Practiced
The lending institutions allowed bank account deposit	2	Not Practiced
The lending institution set a meeting place for receiving of payments	1	Practiced
Payments are sent via remittance centers.	2	Not Practiced
<b>Aggregate Mode</b>	<b>2</b>	<b>Not Practiced</b>

The table on weekly net income from weekly sales is shown in Table 3. The categorization of net income was a systematic interpolation of empirical and available data based on the PSA result on the minimum income of retail businesses in the Philippines and Templ's formula.

The table shows that there are forty (40) or 75.5.% of rice retailers who have lent sum of money from informal lenders who are earning a median income between ₱978.00-₱3,425.00, while only six (6) respondents earn a high income greater than ₱3426.00. A similar finding was reported by Cuevas and Sumalde (2015) on the annual income of farmers engaged in the lending of money from formal and informal lending institutions.

The data reveals that the majority of rice retailers in the city of Borongan earn an average income. This also indicates that financial expenses are high among micro-enterprises, such as that of retailing business sectors. These incomes, however, are small and are not enough to buy necessities for a

family of five. The Philippine Statistics Authority revealed that an average monthly income of ₱7,337 for food needs and an average of ₱10,481.00 is enough for food and essential non-food needs for a family of five to be considered having a dignified life. Thus, results indicate better profitability management among owners.

**Table 3. Weekly net income of rice retailers in the city of Borongan**

Net Income		Frequency	Percent
Less than ₱978.00	Low income	7	13.2
₱978.00-₱3,425.00	Median income	40	75.5
3,426 and above	High income	6	11.3
<b>Total</b>		<b>53</b>	<b>100</b>

**Multiple regression analysis on business profiles as predictors of profitability among rice retailers in the city of Borongan.**

Table 4 shows the result of multiple regression analysis on the criterion value of profitability of rice retailers' weekly net income accounted from the profile predictors of year in business, initial capital, and source of capital of the fifty-three respondents. The data obtained an R square value of .305 and a significant value of 0.000, which revealed that 30.5 % of the variation of profitability criterion is attributed by the industry profile in terms of the year in business, initial capital, and source of capital of the fifty-three respondents in the rice retailing sectors. The regression model statistically predicts the outcome variable ( $p < .05$ ). The predicted weekly net income is equal to  $117.57 + 217.05(\text{years in the business}) + 140.60 + 0.003 (\text{Source of capital})$ . Of the three predictors, only years in business profile shows a significant impact on the profit of the respondents. This means that the weekly net income will increase by 217.05 in every increase of years in the business. Moreover, the Spearman rho test was used to analyze the relationship between the two variables, and the data revealed that years in the business and weekly net income possess moderately significant relationship. A similar result on the significance of profit and years in the business was found by Gamad (2017) among MSEMs in the Philippines. Over-all, the findings show that rice retailing in the country is in a good state, considering rice as the primary commodity among Filipino families in the country.

**Table 4. Multiple regression analysis on business profiles as predictors of profitability among rice retailers in the city of Borongan.**

Predictive Variables	$\beta$	$\rho$	Correlational Interpretation	p-value	Interpretation
Years in the business	217.05	.500	Moderate Correlation	.000	*Significant
Initial Capital	146.60	.073	Negligible Correlation	.571	Not significant
Source of Capital	.003	.076	Negligible Correlation	.541	Not significant

Criterion variable: Weekly net income,  $F = 5.158$ ,  $R^2 = .305$  (30.5%);  $p < .05$ , Constant: 117.57,  $*\alpha = 0.05$

### Spearman's test of relationship between rice' retailers weekly-based net Income and informal lending institutions level of practices

Table 5 shows the result of the test on the relationship between rice' retailers' weekly-based net Income and informal lending institutions' level of practices using Spearman rho correlation analysis. As depicted in the table, all three predictive variables failed to show a significant relationship to that of the respondents' weekly net-income. It can be noted that the majority of the responses to the predictive variables from Table 3 are not practiced among informal lending institutions. This can be attributed from the limited samples acquired by the researchers as it was also the results in the previous study, for instance, Aldaba (2012) on the small and medium enterprises' (SMEs) access to finance: a case in the Philippines and a negative results between profitability and debt factors by Cassar and Holmes (2003)

**Table 5. Spearman's test of relationship between rice' retailers weekly-based net income and informal lending institutions level of practices**

Predictive Variables	Criterion Variable	$\rho$	Correlational Interpretation	p-value	Interpretation
Loan requirements		-.181	Negligible Correlation	.194	Not significant
Re-availment	Weekly net income	-.065	Negligible Correlation	.688	Not significant
Mode of collection		-.055	Negligible Correlation	.697	Not significant

### CONCLUSION AND RECOMMENDATION

Based on the findings of the study, the following conclusions were drawn. The majority of the respondents had been in the middle years of retailing business, and had utilized an average initial capital sourced out from their personal savings. The initial capital to put up a rice retailing business in Borongan City is high and generally comes from the personal savings. This scenario indicates a burden for those aiming to be in this line of business and the same circumstance is a factor that dictates the price of retailed rice. The informal lenders assess clients' financial needs and willingness to pay without requiring collateral from them. Also, rice-retailers reloan due to fast processing of funds and the great customer service provided and that the informal lenders are using traditional method of collecting payments. Majority of the rice retailers falls within the average weekly income that is enough for food needs based on Philippine Statistics Authority standards. Regression analysis revealed year in business as a significant predictor of increase in the profitability of rice retailing services in the city of Borongan, considering that rice is a primary commodity among Filipino families in the county. Finally, there is no significant relationship between the rice retailers' weekly net income and the level of practice among informal lenders.



Hence, the following recommendations are offered. An external intervention by either private sector or government authorities to assist this group with a provision similar to the informal lending sector which is duly recognized by the government to safeguard the integrity of the lender; The government needs to re-visit and reinforce the “Magna Carta for MSME’s” which requires banks and other formal lending institutions to allocate at least 8% of their loan portfolio to micro and small enterprise. Simplified loan requirements, loan qualification and process should also be established by banks so that informal lenders will turn to banks rather than informal lending sector. Intervention and assistance should be in terms of easier and higher initial capital so that net income of rice retailers will improve and that the informal lending sector will not flourish in their business but rather the formal lenders, and a wider scope of the study should be made to include other small business sectors that are affected by informal lenders.

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