BUSINESS BORROWING TREND IN RETAIL INDUSTRY: CASE STUDY OF GROCERY STORES IN KARACHI PAKISTAN

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ABSTRACT

Given that most types of borrowings are simply not available for the small scale retailers in Pakistan, the business borrowing without collateral for this sector is a critical factor to be reckoned with. The main objective of this study is to explore the availability of loans to retailers owning shops, especially grocery stores, worth ten to fifteen million rupees and minimum stock of half million rupees and five or less than five persons at their service counters. In this connection, linkages of business borrowing with collateral, volume of business and insurance and its implications on business growth are being examined by randomly surveying150 shops of different localities in Karachi. This paper also attempts to investigate how business borrowing to this cash-starved sector influences its growth.

INTRODUCTION

Retail industry in Pakistan is growing very fast. Our focus was the retail grocery stores where business borrowing is rare. Our preliminary findings showed that a good number of stores do close down due to failure. This motivated us to find the critical factors that make a business successful. We found that beside other factors, availability of fund is a major factor. Thus we focused our study on this aspect of business. The concept of retail chain store has not matured yet and the multinational retail stores are not as successful as they thought they would be at the start of their businesses. Most of the retail outlets are small shops owned by single owners and operated by five or less persons at any given time. Even in the posh localities big shops having employees in double digits are rare. Almost all of them are family businesses and managed by father and sons.

The need and importance of business borrowing in large businesses is very well established. But in small businesses like retail the trend is not there, more so when the interests of financial institutions are not at stake because of the collaterals. We feel that during the new millennium the interaction between banks, insurance and small businesses have increased many folds. Banks are offering loans for establishing retail businesses and such businesses are insured on a selective basis. But those cases where no loans have been obtained from the bank, insuring the business is not a trend in Pakistan. The main objective of this study was to understand the role of business borrowings in the small scale retail business. Whether and how business borrowing can influence growth in the retail business became our topic of interest. The rationale behind the idea is two folds: on the one hand, the importance of borrowing within the financial intermediation has increased over time, second the magnitude and intensity of links between banking and business have also increased. The strength of banks in finance growth relationship with businesses has diminished over time due to market factors. The question arises: is there any relationship between the financial sector and retail business to support the economic growth of the later.

A number of valuable economic functions are served by business borrowing. They are mostly distinct from other types of financial offerings. The unique features may be highlighted by focusing the services not offered by others. The commercial transactions are facilitated by indemnification and risk pooling properties. These are also responsible for mitigating losses and the measurement and management of verifiable risks. As we know financial contracts involve periodical payment including risk coverage of losses. This income smoothing effect among other things helps to avoid bankruptcies. Thus it helps to facilitate businesses to grow. This is the reason that risk adverse people remain willing to take higher risks than they would do in the absence of capital, promoting higher productivity and growth.

Major entrepreneurial activity in retail business includes resource management. They weigh the pros and cons of available opportunities. This includes management of scarce resources, choosing the best alternative and monitor results to refine choices. Those who do not apply a structured process still make decisions about risk, although sometimes by default rather than by design. The scope of business borrowing affects both the range available alternatives and the quality of information to support decisions. Business borrowing also contributes specialized expertise in the identification and utilization of resources. This expertise enables them to accept carefully specialized utilization of resources at lower costs. They also have an incentive to collect and analyze information about loss exposures,, since the more precisely they measure the cost of risk, the more they can expand. As a result, lending market generates signals to the entire economy, helping to allocate resources to more productive users.

It is true that business borrowing plays an important role in economic development. During the new millennium, contributions of borrowing for economic growth and well being of entrepreneurs have been assessed. Earlier findings conclude that business borrowing contributes to economic growth by helping to improve investment climate and promoting a more efficient mix of activities. This contribution is supplemented by other financial systems like insurance. It has been seen that business insurance contributes to growth and prosperity at different stages of development. In wealthy countries the trend is more obvious. The relationship between insurance penetration and income level is a strong indication of insurance coverage in that country or in specific business.

Several interesting lines of research have begun to map the specific contributions of business borrowings in retail sector to the economic growth process and the well being of the retail industry. This contribution is supplemented by complementary development of banking and other financial systems. It has been seen that business borrowing is linked to insurance. Insurance thus contributes to growth in countries at many different levels of development. Insurance makes a substantial contribution to growth mostly due to the fact that business borrowing is secured by insurance. The relationship between income level and insurance penetration is also strong in the reverse direction – with increasing income a strong driver of insurance coverage.

The contribution of business borrowing to an economy's growth is not the only entry point into its role in development. The contribution to poverty alleviation and the welfare of the poor is also potentially of considerable importance, although the quantitative evidence on this point is not very firm grounding. Qualitative evidences make a persuasive case that the potential social value of business borrowing for small scale entrepreneurs warrants a great deal more experimentation with business models and products to develop scalable approaches that combine commercial and entrepreneurial elements. Pattern of borrowing coverage suggests a positive correlation with income – at least up to a point where the value begins to diminish relative to the value of overall business income. But this does not tell us anything about the potential social value of overall business asset. Market development for business borrowing faces many informational challenges that have been extensively documented even in wealthier countries. It is likely to be more expensive for small scale retailers because of high informational problems and transaction costs relative to the size of the borrowing. Most types of borrowings are simply not available for the small scale retailers in Pakistan.

Before we conducted the actual survey some fact finding interviews were made by visiting selected bank branches. The objective was to find the existing trend of business borrowings. We came to know from our preliminary survey that bank loan offerings are not available currently without any risk coverage. Risk coverage includes collateral, fixed deposit, bonds etc. However government employees can take loan from National Bank or Sindh Bank against their salary slips. This loan is given without any risk coverage. There are some products like BTF (Balance Transfer Facility) practiced by most of the private banks. In BTF running finance is given to the business account holder at a certain markup. The account holder should maintain an account in the bank and must have an agreed minimum balance. Another type of loan is given against a fixed deposit, in this case as high as 70% of the fixed deposit may be given as loan against the deposit. Bank gives the same mark up on the deposited amount as to the borrowed amount. Thus the businessman enjoys the borrowings at no extra cost. However, there are car financing and home financing schemes against mortgage or co-lateral. Valuables including Defence Savings Certificates are also acceptable as collateral.

LITERATURE REVIEW

Tokatli and Bouaci (1998) have rightly pointed out that the landscape of retailing is changing. The transformation started during the nineties in Turkey. They say that retailing is an inherently geographical phenomenon and location dynamics play a very important role in the retail business. Disyatat (2011) quoted Cetorelli, Nicola, and Linda S. Goldberg (2008) and Altunbas, Yener, Leonardo Gambacorta, and David Marqu´es Ib´an´ez. (2009) saying that banks with large global operations usually do not have monetary policy shocks. According to the authors these results have been interpreted as identifying the characteristics. These characteristics help the banks to offset declines in deposits due to certain policies. Markets for uninsured funding can be easily accessed by big and well capitalized banks. The banks that securitize heavily may affect the cash and security deposits. Daisuke Tsuruta (2012) found that instead of bank loans trade credit increases in small businesses with higher credit demand. Second, to finance their working capital small businesses with greater collateral assets also use more trade credit more. More trade credits are used by firms in financially developing counties since they cannot borrow sufficiently from banks. This is also easy to obtain since there are less formalities in trade credit as compared to bank loans. The author found that trade credits are more common in small businesses of financially developed countries but they further added that this is not because of lack of availability of bank loans. They do not obtain bank loan primarily because of the collateral involved in the process. The trade creditors have an advantage in the day-to-day monitoring of borrowers. This is because of the reason that trade credits are used more to finance the working capital of small businesses in unstable industries. Between an organization and financial institution use of collateral is a widespread phenomenon. Steijvers and Voordeckers (2009) quoted a survey (National Survey of Business Finance 1998) in which it was found that business collaterals had to be provided for 30.3 percent of loans. The collateral was increased to 45 percent of the loans granted by 2003.

To obtain bank finance collateral has become a major tool. Currently half of the loans granted seem to be collateralized. Manigart *et. al.,* (2000) and Huyghebaert and Van de Gucht (2007) found that for new businesses in Europe bank loans and trade credit are the only available sources of external funding. Franck, Huyghebaer and D'espallier (2010) demonstrated that highly leveraged business start-ups are not only more profitable but also realize larger annual earnings growth. Entrepreneurs in indebted ventures face strong pressure from financial markets to maximize earnings in order to reduce the firm's liquidation. The authors also found that the positive influence of leverage on earnings growth bears no relations with firm's year of operation. The findings suggest that bank loans can be instrumental to force firms to maximize performance in the start-up context. The pressure is created because of the compulsion of repayment of loan in periodical installments. Their positive impact is worthwhile when developing financial programs to alleviate the financial constraints of business start ups. The costs of liberalization-induced structural change are considered higher than is often assumed by Menkhoff and Suwanaporn (2008). This may call for a less radical liberalization policy than was practiced in the 1990s.

There are evidences on four major findings: liberalization lowers interest rates, spreads and reduces collateral requirements. It helps to improve decision making. There is indicative evidence that methods of risk control have improved. This has helped to increase the risk taking in lending. It appears to be justified to apply the new simultaneous regression approach.

According to Huff (2011) in Southeast Asia the prewar rural credit provision was mostly the province of informal finance by individual moneylenders, shopkeepers, wealthy landowners etc. During the last thirty years microfinance in Southeast Asia shows how a strong state may succeed in overcoming historic problems of regionalism and rural financial provision. The state, however, within limits can still strongly influence ownership and financial structures. According to Hassan (2011) there are challenges of microfinance and the responsible factors are as follows: risk involved in lending to poverty clients, expensive transaction services, and the costs involved in lowering these risks and losses from default is also high.

To create conditions for the development of profitable and sustainable microfinance organizations (MFO) should follow the role of public policy. To cover their costs successful MFOs are willing to be able to charge interest rates. Lowering the borrower transaction costs they have designed products that match the demand from the clients in the market niches where they operate and have adopted lending procedures. Ono and Uesugi (2009) found that borrowers are more likely to have collateral loans that pledge personal guarantees and incur higher short-term interest rates. The collaterals are not affected by the company's riskiness. A more frequent submission of documents is linked with greater use of collaterals. The wider the scope of the relationship and longer the duration, the borrower is more likely to pledge collateral. Loans with collaterals become impetus for improved performance in the business.

METHODOLOGY

While studying the subject and conducting the primary survey we have come to a number of facts. Business loan for retail business without collateral is not available now-a-days (2012). However, loans without collaterals were available during the early part of this century, more specifically from 2005 – 2009. A good number of people including retailers availed loan during this period. Those who utilized the loan prudently prospered but there were some who could not utilize the same as per the dictum of the business and they suffered loss. Some of them even had to wind up their businesses. According to bank officials loan in the retail sector is highly risky since the failure rate in retail business is very high. There are different way of giving loans with security and collateral. Loans are given against cash deposit, against secured bonds or savings certificates or against properties. But as per our findings, less people in retail business opt for loan against properties. We have found that the trend of loan or business borrowing in retail business is not established.

In view of the large number of retail grocery stores in Karachi we fixed certain inclusion criteria. We included shops having a worth of ten to fifteen million rupees and minimum stock level of half a million rupees. We surveyed 150 shops with the following area wise break up:

PECHS	20
Nazimabad	30
North Nazimabad	30
Federal B Area	40
Gulshan e Iqbal	15
Gulistan e Jauhar	15

These were retail grocery shops at the local vicinity. All the shops were having five or less than five persons at their service counter.

RESULT

H1: Old retail businesses were sanctioned loans as compared to new businesses (less than 5 years).

		Loan sanctioned		**Total**	**Chi-Square**	**p-value**
		Yes	**No**			
Business	New business (5 years or less)	7	43	50	108.001	0.000
	Old business (More than 5 years old)	97	3	100		
Total		**104**	**46**	**150**		

It has been seen that 86% of the new businesses (less than 5 years old) did not get any loan from the banks. Among the old business outlets 97% got the loan. The less than 0.05 p-value of Chi-Square test indicates that loans are business dependent. Loans were sanctioned to established businesses and not new ones.

H2: Easy Availability was a Major Factor for Obtaining Loan

	N	Mean	Std. Deviation	Test Value	Mean Difference	t	p value
Easy availability of loan	104	4.134	.522	4	.134	2.628	.010

Easy availability meant that the loans are available without collateral and without any security. The hypothesis was formulated based on this perception. Different degree of agreements about the statement was given to the respondents. The result indicates that majority of the respondents agreed with the statements about easy availability as a major factor for obtaining loan. We took 4 as the test value because 4 was accepted agreement level for availability of loan by the respondents. The mean value of the statement is greater than 4. This indicates that majority of the respondents agreed with the given statement.

H3: Probability of loan sanction is related to volume of business correlation between probability of loan sanction and inventory.

N	Correlation Coefficient	p value
104	0.828	.000

The result shows that there is strongly positive relationship between probability of loan sanction and volume of business. That means higher the volume of business higher the chances of loan sanction.

H4: Loan Helped the Business to Grow

	N	Mean	Test Value	Mean Difference	t	p value
Loan helped business to grow	104	4.269	4	.269	3.584	.001

The result indicates that majority of the respondents agreed with the statements that loan helped the business to grow. The p-value of t-test indicates that there is positively significant difference between the mean value of the statements and test value which is 4 (agreement level).

Hypotheses Assessment Summary

	Hypotheses	Test Statistics	p-value	Empirical Conclusion
H1	Old retail businesses were sanctioned loans as compared to new businesses (less than 5 years)	108.001	0.000	Accepted
H2	Easy availability was a major factor for obtaining loan	2.628	0.010	Accepted
H3	Quantum of loan is related to volume of business	0.828	0.000	Accepted
H4	Loan helped the business to grow	3.584	0.001	Accepted

CONCLUSION

Retail industry is one of the most dynamic sectors in the world. Following the international trend, it is growing in Pakistan. But the growth needs the help of business borrowings which is lacking in this sector. Without business borrowing it is not easy to establish a business including retail business. In this study it was found that although easy loans were available few years back, presently loan without collateral is not available. Loans were not available for new businesses (of less than five years age) where it is required most. Paradoxically, loans were available for businesses running for more than five years. Besides, the probability of loan sanction is linked to the volume of business to the detriment of the growth of this vibrant sector of economy.

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