

Functioning of Enterprises

6.1 Source of Raw Materials

Most (81%) of the micro-enterprises use local raw materials, whereas 16 per cent of the enterprises use raw materials available elsewhere in the country (Table 26 and Fig. 3). Only three per cent of the enterprises (one garment and two handloom units) depend on imported raw materials. The advantage of using locally available material, however, is often nullified by other disadvantageous conditions in the context of marketing, support services, and credit, particularly in activities such as dairy farming, metal crafts, Nepali paper, rice mills, tea packaging, and wooden furniture.

Table 26: Sources of Raw Materials for the Enterprises

Type of Enterprises	Local	Elsewhere in Nepal	Outside Nepal
Rice Mills	17		
Garments	11	2	1
Handloom Products	9	2	2
Nepali Paper	10		
Hosiery	4	4	
Wooden Furniture	6		
Bamboo Furniture	3		
Dairy Farming	5		
Rabbit Farming	3		
Tea Packaging	3		
Sericulture	3		
Broom Making	5		
Metal Crafts	2	8	
Total	81	16	3

Source: Field Survey 1996

6.2 Sources of Financing for Micro-enterprises

Entrepreneurs' own savings were the main source of capital for most of the enterprises. More than seventy-five per cent of the capital for micro-enterprises came from individual savings, 7.12 per cent from bank loans, 3.92 per cent from moneylenders, 12.68 per cent from relatives, and 0.14 per cent from NGOs. Bamboo, brooms, dairy, rabbit farming and tea packaging had been established without bank loans. Rabbit farming however, had been financed by NGOs. Rice mills, wooden furniture, and tea packaging units had obtained capital moneylenders as well. Some enterprises had been established with financing from relatives, along with other sources of finance (Table 27).

Although 45 per cent of the enterprises financed their investment through loans, the share in total capital investment was only 24 per cent. This implies that loans are taken for smaller units - either from banks or from informal sources. Of the total loans taken by enterprises, bank loans accounted for seven per cent, and this is substantially lower than cited in the rural credit survey, i.e., bank financing at 20 per cent of rural borrowings (Fig. 4).

Entrepreneurs prefer to use their own savings and, in case of shortfall, borrow from relatives; they are reluctant to approach institutional sources because of procedural delays and transaction costs. One very common complaint against institutional credit is that too much emphasis is placed on collateral as a pre-condition for loan eligibility and, on the contrary, very little

Figure 3: Sources of Raw Materials for the Enterprises

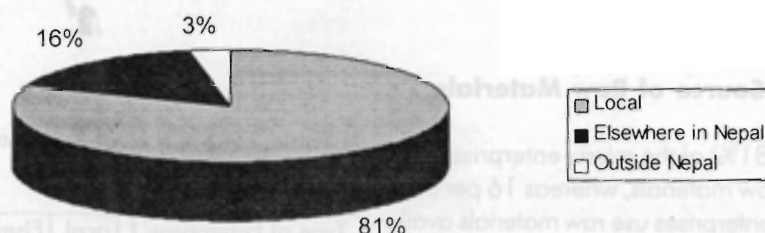


Table 27: Sources of Capital for Micro-enterprises

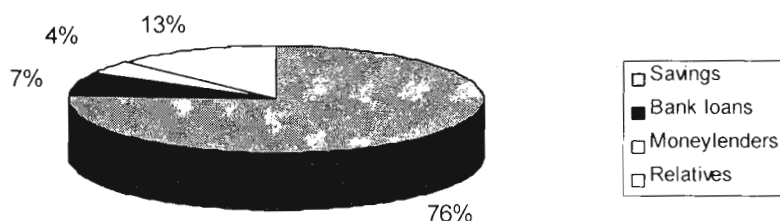
(Rs '000)

Type of Enterprises	Savings	Bank loans	Money-lenders	Relatives	NGOs	Total
Rice Mills	1,319	180	100	281		1880
Garments	381	10		50		441
Handloom Products	365	10				375
Nepali Paper	1,271	230		120		1621
Hosiery	326	80		59		465
Wooden Furniture	393	25	217			635
Bamboo Furniture	50		10			60
Dairy Farming	1,122			679		1801
Rabbit Farming					5	5
Tea Packaging	650		50			700
Sericulture					9	9
Broom Making	609					609
Metal Crafts	836	150		30		1016
Total	7,322	685	377	1219	14	9617
Percentage share	76.1	7.12	3.92	12.6	0.1	100.0

Source: Field Survey 1996

consideration is given to the feasibility of the enterprise. The transaction costs are also very high. The Rural Credit Survey (NRB 1992) had indicated that transaction costs were up to seven per cent of the amount borrowed. The potential borrower has to spend time and money as travel costs, forego some days' income, and still remain uncertain about the availability of the loan. Added to this are the lengthy and cumbersome procedures for obtaining loans that discourage entrepreneurs from applying for loans from institutional sources.

Figure 4: Sources of Financing for Micro-enterprises



Although institutional credit is provided at a lower interest rate than that charged by moneylenders and other non-institutional sources, borrowers seem to prefer individual or non-institutional sources because of the easy availability and simple procedures with no transaction costs incurred.

6.3 Interest Rates on Borrowing

The average interest rates on loans from banks, relatives, and moneylenders are 15.81 per cent, 24.0 per cent, and 27.0 per cent respectively (Table 28). The Rural Credit Survey carried out by Nepal Rastra Bank (NRB 1988) cited the interest rate charged by moneylenders in the informal market to be as high as 60 per cent (the average rate being 37 per cent). The findings of our survey suggest relatively lower rates in Ilam and Bhojpur.

Table 28: Average Interest Rate Structure

Lending Agencies	Average Interest Rate (%)
Banks	15.81
Relatives	24.00
Moneylenders	27.00

Source : Field Survey 1996

6.4 Repayment Period for Loans

Most of the enterprises apply for short-term credit. The repayment period ranges from one to three years for most of the enterprises. Of the enterprises taking loans, 44.4 per cent had managed to repay in less than one year, 35.6 per cent in one to two years, 15.6 enterprises in two to three years, and only four per cent in more than three years (Table 29).

6.5 Marketing Micro-enterprise Products

Micro-enterprises sell their products through different channels. As noted earlier, most of the enterprises sell their products directly to the market. Of the total micro-enterprises surveyed, 66 per cent were selling their products directly to customers, whereas 11 per cent were selling to wholesalers, and 18 per cent to retailers. A few (5%) entrepreneurs (rabbit farming and sericulture) were selling through NGOs. Broom, dairy, metal craft, Nepali paper, wool, and wooden

furniture units were relying mostly on wholesalers and retailers. Bamboo furniture, garments, handloom, hosiery, and rice mills were selling directly to or servicing their products for customers (Table 30).

6.6 Production on Order by Micro-enterprises

A majority of the enterprises produce for open sales rather than on the basis of prior orders. Only 14 per cent of the entrepreneurs produce on prior order, 12 per cent on advanced credit, and 16 per cent on advance delivery of raw materials. A significant proportion (25 to 40%) of the products of garment, Nepali paper, and hosiery units is ordered by customers, whereas the wooden furniture and brooms are produced on an advance credit basis (Table 31).

Table 29: Average Repayment Period for Loans

Repayment Period	No. of Enterprises	Percentage
less than 1 year	20	44.44
1 to 2 years	16	35.56
2 to 3 years	7	15.56
3 year and above	2	4.44
Total	45	100.00

Source : Field Survey 1996

Table 30: Marketing the Products of Micro-enterprises

Type of Products	WH	RE	DC	NGO	Total
Rice Mills			17		17
Garments			14		14
Handloom Products			13		13
Nepali Paper	4	6	0		10
Hosiery			8		8
Wooden Furniture	2	2	2		6
Bamboo Furniture			3		3
Dairy Farming	1	3	1		5
Rabbit Farming		1		2	3
Tea Packaging	1		2		3
Sericulture				3	3
Broom Making	2	3	0		5
Metal Crafts	1	3	6		10
Total	11	18	66	5	100

Source: Field Survey 1996

Note : WH = Wholesale

DC = Direct customer

RE = Retailer

Production based on prior order, or raw material advance, is generally considered safer than production based on the owner's projections. The former provides an assured market whereas, in the latter case, there is an element of uncertainty. A large proportion of MEs cannot arrange prior orders and, hence, produce or service based on their own projections. This is due to the nature of the enterprise and linkages with buyers. Garments, Nepali paper, and hosiery products are also sold through retailers or wholesalers. Retailers or wholesalers place orders based on their product patronage. The MEs receive advances or simply an order to produce specified quantities based on their linkages. Enterprises with such linkages reduce risks by producing

Table 31: Production on Order by Micro-enterprises

Type of Products	Production on Order	Credit/Advance	Raw Material
Rice Mills	0	1	8
Garments	4	1	1
Handloom Products	1	2	3
Nepali Paper	4	3	0
Hosiery	2	0	2
Wooden Furniture	1	2	0
Bamboo Furniture	0	0	0
Dairy Farming	0	0	1
Rabbit Farming	0	0	0
Tea Packaging	1	1	0
Sericulture	0	0	0
Broom Making	1	2	0
Metal Crafts	0	0	1
Total	14	12	16

Source: Field Survey 1996

some goods on the basis of prior orders and the remainder on the basis of their own projections.

6.7 Cost Structure

The cost structure shows that a major portion was spent on raw materials (81.22%), followed by labour (8.53%), fuel (3.31%), interest on loans (3.12%), and the rest on office expenses, rent, salary, and transportation (Table 32). Thus, raw material and labour constitute nearly 90 per cent of the cost of production of micro-enterprises. There are, of course, industry-wise variations in the cost structure. Metal craft, tea processing, dairy, and broom units incur over 80 per cent of their costs on raw materials. Only rice mills pay a significant amount (40.5%) on labour; and others spending more than 10 per cent of total costs on labour are bamboo furniture, Nepali paper, garments, handloom products, hosiery, and tea packaging units. Interest payments are as high as 17 per cent for rice mills, 12 per cent for hosiery, and three per cent for garments and bamboo furniture units and dairy. In other cases the item is very small, mostly less than one per cent. Fuel costs account for relatively high proportions for rice mills (33.54%), as the mechanical devices operate either from petroleum fuel or electricity. Bamboo furniture pays a significant amount (10.87%) of rent as all of the units are located in rented premises. Sericulture and rabbit farming have zero costs as these units incur no paid-out costs (Fig. 5).

6.8 Expenses on Energy

Energy was not a necessary input for more than half of the enterprises under survey. Garments, hosiery, handloom, bamboo furniture, rabbit farming, tea packaging, and broom units do not

Table 32: Cost of Production by Types of Input

(in Percentages)

Type of enterprise	Raw material	Labour*	Interest	Fuel	Transport	Rent	Salary	other
Rice Mills	0.00**	40.50	17.93	33.54	0.00	0.00	3.20	4.83
Garments	69.80	14.12	3.53	0.00	0.00	1.18	2.35	9.02
Handloom Products	77.86	13.84	0.40	0.00	0.00	1.58	2.37	3.95
Nepali Paper	75.55	14.00	1.52	2.60	2.00	3.00	1.00	0.33
Hosiery	70.46	11.13	12.85	0.00	0.00	0.00	0.00	5.56
Wooden Furniture	80.00	7.65	0.78	1.30	1.22	1.57	0.35	7.13
Bamboo Furniture	65.12	20.35	3.66	0.00	0.00	10.87	0.00	0.00
Dairy Farming	87.50	4.24	3.00	3.88	0.72	0.30	0.22	0.14
Rabbit Farming**	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Tea Packaging	88.30	10.25	0.93	0.00	0.00	0.00	0.00	0.52
Sericulture**	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Broom Making	86.91	9.44	0.00	0.00	0.00	1.57	0.17	1.91
Metal Crafts	93.88	1.28	0.51	2.47	0.00	0.86	0.00	1.00
Total	81.22	8.53	3.12	3.31	0.35	1.07	0.52	1.88

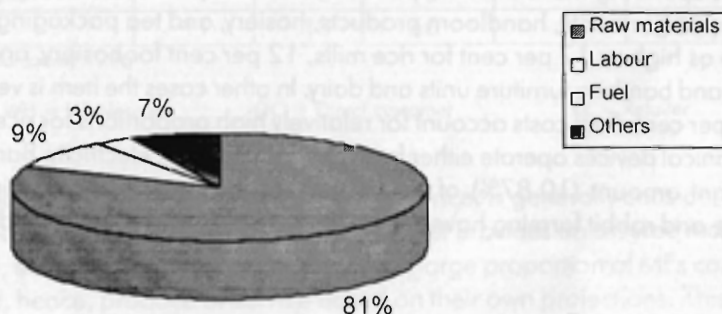
Source : Field Survey 1996

Note : * = includes only wages paid to hired labour

** = Zero cost - no paid out cost

use fuel for production for the most part. The remaining micro-enterprises also report energy costs of less than five per cent of the total production cost. As fuel only accounts for a 3.31 per cent share of the total cost of production, on an average, the micro-enterprises under study can be categorised as not being very fuel intensive.

Figure 5: Cost of Production by Types of Input



Energy consumption varies for different product lines. The type of product and method of production influence the type of energy used (Rijal 1996). Every enterprise uses some form of energy. Some enterprises operate on traditional fuels, some on human energy, and others with either petroleum fuel or through electricity. Forty-nine per cent of the enterprises use some type of energy other than human energy. These enterprises use either fuelwood, petroleum fuel, or electricity. Rice mills use both petroleum fuel and electricity while wooden furniture units operate either on electricity or on human energy. Nepali paper, dairy farm, and metal craft units rely on fuelwood as the major source of energy.

The survey revealed that 54 per cent of the micro-enterprises under survey are not using any type of energy except for sunlight. Bamboo furniture, broom, garment, handloom, rabbit farming, and sericulture units consume no energy except human energy. Brooms, garments, and handloom enterprises use equipment that requires manual operation and other forms of energy are not needed. Other energy forms are also beyond their budgets because most enterprises are established on a low investment basis. It is noted that overdependency on traditional fuels can lead to environmental degradation. Therefore, the shift to alternative sources of energy (solar and electric power) is imperative to improve productivity and efficiency and to preserve the environment, especially in the case of Nepali paper, metal crafts, and dairy farming. However, grid electricity is not accessible to Nepali paper and dairy units because of their location. Most metal craft enterprises are going out of business and the provision of power alone would not revitalise their performance. Energy consumption to total expenditure ratio is the highest for rice mills (33.54%) and then dairy (3.88%) and Nepali paper (2.60%) (Table 33, Fig. 6). Thus, from the energy conservation point of view, the enterprises that need to be encouraged are mainly bamboo, brooms, garments, and handloom.

6.9 Types of Energy Consumed

Firewood (FW) is the principal source of energy among the fuel-consuming enterprises (54%). Dairy, metal crafts, and Nepali paper units are the main users of firewood. Fifteen rice mills and two wooden furniture units use petroleum fuel (PF) as the principal source of energy, while two rice mills and two wooden furniture units use electricity (Table 34).

Twenty-five per cent of the enterprises use traditional fuel, 17 per cent of the enterprises use petroleum fuel, and four per cent use electricity. Electricity is the major source of energy for two wooden furniture and two rice mills. Some metal crafts also use electricity for polishing, but none of the Nepali paper units uses other sources of energy apart from fuelwood.

Table 33: Expenses on Energy (Rupees)

Type of Products	Exp. on Energy	Total Expenses	Percentage
Dairy Farming	206.88	5,332	3.88
Nepali Paper	31.43	1,209	2.60
Metal Crafts	15.80	64	2.47
Rice Mills	186.81	557	33.54
Wooden Furniture	14.90	1,149	1.30
Total	455.82	8,311	5.48

Source : Field Survey 1996

Figure 6: Expenses on Energy

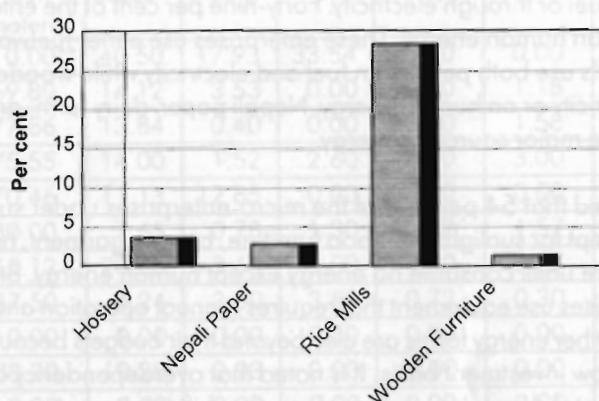


Table 34: Types of Energy Used by Different Enterprises

No.	Type of Products	PF	FW	EL
1	Rice Mills	15		2
2	Nepali paper		10	
3	Wooden Furniture	2		2
4	Dairy Farming		5	
5	Metal Crafts		10	
	Total	17	25	4

Source : Field Survey 1996

Note: PF = petroleum fuel

FW= fuelwood

EL = electricity