

# Impact of Micro-Credit Services on Operation of Small Enterprises in Nepal

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## Abstract

*This paper aims to examine the impact of micro-credit services on the operation of small enterprises in Nepal. The research is based on a survey research design at Tanahun district of Nepal. The survey design was administered to 255 micro entrepreneurs inter mentioned by microfinance institutions for the last 5 or more years, based on a stratified random sampling technique, consisting of 75 from Dalit, 85 from Adhabashi and Janajati, and 95 from an upper caste. Both descriptive and inferential statistics have been used to analyse the data. The results show that microfinance has contributed a significant role in micro-enterprises growth and expansion as the volume of sales, range of profit, and the value of assets increased after the intervention of microfinance services. The government and supporting institutions need to focus on the expansion and growth of micro-enterprise to increase employment opportunity, reduce cultural and caste disparities, and thereby improving the economic and social status of people.*

**Key Words:** Micro-credit, micro-enterprise, microfinance

## Introduction

Microfinance (MF) is the provision of financial services to poor and low-income households. It is a way to enhance financial services to unbanked people who are financially, geographically, and socially vulnerable. Microfinance institutions (MFIs) provide a collateral-free loan to the poor and marginalized people on the recommendation of the groups. It also provides non-financial services for empowering its members, such as group formation, sewing and weaving training, financial education, and capability enhancing activities (Ledgerwood, 1999). MF is a powerful tool for reaching poor and marginalized people to enhance socio-economic transformation. Microfinance has transformed the economic status of the people through the productive application of micro-credit (Dhungana, 2018).

Microfinance institutions deliver a variety of financial services such as micro-credit, micro-savings, micro-remittance, and micro-insurance. MFIs supply financial services to micro-enterprises and low-income families.

MFIs help to address various issues related to poverty, unemployment, and inequality in terms of the socio-economic perspective of the rural and disadvantaged societies, especially women (Simanowitz & Walter, 2002). MF is one of the best alternatives to financial inclusion and poverty reduction in developing countries like Nepal. The government should develop a good mechanism to expand micro-finance services to the target people by encouraging public-private partnership models so that financial inclusion and poverty reduction goal can be achieved (Dhungana, 2013).

The financial inclusion in the case of Nepal is poor, and yet more than half of the adult people are unbanked. Among the account holders, only around 50 percent uses their account properly (The World Bank, 2017). Dhungana and Kumar (2015) find financial inclusion led by banks and financial institutions in far western and mid-western development region has poor penetration of formal financial services as compared to other development region. The microfinance industry is necessary to develop as a tool of inclusive financial market through the wider expansion of its services in remote rural and hilly areas of Nepal.

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The development of micro-enterprise is one of the significant parts of micro-credit and microfinance. The micro-enterprises sector has been recognized as an important pillar of economic growth for all developing and underdeveloped country. Micro-enterprises play a very important role in the development of a country because of its innovative entrepreneurial spirit. Dhungana and Chapagain (2020) find significant differences between multiple and non-multiple financing clients in terms of micro-enterprise creation, total investment, profit per month, and saving. The non-multiple financing clients are more likely to earn more profit, create new business, and have the potential of large-scale investment. The study concludes that the performance of non-multiple financing clients is significantly better than multiple financing clients.

Although microfinance programs empower clients, the results of the investment, saving, micro-enterprises creation, capital and consumption expenditure, and income generation of clients are not convincing. The regulatory authority should identify the problems of multiple borrowing whether the financing from microfinance institutions is just for their profit or for productive application of loan. The socio-economic performance of clients relates to the effective monitoring of clients made by microfinance institutions whether the loan has been properly utilized or not (Dhungana & Chapagain, 2019).

In this study, we have explored whether microfinance intervention increases the profitability, sales revenue, total assets of micro enterprises, and employment capacity of micro enterprises or not. Besides, we have explored whether microfinance intervention equally provides benefits to all the caste. The research has been confined to Tanahun district of Gandaki province of Nepal who have operated small enterprises with the help of micro-credit services.

## Literature Review

Chapagain and Dhungana (2020) find an encouraging impact of microfinance on income, consumption, capital accumulation, and savings habits. Microfinance intervention has a significant effect on the professional profile and micro-enterprise generation. The structural equation model shows that income, consumption, and

capital accumulation of MF clients are the major factors that undoubtedly impact the living standard of clients. The study concludes that microfinance is an effective strategy for financial inclusion, reaching a rural area, increasing livelihood status, and ultimately reducing poverty.

The size of the micro-credit has a positive association with its application. The small size of micro-credit has been spent on domestic purposes and unproductive areas. Likewise, the greater size micro-credit has been found to apply in productive sectors. MF intervention has made significant improvements in micro-business and enterprise generation activities through the productive application of micro-credit (Dhungana, 2018).

Fiala (2018) conducted an experimental test of microfinance programmes and found little or no impacts on business and house hold income outcomes. Micro-enterprise owners were randomly offered either capital with repayment (discounted loans) or without (grants) and were randomly chosen to receive business skills training in conjunction with the capital. The study finds no short-run effects for female-owned enterprises from either form of capital or training. However, the study finds large effects on profits and sales for male-owned enterprises that were offered loans.

Kapoor and Dhaka (2017) showed a positive relationship between MFIs credit and the sales revenue, physical assets, and capital structure of micro small medium enterprises (MSMEs) whereas for profitability, there exists an insignificant relationship between the profitability and the MFIs credit. Hence, it can be concluded that MFI credit has a positive impact on the development and growth of MSMEs.

Viswanath (2017) examines the role of market structure in mediating the impact of micro-lending to such survival enterprises. While there have been many evaluations of microfinance institutions (MFIs), there have been very few that look at market conditions as an input into the success of micro-lending. My theoretical analysis suggests that when introducing an extensive program of micro credit in undeveloped and relatively isolated rural areas, it is important to look at how the market structure mediates the impact of the provision of loans on the demand and supply for the end-product or service.

Dhungana (2016) examines the loan size and its productive application after involvement in the micro-finance programme in the western development region of Nepal. The study shows that there is a positive association between size of savings and loans, size of savings and loan application, current loan size and ethnicity, loan size and duration of membership, and finally loan size and its application. It has been found that clients who have taken the small size of loans have mostly spent their loans on domestic purposes and found the poor application of loans in micro-business whereas big loan size clients have the greater application of loans in productive sectors.

Mohamed, M. A. (2016) explored that financial sustainability, financial literacy and risk diversification have a moderate positive relationship with the financial performance of microfinance institutions in Mogadishu. Micro-finance has transformed the economic status of the people through the productive application of micro-credit. MFIs should encourage the productive application of the micro-credit towards micro-business or enterprises creation that ultimately helps to transform the economic status of the people (Dhungana, 2016).

Dhungana (2015) finds that the micro-business or enterprises creation, employment generation, occupational status, and income level of the people have been significantly improved after involvement in the micro-finance programme in Nepal. Micro-finance has facilitated to generate of self-employment and employment opportunities through micro-credit services however, there is lacking enough orientation regarding the productive application of loans.

Micro-credit is positively and significantly related to the performance of MSEs across all the micro-credit programmes under investigation. Other entrepreneur-specific factors, especially entrepreneurial values and management practices are equally significant for enhancing firm performance (Mahmood & Rosli, 2013). Alhassan and Akudugu (2012) find access to microcredit helps improve the income generation capacity of women in the study area. It is therefore recommended that the government and its development partners should intensify their efforts in the provision of microcredit to women which will help them out of poverty.

There is much evidence of the positive impact of microfinance, particularly through increasing income (Wright, 2000; McGuire & Conroy, 2000; Khandker, 2001; Chan & Ghani, 2011), increasing consumption of household (McGuire & Conroy, 2000; Rahaman, 2010; Berhane & Gardebroke, 2011) and reducing vulnerability (Wright, 2000; Zaman, 2000; Salia & Mbwambo, 2014).

## Research Methodology

The research is based on a survey research design. Data were collected through primary sources and structured questionnaire and interview were administered to the owners of micro-enterprises. A stratified sampling technique was used to select the respondents located at Tanahun district. The survey includes 255 owners of micro-enterprises who have been the member of Chhimek Laghubitta Bikash Bank Limited at least last five years located in different geographical area Tanahun district.

To maintain the validity of the research, expert suggestion and review analysis was done. The questionnaire was developed based on the literature review related to the study area. To maintain reliability, a pilot test was conducted and the Cronbach alpha was calculated to check further reliability of the data. The value of Cronbach alpha is 0.82 and confirms the good reliability.

Both descriptive analysis and inferential statistics were employed to analyze data. The descriptive analysis includes table, percentages, and frequencies. The Wilcoxon test and Chi-Square test, and one-sample t-test were inferential tools used to analyze the quantitative data. The software used for data analysis was the Statistical Package for Social Sciences (SPSS).

## Result and Discussion

### Demographic profile of respondents

Here we presented demographic information of micro-entrepreneurs such as marital status, number of children, educational background, monthly family income and age structure. The result of the demographic information of micro entrepreneur is mentioned in Table 1.

**Table 1 : Demographic Profile of Respondents**

Demographic variables	Categories	Number of	
		respondents	Percent
Marital Status	Married	225	<b>88.24%</b>
	Widow	30	11.76%
	Total	255	100.00%
No of children	Zero to One	67	26.27%
	Two to Three	143	<b>56.08%</b>
	Four and Above	45	17.65%
	Total	255	100.00%
	Literacy status	Illiterate	48
Literate but not			
Formal Education		28	10.98%
Under SLC#		154	<b>60.39%</b>
SLC#		15	5.88%
Above SLC#		10	3.92%
Total		255	100.00%
Family Monthly Income (RS)	Below 20000	55	21.57%
	20,000 - 40000	128	<b>50.20%</b>
	Above 40,000	72	28.24%
	Total	255	100.00%
Age	Up to 30	25	9.80%
	31 to 60	180	<b>70.59%</b>
	61 and above	50	19.61%
	Total	255	100.00%

*Note: # SLC denotes School Leaving Certificate. NRS refers to Nepalese Rupees.*

*Source: Field Survey, 2020.*

Table 1 shows that the majority (88.24 percent) of the member surveyed were married followed by widow 11.76 percent. Likewise, about 56.08 percent of women had 2 to three children followed by 26.27 percent had one child and 17.65 percent had four and above children, respectively. Furthermore, around 60.39 percent of members have less than SLC level education followed by illiterate, literate but not formal education, SLC and above SLC level education, respectively. Furthermore, around 70.59 percent of members are age 31 to 61 followed by 61 and above and less than 30, respectively.

In conclusion, the majority of the selected microentrepreneurs were married, had two to three children, had under SLC level education, had monthly income level 20000-40000 and age 31 to 60 years.

#### **Clients Ethnicity and Line of Business**

In Nepal, people with different caste are living. Generally, caste can be categories as Dalit, Adhibasi and Janajati, and Upper caste. Dalit represents the lower caste people such as B.K., Pariyar, Sarki etc. Adhibasi and Janajati represents Gurung, Magar, Newar etc. Higher caste represents Bramhins and Chhetries. The caste and line of business of micro-entrepreneur are mentioned in Table 2.

**Table 2: Ethnicity and Line of Business**

Line of your business	Ethnicity			Total
	Dalit	Adhibasi & Janajati	Upper Caste	
Agriculture	45	15	20	80
Business	24	45	25	94
Services	6	25	50	81
Total	75	85	95	255

*Chi-square p value= 0.025*

*Source: Field Survey,2020.*

Table 2 shows the result of the nature of the business of clients and their ethnicity. Among the respondents 75 were Dalit, 85 were Adhibasi and Janajati and 95 were upper caste. The result shows that most of the clients belonging to Dalit were running enterprises related to agriculture such as poultry farming, fisheries, professional agriculture, and professional livestock. Furthermore, 24 clients belonging to Dalit were engaging business such as cosmetic shop, retail stores and groceries shop. Further 6 clients belonging Dalit were operating service business such as tea shop, bakery etc. Similarly, 45 Adabashi and Janajati were involved in business followed by 25 in service and 15 in agriculture. Furthermore, 50 people from the upper caste were involved in service-related microenterprise followed by 25 in business and 20 in agriculture. The result shows that there was a significant association ship between ethnicity

and line of business. In conclusion, the majority of Dalit were involving in agriculture-related microenterprises, Adabashi and Janajati were involving in business and upper castes were involving in service-related microenterprises.

#### **Impact of Microfinance Intervention on Different Economic Aspect of Microenterprises.**

Here, we discussed the progress of microenterprises before and after the involvement of microentrepreneur in microfinance. Various economic aspects of microenterprise are compared such as the volume of sales, amount of profit, value of assets and number of employment generation before and after the intervention of microfinance. The results before and after the intervention of microfinance and its significance (Wilcoxon test p-value) is presented in Table 3.

**Table 3 : Economic Progress of Microenterprises**

Sales Amount (in Rs)	Before		P-value
	Microfinance Involvement	AfterMicrofinanc e Involvement	
Up to 50,000	180	60	
50,001-1,00,000	45	80	
100,001-150,000	18	55	0.005***
Above 150,000	12	60	
Total	255	255	
Profit (in Rs)			
Up to 5,000	195	25	
5,001-15,000	40	40	
15,001-25,000	10	58	
25,001-35,000	8	45	0.04**
Above 35,000	2	87	
Total	255	255	
Property Range (in Rs)			
5,00,000-1,000,000	85	50	
1,000,001-1,500,000	89	108	0.027**
Above 1,500,000	81	97	
Total	255	255	
Employment range			
Below three	200	190	
Three to six	35	35	
More than six	20	30	0.25
Total	255	255	

Note: RS denotes Nepalese Rupees and 1 \$ = RS 116.84 as per 5th March 2021.

\*\*\* denotes significance at a 1 percent level and \*\* denotes significance at a 5 percent level.

Source: Field Survey, 2020.

Table 3 shows the result of sales, total profit, asset, and employment range of microenterprises. Before involvement in the microfinance activities, 180 members' microenterprises had sales figures upto Rs 50,000. Likewise, 45 members' microenterprises had sales figure between Rs 50,001 and Rs 100,000, 18 member's microenterprises had sales figure between Rs 100,000 and Rs 150,000, and 12-members' microenterprises had sales figure more than Rs 150,000.

Likewise, after involvement in microfinance activities, we observed that out of 255 respondents, 60 respondents'

microenterprises had monthly sales was below 50000. 80 respondents' microenterprises monthly sales were 50001-100000, 55 respondents' microenterprises sales were 100001-150000, and 60 respondents' microenterprises sales were more than Rs 150000. Thus, the Sales figure shows that after involvement in the microfinance activities sales grew significantly (Agwu, 2016).

From the above table, we observed that out of 255 respondents, 195(microenterpriseshad monthly profit up to 5000, 40 (microenterprises had monthly profitRs 5,001

to Rs 15000, 10 of microenterprises had earned profit between Rs 15,001 and Rs 25,000, eight microenterprises had profit between Rs 25,001 to Rs 35,000 and only 2 micro-enterprises had profit more than Rs 35,000 before involving the owner on microfinance.

However, after the involvement in microfinance activities, 25 (microenterprise had monthly profit was up to Rs 5,000, 40(microenterprises had monthly profit Rs 5,001 to 15,000, 58 of microenterprises had earned profit between Rs 15,001 and Rs 25,000, 45 micro-enterprises had profit between Rs 25,001 to Rs 35,000 and 87 microenterprises had profit more than Rs 35,000. Thus, the profit of microenterprises increased significantly after the involvement of microfinance activities.

While comparing the composition of the assets of microenterprises, we found a significant increase in the value of properties of microenterprises after the involvement in microfinance activities. Before the involvement, 85 microenterprise had value of property between Rs 500,000 to Rs 1,000,000, 89 microenterprise had value of property between Rs 1,000,001 to Rs 1,500,000 and 81 enterprises had value more than Rs 1,500,000. However, after the involvement in the microfinance program, 50 microenterprises had a value of

the property between Rs 500,000 to Rs 1,000,000, 108 microenterprise had a value of the property between Rs 1,000,001 to Rs 1,500,000 and 97 enterprises had value more than Rs 1,500,000.

Moreover, microfinance involvement had improved employment capacity somehow. Before the involvement in microfinance activities, 200 microenterprises employed less than 3 people, 35 employed 3 to 6 people and 20 employed more than 6 people. After the involvement in microfinance 190 microenterprises employed less than 3 people, 35 employed 3 to 6 people and 30 employed more than 6 people. Although there is some improvement in employment capability, the capability was not improved significantly.

#### **Supports of microfinance involvement in Microenterprise Development.**

In Table 4, the status of microfinance clients about the role of microfinance services for microenterprise development are mentioned. The opinion of micro-entrepreneurs was measured in a 5-point Likert scale on which 1 strongly disagrees and 5 strongly agrees on the given statement. The views are tested using one-sample t test-taking 3 as a test value. The results are presented in Table 4.

**Table 4 : Status of Support of Microfinance Activities on Enterprise Development.**

Statements	Maximum	Minimum	Mean	P-value
Microfinance involvement enhances my leadership skills	5	2	3.75	0.0001***
Microfinance involvement enhances my social network	5	1	3.62	0.0001***
Training from microfinance institutions is useful for my business growth	5	2	3.89	0.0001***
Microcredit provided by microfinance institutions is useful for my business expansion	5	1	3.5	0.002***
Microfinance institutions services satisfy me	5	1	3.68	0.001***
Staffs of microfinance institutions frequently provide necessary suggestions useful to my business	5	2	3.85	0.04**
The capital structure of my business has been improved after involvement in microfinance	5	1	3.78	0.0001***

Note: \*\*\* denotes significance at a 1 percent level and \*\* denotes significance at a 5 percent level.  
Source: Field Survey, 2020.

From Table 4, results show that micro-entrepreneurs were agreed with the statements that microfinance involvement enhances leadership skills, social network. They were also agreed with the statements that microfinance institution provides training useful to grow micro-enterprises, microcredit for enterprise expansion, useful suggestions for the growth of microenterprise and helps to improve their business. The result is significant as p-value of one sample t-test is significant at 1 percent and 5 percent level.

## Conclusion and Suggestions

Microfinance institutions play an important role in the development and expansion of micro-enterprises with the help of collateral-free micro-credit to the clients. Microfinance institutions provide both financial and non-financial services to enhance the skills for the development of microenterprises. After becoming a member of microfinance, microentrepreneurs were able to increase sale revenue, profit, and value of assets on their microenterprise significantly (Gazia, & Trivedi, 2014). However, the number of employments is not changed significantly. From this, we can conclude that still microenterprises are run by microentrepreneur as a family business.

Additionally, from this research, we can conclude that the ethnicity and line of business vary. Lower caste people are still engaging in agriculture-related business, but Adhabasi Janajati, and upper caste people are engaging in business and service-related business. This result shows the social and cultural disparities that are still prevailing in Nepalese society.

It is suggested to the government and other supporting institutions to provide extra facilities for the expansion of the microenterprises, thereby increasing employment opportunity and entrepreneurship culture in the country. Besides, microfinance institutions, government organization and non-governmental organization need to work more for removing the caste and cultural disparities of the Nepalese society.

At last, the research has some limitation. It is only based on parts of Tanahun district with clients running a small enterprise. So, it is suggested for future researchers to conduct the same study across different districts. It is also

suggested to conduct the same study to the micro-entrepreneur running the microenterprise but not becoming a member of microfinance to further confirm the results.

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