

## Net Profitability of Micro Businesses: Building Resilience through Financial Access and Microfinance Plus Programs

*A study featuring findings from seven most frequently occurring businesses run by Kashf clients to assess profitability and understand resilience in the context of rising inflation.*

### **Abstract**

Kashf Foundation undertook a research with micro-entrepreneurs in Sept/October 2023 to assess the net profitability of microbusinesses and how, in comparison to 2022, it has shifted against the backdrop of rising inflation. The research further looked into understanding the resilience of subsistence (*also referred to as small businesses operating at basic/minimal level*) and non-subsistence (*also referred to as large businesses that have scaled up from subsistence level*) businesses to the impact of inflation. The research was undertaken in Kasur and data was collected using a structured questionnaire. Forty-two entrepreneurs, across seven most frequently occurring businesses in Kashf's network, were interviewed. The businesses were Catering, Dairy, Embroidery, Kiryana, Parlor, Rickshaw and Stitching. The results revealed that of the seven businesses interviewed, compared to 2022, the NPR of four businesses increased, two decreased while one registered no change.

Data analysis of subsistence and non-subsistence businesses showed that non-subsistence businesses reported improvement in their NPRs, while the profitability of subsistence businesses suffered reduction. The results indicate better resilience of non-subsistence businesses in absorbing price shocks and in maintaining profitability even during challenging macroeconomic situations. While the average revenues reported by microbusinesses were at least twice as high compared to subsistence level businesses, cost as a percentage of sales did not increase by the same proportion. This showed that profitability of businesses increased with scale as the incremental cost of procurement decreased, allowing for higher profit margins for non-subsistence whilst maintaining price. Higher liquidity maintenance due to high volume and comparatively higher profit margins allowed non-subsistence businesses to effectively offset the increase in the cost of business and maintain business scale during challenging economic circumstances.

While businesses operating at subsistence level also continued to be profitable even during high inflation, reduction in net profitability was largely a result of the inability of the businesses to absorb price shocks due to lower profit margins, as well as their inability to pass the price on to the customer. This resulted in reduction in liquidity and subsequently business contraction.

However, the fact that microbusinesses continued to be profitable despite challenging macroeconomic situation is reflective of the significant role that microbusinesses play in sustaining low income households and generating employment. The results highlight the need for continuous interventions in scale enhancement of microbusinesses, which seems to present itself as an important tool for enhancing resilience of low income households, paving way for their upward mobility. Furthermore, the results signify the need for development of specialized microfinance products that can facilitate microbusinesses in managing liquidity more effectively, further enabling their growth and development.

## Introduction

Profitability of microbusinesses as well as factors impacting it is a topic that requires further research. It is despite the fact that MSMEs typically represent over 70% of the total employment in a developing economy (Munro, 2013). A thorough understanding of the business cycles of MSMEs and challenges they face in business continuity allow for development of specialized financial and microfinance plus programs that could cater to the unique needs of these businesses.

To fill this gap in research as well to understand the profitability and thus sustainability of microbusinesses, Kashf undertook research to assess the net profitability ratio (NPR)<sup>1</sup> of microbusinesses in Oct 2018 and then again in Oct 2022. With YOY inflation recording significant increase in the first two quarters of 2023<sup>2</sup>, Kashf repeated the research in September/October 2023. The purpose of the research was:

- I. Assess how high inflation and economic contraction is impacting micro-businesses
- II. Understand the variability in profits and cash-flows for micro-businesses operating at subsistence and non-subsistence levels
- III. Enable the organization to develop further financial products that could support the growth and development of micro-businesses.

### A. Research Methodology

The research was undertaken in Kasur for the purpose of uniformity i.e., to control for changes in the business environment for each enterprise like inflation, cost of utilities and rent etc. Kashf selected the seven most frequently occurring businesses for which credit was withdrawn. Catering business, however, was interviewed in Lahore due to lack of availability of catering clients in Kasur. Each business was divided into two categories; subsistence and non-subsistence. Criteria defined for each business category is given in the table below:

Business	Subsistence	Non-Subsistence
Catering	<ul style="list-style-type: none"> <li>• Operational from home/shop</li> <li>• Do not have paid employees</li> <li>• Monthly sales up to Rs.150,000</li> </ul>	<ul style="list-style-type: none"> <li>• Operational from home/shop</li> <li>• Have paid employees</li> <li>• Monthly sales of more than Rs.150,000</li> </ul>
Dairy	<ul style="list-style-type: none"> <li>• Up to 2 animals on milking</li> </ul>	<ul style="list-style-type: none"> <li>• Between 3-5 animals on milking</li> </ul>
Embroidery	<ul style="list-style-type: none"> <li>• Working from home</li> <li>• Have up to 5 households engaged with them</li> </ul>	<ul style="list-style-type: none"> <li>• Working from home/market</li> <li>• Have between 5-10 households engaged with them</li> </ul>
Kiryana	<ul style="list-style-type: none"> <li>• Weekly cost of inventory of up to Rs.150,000</li> </ul>	<ul style="list-style-type: none"> <li>• Weekly cost of inventory above Rs.150,000</li> </ul>

<sup>1</sup> Net Profitability Ratio: ratio of net profit divided by the total sales. Net profitability shows how much profit is generated for every rupee earned.

<sup>2</sup> Month	Oct 22	Nov 22	Dec 22	Jan 23	Feb 23	March 23	April 23	May 23	June 23	July 23	Aug 23	Sept 23
General Inflation- National (%age) YoY	27	24	24	28	31	35	36	38	30	28	27	31

Parlor	<ul style="list-style-type: none"> <li>Parlor in the house</li> <li>Have a small setup of one chair</li> </ul>	<ul style="list-style-type: none"> <li>Parlor in the house or in market</li> <li>Have two or more chairs</li> </ul>
Rickshaw	<ul style="list-style-type: none"> <li>One rickshaw</li> </ul>	<ul style="list-style-type: none"> <li>More than one rickshaw</li> </ul>
Stitching	<ul style="list-style-type: none"> <li>One machine</li> <li>Operational from home</li> <li>Do not have paid employees</li> </ul>	<ul style="list-style-type: none"> <li>More than one machine</li> <li>Operational from home/in the market</li> <li>May or may not have paid employees</li> </ul>

Six entrepreneurs were interviewed from each business; three who were operating a subsistence level business and three entrepreneurs who were operating a non-subsistence level business. A structured questionnaire was developed to capture data across various business aspects. With each successive study, the questionnaires were revised in line with the business cycles of the selected micro-business given the unique nature of each trade. In-person interviews were conducted with the entrepreneurs in the field as well. Furthermore, each business had to have completed at least 18 months of business operation to be selected for the interview in order to ensure overall robustness and comparability of outcomes.

## B. Results

	NPR 2023	NPR 2022	Change
<b>Catering</b>	34%	34%	Static
<b>Dairy</b>	56%	80%	Decreased
<b>Embroidery</b>	27%	34%	Decreased
<b>Kiryana</b>	30%	22%	Increased
<b>Parlor</b>	80%	68%	Increased
<b>Rickshaw</b>	64%	61%	Increased
<b>Stitching</b>	86%	80%	Increased

Compared to 2022, NPR of two businesses reported a decrease (dairy and embroidery), one stayed the same (catering), while four businesses reported increase (kiriyana, parlor, rickshaw and stitching).

NPR for kiriyana business increased from 22% to 30%, it increased from 68% to 80% for parlor, 61% to 64% for rickshaw and 80% to 86% for stitching.

In depth analysis of interviewed businesses showed that businesses reporting decrease in their NPR also reported significant reduction in their average monthly sales (-23% for dairy and -21% for embroidery), while average sales of other businesses either increased (parlor 116%, kiriyana 30%, stitching 2%) or decreased by a very small percentage (-3% catering and -6% rickshaw). Furthermore, businesses reporting improvement in NPR either reported increased business profits over the year or were able to maintain monthly profits, indicating their ability to pass the increased cost of business on to the customer to a large extent.

However, businesses reporting reduction in sales also reported reduction in their average monthly cost, signifying an overall decrease in business scale. This is likely a result of reduction in business volume due to inability to manage liquidity required to maintain scale, especially when real value of money has decreased as a result of inflation. Dairy stood out as an exception, which despite reporting a monthly decrease of 23% in business sales, reported a 73% increase in business cost; likely a result of fixed cost of animal maintenance associated with the business.

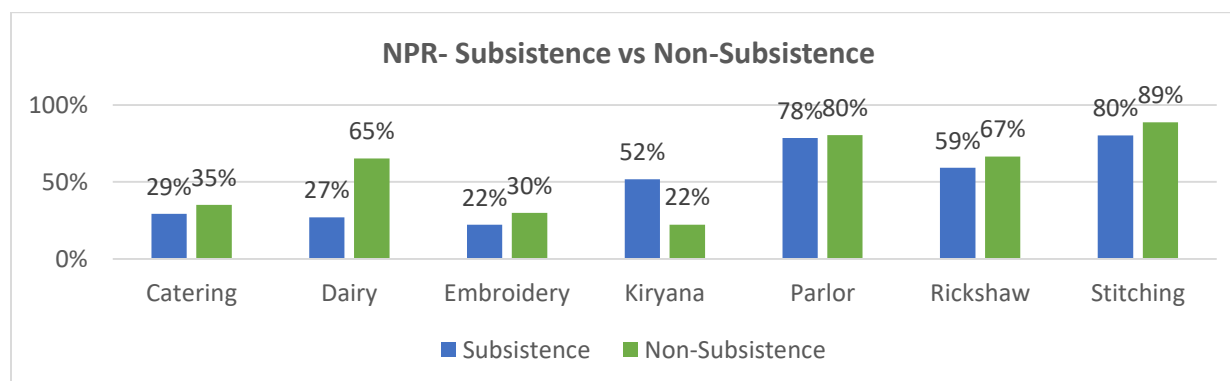
%age Change from 2022	Monthly Sales	Monthly Cost	Monthly Profit
<b>Catering</b>	-3%	-5%	-1%
<b>Dairy</b>	-23%	73%	-47%
<b>Embroidery</b>	-21%	-13%	-37%
<b>Kiryana</b>	30%	17%	78%
<b>Parlor</b>	116%	36%	153%
<b>Rickshaw</b>	-6%	-14%	-1%
<b>Stitching</b>	2%	-37%	13%

A breakdown of business costs showed that material/input cost constituted a major proportion of the total cost of microbusinesses. Compared to 2022, the cost of material/inputs increased from 73% to 75% in 2023, while the proportion of other costs (that includes transport, utilities, salaries, cost of loan, maintenance cost etc.) in the total cost decreased from 27% to 25% in a year. The proportion of “other cost” in microbusinesses is lower by dint of the fact that these businesses normally operate from home, are unregistered and have few employees.

One point of commonality among businesses that reported improvement in their NPR was direct and frequent interaction with the end consumer. This allowed these businesses to manage cash flows more effectively, making it comparatively easier for them to maintain business volume, compared to businesses where the interaction with the end consumer was infrequent or middle men were involved resulting in lower profit margins for business (dairy, embroidery).

### Subsistence vs Non-subsistence Businesses

A comparison of subsistence and non-subsistence businesses showed that NPR for non-subsistence businesses was higher compared to their subsistence level counterparts.



Furthermore, non-subsistence businesses reported higher profits than subsistence businesses. The %age difference in profit ranged from a minimum of 23% (kiryana) to a maximum of 151% (dairy business).

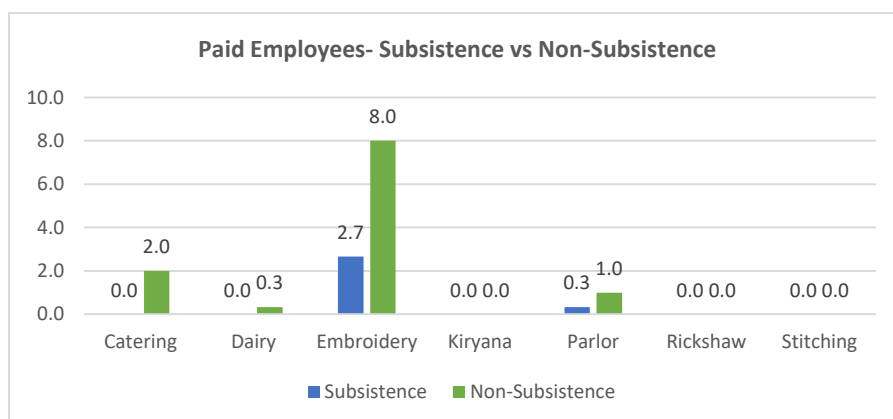
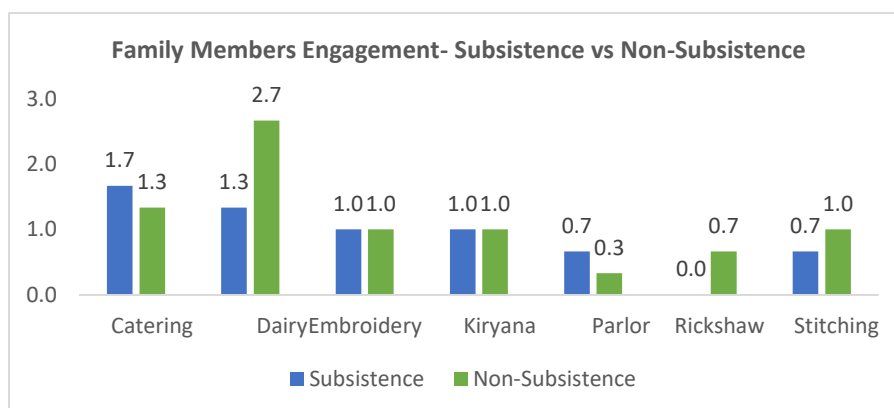
Business	Catering	Dairy	Embroidery	Kiryana	Parlor	Rickshaw	Stitching
<b>%age Difference in Net Profits</b>	142%	151%	91%	23%	87%	90%	61%

Sales and cost estimates of these businesses revealed that the average monthly revenues of non-subsistence businesses were at least twice as high compared to subsistence businesses.

	Sales		Costs		Profits	
	Subsistence	Non-Subsistence	Subsistence	Non-Subsistence	Subsistence	Non-Subsistence
<b>Catering</b>	100,028	494,272	70,811	320,667	29,216	173,605
<b>Dairy</b>	25,088	74,487	18,338	25,880	6,750	48,607
<b>Embroidery</b>	134,361	264,444	104,598	185,268	29,763	79,177
<b>Kiryana</b>	129,817	381,333	62,584	296,380	67,233	84,953
<b>Parlor</b>	67,128	166,144	14,455	32,633	52,672	133,511

<b>Rickshaw</b>	49,449	115,667	20,195	38,714	29,254	76,953
<b>Stitching</b>	44,725	74,500	8,829	6,741	35,896	67,759

Analysis of the difference in revenue showed that volume of product/services, product variety and price of goods were the key factors leading to higher revenue for non-subsistence businesses. Predominantly, the difference in revenue was a result of high volume of units sold/ higher no. of clients catered to by non-subsistence businesses. For example, embroidery businesses at subsistence level were producing an average of 5 dresses in a month, while non-subsistence businesses were producing 21. Similarly, subsistence level dairy businesses were selling an average of 5 kilos of milk in day, while non-subsistence dairy business were selling 25 kilos. While there was change in scale, the price charged for the product remained the same. However, lower incremental cost of producing additional unit for these businesses resulted in increased business margins and subsequently higher net profits for non-subsistence level businesses.



8 employees, catering 2, parlor 1 and dairy 0.3. Among subsistence businesses, only embroidery business reported engagement of 2.7 paid employees and parlor 0.3.

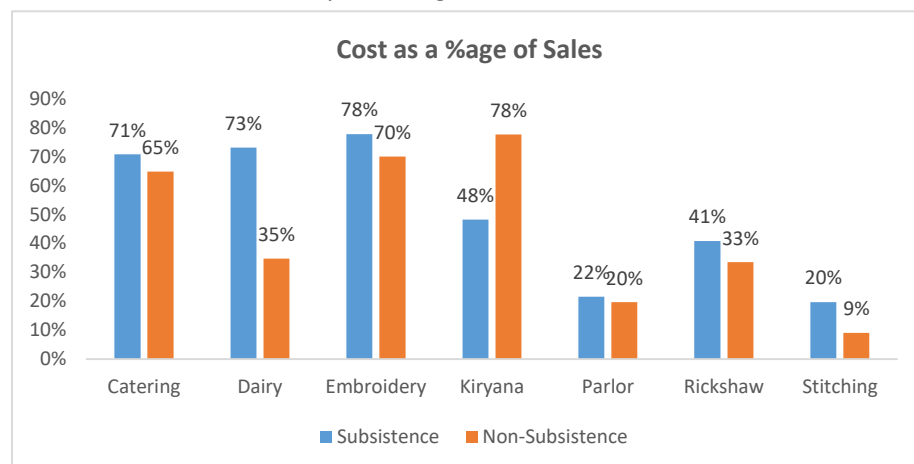
The economic activity and subsequently employment generated by microbusinesses highlights the important role that microbusinesses are playing in the local economy.

Among the interviewed businesses, only parlor and stitching business reported higher price of services when it was offered by a business operating at a non-subsistence level. For these businesses, volume of product produced or no. of clients served did not vary significantly with scale. A subsistence level parlor

Increase in volume in businesses, however, was largely a result of involvement of family members/employees. Though engagement of family members (in some capacity) was reported by almost all businesses operating at either subsistence or non-subsistence level, engagement of paid employees was more frequently reported by non-subsistence businesses. While rickshaw and stitching businesses reported no paid employee, embroidery business operating at non-subsistence level reported

was serving an average of 115 clients in a good month, while a non-subsistence level parlor was catering to 117 clients. Similarly, a subsistence level stitching business was stitching an average of 78 dresses a month, while a non-subsistence stitching business was stitching 83 dresses. Difference in product price along with advanced skills were the key factors determining difference in revenue for these businesses.

While the revenue increased with scale, the cost of business also reported increase. The graph below shows cost as a %age of sales for businesses operating at subsistence and non-subsistence level. The results show that cost as a percentage of sales decreased with scale. This shows that businesses were only



able to increase profit margins by reducing costs when they increased business volume, highlighting the importance of business enhancement in increasing profitability. Cost as a percentage of sales decreased significantly for dairy business, from 73% to 35%, likely a result of

limited incremental cost of animal maintenance on an established setup. Kiryana business stood out as an exception, where increase in business scale led to increase in cost to a larger extent; from 48% to 78%. A deeper analysis of the business showed that while subsistence level kiryana businesses were offering basic snacks, non-subsistence businesses, were increasing sales volume by offering product variety (vegetables, grocery items like pulses, wheat, washing powder etc.). The higher value products were leading to higher procurement costs with comparatively lower profit margins.

However, despite the higher cost to sales ratio, the subsistence and non-subsistence level kiryana businesses reported improvement in their NPR; with non-subsistence kiryana businesses reporting an increase from 26% to 44% and subsistence level businesses reporting increase from 20 to 22%.

	Subsistence		Non-Subsistence	
	NPR 23	NPR 22	NPR 23	NPR 22
<b>Catering</b>	31%	44%	36%	33%
<b>Dairy</b>	28%	72%	59%	83%
<b>Embroidery</b>	22%	48%	30%	29%
<b>Kiryana</b>	44%	26%	22%	20%
<b>Parlor</b>	78%	71%	80%	66%
<b>Rickshaw</b>	53%	68%	68%	59%
<b>Stitching</b>	79%	87%	90%	79%

A further comparison of NPR of subsistence and non-subsistence businesses showed that the profitability of non-subsistence businesses continued to increase while subsistence level businesses pre-dominantly reported reduction.

Reduction in NPR for subsistence businesses seemed to have been a result of increased cost of business which could neither be

absorbed in profit margins, nor be effectively offset by volume that the subsistence level businesses were able to produce, resulting in reduction in business scale.

Among non-subsistence businesses, those with relatively lower costs as percentage of sales were able to enhance profitability even when the inflation was high. The NPR for a non-subsistence level parlor

business increased from 66% to 80%, it increased from 79% to 90% for stitching and from 59% to 68% for rickshaw business. Lower cost to sales ratio, shows flexibility in determining price of service being provided, resulting in higher capacity of passing the increased price of business on to the end consumer. For other non-subsistence businesses, the increase in profitability was marginal; 33% to 36% for catering and 29% to 30% for embroidery. These businesses had significantly higher cost to sales ratios.

Nevertheless, the fact that four out of seven interviewed micro businesses, reported reduction in business volume, and subsequently profits, shows the impact of inflation on microbusinesses. It further highlights the importance of maintaining liquidity in managing business cash flows and thus sustaining profitability.

%age Change from 2022	Subsistence			Non-Subsistence		
	Sales	Cost	Profit	Sales	Cost	Profit
<b>Catering</b>	38%	75%	-9%	-9%	-13%	1%
<b>Dairy</b>	-50%	45%	-82%	-7%	99%	-28%
<b>Embroidery</b>	-9%	37%	-58%	-26%	-27%	-23%
<b>Kiryana</b>	-15%	-45%	74%	59%	54%	81%
<b>Parlor</b>	137%	94%	152%	109%	20%	154%
<b>Rickshaw</b>	-21%	-2%	-30%	2%	-19%	16%
<b>Stitching</b>	67%	155%	53%	-17%	-68%	-1%

### C. Conclusion

The results of the study show that microbusinesses operating at non-subsistence level proved to be more resilient in the face of challenging macroeconomic situation and rising inflation. Compared to subsistence level businesses, average profits decreased by a lower percentage for non-subsistence businesses. High liquidity maintained by non-subsistence businesses, as well as higher profit margins resulting from lower incremental cost of procurement seemed to have acted as a buffer in offsetting the increased cost of business, allowing these businesses to maintain cash flows more effectively. Subsistence level businesses, due to lower business volume, were more sensitive to price changes and their inability to pass the price on to the end consumer resulted in liquidity constraints leading to business contraction.

However, despite continuing to be profitable, business did report reduction in business volume indicating the impact of inflation on average business profits, and subsequently business scale.

The resilience of microbusinesses, as reflected through the research, shows the important role they play in the local economy and in sustaining low income households against economic fluctuations. Therefore, there is a need for focused and continuous interventions in strengthening and further developing resilience of microbusinesses. The insights provided by this research signifies the importance of development of specialized microfinance products that allow microbusinesses to effectively manage their cash flows and maintain business volumes. Products like recapitalization loan, running finance facility and pension insurance programs can provide the necessary capital injections that can enable businesses to manage seasonal variations in demand. Furthermore, scale enhancement through capacity building programs has the potential to pave way for upward mobility of low income households.