# IMPACT OF MICRO FINANCE ON THE POVERTY REDUCTION IN SRI LANKA: EVIDENCE FROM NORTH CENTRAL PROVINCE


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## ABSTRACT

The purpose of this research is to examine how micro finance schemes operating affect reduction lives of people living in terms of poverty reduction in Central Province of Sri Lanka. Descriptive explanatory approach is used in the study and data is collected from 100 users of micro finance selected based on convenience through a questionnaire administered. Aspects of income generation, life style change, quality of dwelling, business expansion, and improvements in health care, education of the children, consumption level and level of savings are covered to test the impact of poverty reduction.

Results of the study reveal that people perceived that micro finance helps them to reduce the level of hardship that faced. On the other hand, it is found that users of micro finance are not capable of realizing the real impact of it on their lives mainly due to poor financial literacy, lack of entrepreneurship skills, lack of guidance on use of finance in businesses. All the respondents were unaware of effective annual interest rate charged on borrowing and rather they believe that it was not that high though the case is yes.



**Keywords:** Micro Finance, Poverty, Lending, Borrowing, Interest Rate

## INTRODUCTION

Micro Finance or micro credit is a very popular debt financing service among the unemployed or low income individuals or groups who otherwise have no other access to the financial services. Micro Finance can be introducing as a method of promoting economic development, employment and growth through the support of micro entrepreneurs and small businesses by managing the finances of the low income people more effectively by minimizing the credit risk. Micro finance facilities serve the people who are difficult to get served by licensed and specialized commercial banks being they are very poor to provide a collateral against the credit facility.

Micro Finance originated in 1970s with the initiation of Dr Muhammad Yunus, who is the founder of Grameen Bank in Bangladesh and later this concept spread rapidly to other developing countries from Bangladesh. As a result, micro finance was introduced to Sri Lanka and through Samurdhi Bank, Samurdhi program was implemented on 1996 as the first National program to alleviate poverty. It is the largest government sponsored micro finance program in Sri Lanka. With the initiation of Samurdhi program, Micro finance sector has been expanded in Sri Lanka during past few decades and at 2018 comprises of 26 licensed commercial banks, 43 licensed finance companies, 20 specialized leasing companies, 15 authorized primary dealers, pension/ provident funds and credit co-operative societies. (Central Bank of Sri Lanka,2018)

With the functioning of a large number of diverse financial institutions in Sri Lanka, the MFIs certainly plays an important role in providing safety net and consumption smoothing of the rural poor people, during its commencement. At present, there is a trend among the low income population segment in the urban sector to receive the service of the MFIs. However, being there is a limited industry data and monitoring mechanisms for the micro finance sector in the country leading to lack of clarity on the market structure, market potential and avenues of growth for the existing players, it is a doubt whether microfinancing institutions really eliminate poverty of their clients or do they pull their clients to a debt trap even without the knowledge of the clients.

This paper is a critical appraisal of the debate on the effectiveness of microfinance as a poverty reduction tool of the low income population in Sri Lanka. It argues that while micro finance has rapidly developed many innovative business strategies to attract more customers and to market their products, the impact of it on poverty reduction of the Sri Lankans still remains in doubt because of the two-digit interest rates that are charged by the poor people who are unsound on finance.

## LITERATURE REVIEW

Micro finance is an area that was subjected to contradictory views of many scholars. While some scholars state that micro finance has a significant positive impact on the poverty reduction of the countries, some scholars bear an opposite idea to that idea.

In his survey, Seibel (2003) proved that micro finance is that chemical through which the germ of poverty can be killed. Seibel further stated that micro finance would not be a poor solution for the poor countries if it is properly regulated and supervised. Though micro finance is a good tool as a survival strategy, it cannot define as a key to development. (Bello,2006)

Colombage (2004) states that even though, micro finance has several positive impacts on client's livelihood development; factors such as lack of entrepreneurial skills, small size of loans, investigating in low value added activities, limited product diversification and poor physical infrastructure adversely affect the clients' socio economic development. MF allows the poor to get out of poverty through their own efforts by providing with the financial means to realize the entrepreneurial potential. (Chang,2010; Hulme and Mosley,1996) Ali & Alam (2010) concluded that MF is the most important resource to provide loans and other basic financial services to increase the employment rate, productivity and earning capacity. Further Ali & Alam(2010) stated that MF will impact the lives of people through removing poverty, improving living standards such as health, education, food and other social impacts. Unemployment is a common problem in majority of the under developed and developing countries. Creating self-employment opportunities is one of the ways that the problem of unemployment can addressed. The reason for poor to remain as poor is the lack of finance to fulfil their basic living requirements. Therefore, MF is an effective instrument to lift the living conditions of poor above the level of poverty by providing them self-employment opportunities and making them credit worthy. MF facilities help to develop the skills of people and enable them to earn money through micro enterprises. (Mawa,2008) According to the research findings of Rena, Ravinder & Tesfy, Ghirmai (2006), there is a fundamental linkage between MF and poverty eradication, in that the latter depends on the poor gaining access to, and control over, economically productive resources, which includes financial resources.

MF increase the self-confidence of the poor by meeting their emergency requirements, ensuring need based timely credits and making the poor capable of savings. (Gopalan,2007) As MF provides small scale credit facilities to poor people with no collateral, it gives an opportunity for the poor to set up their own business at small scale or widen their agricultural activities. Moreover, provision of MF helps them to smooth their consumption level and manage unexpected risks. Therefore, MF is a way to smoothen the consumption level of the facility borrowers and to manage their unexpected risks. MF helps the poor to build assets, educate their children and have a better quality of life. (Durrani,KK, Usman, A,Malik MI & Ahmad,S 2011) MF has a significant positive impact on household income.(Mithrarathna,2003 & Dias, (2001) Credit would create economic power that would generate into social power, lifting the poor out of poverty.(Yunus,1999.p.150)

MF is a good tool as a survival strategy, but it is not a key to development. (Bello,2006) It is because, MF allows the poor to get out of poverty through their own efforts, by providing them with the financial means to realize their entrepreneurial potential. (Chang,2010; Hulme & Mosley,1996)

According to the research finding of many scholars, there is a tendency among the women to get MF compared to men and this is more significant in low income developing countries. Gunathilake and de Silva (2010) have found that loan increases a woman's control over the loan assisted project and through that it has a significant and positive impact on her level of empowerment. Poor women are particularly empowered by micro credit, as it gives them ability to earn an income and thus improve their bargaining positions. (Gunathilake and de Silva, 2010; Chang,2010) Women's access should be prioritized, as they are very adept at saving, highly creative entrepreneurs, and consistent in ensuring that earnings go directly to meeting family needs. (Yunus,1997,pp.256)

Even though MF has several positive impacts on client's livelihood development, factors such as lack of entrepreneurial skills, small size of loans, investing in low value added activities, limited product diversification and poor physical infrastructure adversely affect the clients'socio-economic development. (Colombage, 2004) MF performs a conjuring trick as it achieves higher rates of loan repayment than conventional banking, without having access to the collateral which conventional banks employ to protect their loan portfolio. It performs this trick through constructing social relationships, which substitute for collateral by putting pressure on the borrower to repay loans. These relationships may be either group based which the pressure to repay comes from the members in the group being the default of one member in the group is affecting to the whole group, or individual based, in which case the pressure comes from loan officers and in some cases mentors and others within the client's community. (Velasco & Marconi, 2004, pp.521)

## RESEARCH METHODOLOGY

This study is conducted to examine the effects of MF on the social and economic condition of the people living in the North Central Province of Sri Lanka. The study is predominantly quantitative in nature. The questionnaire has been administered among 100 micro finance beneficiaries via convenient sampling method. The research is focusing on evaluating the influence of MF on poverty reduction. Being 'poverty' is a broad term, the questionnaire addresses the areas of income generation, life style, accommodation, business expansion, health care, education of the children, consumption level and savings separately, in order to cover the term poverty. The demographic information of the respondents was addressed in the first section of the questionnaire and next a Likert scale questionnaire about the MF and its effects on reducing poverty in Sri Lanka. The items for the said questionnaire were gathered from the relevant research studies. (Durrani,KK, Usman, A,Malik MI & Ahmad,S 2011; Abiola & Salami 2011; Hassan, 2010; Imai, Gaiha, Thapa, & Annim, 2010; Kumar, Bohra & Johari, 2010; Ali, & Alam, 2010; Chandarsekar & Prakash, 2010; Gurses, 2009; Akhtar, Akhtar, & Jaffri, 2009; Ahmad, 2008; Brownstein, Fleck, Shetty, Sorensen, & Vadgama, 2007) Five options were given to the respondents for filling the questionnaire as strongly agree, agree, neither agree or disagree (neutral), disagree and strongly disagree.

The data was gathered by visiting the residences of selected MF beneficiaries in the North Central Province. The gathered data was put into and screened through Statistical Package for Social Sciences. (SPSS)

## DATA ANALYSIS AND FINDINGS

The results of the study are based on analyzing the relationship between the dependent variable of Micro Finance and the independent variable of poverty.

Over 90 percent of the sample represents the lower middle social strata and the highest level of education of the sample is Ordinary level education. The results of the study show that 8 percent of the respondents have not received school education, 56 percent have received education up to Ordinary Level and 35 percent of the respondents have completed Advanced Level and only 1 percent has completed higher education. Based on the calculated results, it is expressed that even though micro finance is an effective tool to fight against poverty, it does not support to eradicate poverty permanently. 68 percent of the respondents were in the opinion that micro finance has supported them to improve the social standard of their family while 21 states that they have fulfilled only their daily requirements and failed to improve their quality of life.

The purchasing power has increased in all the respondents with the inception of micro finance and while the above 68 percent interpret the improvement in this purchasing power as the improvement of their social standard, the rest 21 percent who states that micro finance did not improve their living standards do not consider the improvement in purchasing power as the improvement in living standards. The rest 11 percent of the respondents do not have a proper idea on the impact of MF to their living standards.

Out of the respondents 9 percent of the respondents have engaged in government jobs while 52 and engaging in private jobs and the rest 39 are self-employers. The reason for most of the respondents to get micro finance facilities is mainly because of their monthly income is not adequate even for their monthly consumption requirements of the family. Majority of the respondents (56%) are in the monthly income category of 10,000-25,000 and this amount is not enough even for a family with minimum 4 members per month. Therefore, most of the respondents who are illiterate about the high interest rates charged, see this micro finance facility as a blessing for their poor families. Most of the MF institutions in the sample are collecting the installments on daily basis or weekly basis and therefore people are ignorant about the actual interest rate that they are paying being the interest rate is added to their regular installments.

Among the purposes of applying micro finance facilities, the common purposes of the respondents are to widen their businesses or agricultural activities and for their daily consumption requirements. Only very few number of respondents have applied micro finance facilities for the education and medical purposes.

## CONCLUSION AND DISCUSSION

Most of the results indicate that micro finance is helpful for poverty alleviation and therefore there is a positive correlation between these two variables as when the people enjoy micro finance facilities, it reduces the poverty level of people. Micro finance to perform effectively in a country like Sri Lanka, the following recommendations should be considered to uplift the quality of the micro finance system.

- Most of the borrowers are illiterate and they do not have proper knowledge about micro finance and therefore a special campaign must be started to familiarize the poor people about this facility and it will help to avoid borrowers falling in debt traps.
- As the interest amount is very high comparatively to the bank rates, so the interest must be reduced and rates should be reasonable to both the lenders and borrowers.
- Special guidance should be given to the borrowers to invest the facility properly to get benefits and it will secure both parties; lender and borrowers, as borrower can repay the loan without arrears.
- Micro Finance Institutions(MFI) should develop a mechanism to avoid multiple loans received by the beneficiaries, because when the poor people receive micro loans from several MFI, then it will become burden for settling it.

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