

ROLE OF MICROFINANCE IN EMPOWERING POOR RURAL HOUSEHOLDS: A CASE STUDY IN BERENDINA¹ IN SRI LANKA

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Abstract

Microfinance has played a significant role in poverty reduction in Sri Lanka throughout the last decades. Although studies have been conducted all over the world regarding the impact of microfinance on poor rural households; referring to Sri Lankan context, the impact of microfinance on poor are less documented. Therefore, this study was conducted to identify the role of microfinance in empowering poor rural households with the objective of assessing the impact of microfinance on micro enterprises, assessing the impact of microfinance on household level improvement and to identify the areas to be improved in the current institutional practices. The study was conducted with reference to Galigamuwa Branch in Kegalle District of Berendina Micro Investments Company Limited with a sample of 126 clients selected using multi stage cluster random sampling technique. The data collection employed a pre- structured questionnaire and collected data were analyzed descriptively. The findings of the study revealed that Berendina Micro Investments Company Limited adopted credit-plus approach in microfinance to serve its clients in the modes of loans and enterprise development services. The clients were empowered socio-economically with the effect of microfinance credit-plus approach through starting and expanding microenterprises in different sectors generating different types of employment opportunities as well as improving basic facilities at household levels including essential infrastructure facilities. Further, the study identified necessary changes to be made in the current practices of credit program and enterprise development program with reference to clients' perception that will guide the institution towards providing a better service to its clients in the future.

Keywords: Enterprise development services, loans, microenterprises, microfinance, poor rural households

¹ The written consent has been obtained from Berendina Micro Investments Company Limited, stating that the Company does not have any objections in disclosing its organizational name in this paper.

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1. Introduction

Microfinance has been recognized as an effective tool for poverty reduction throughout the world, and been increasingly used in Sri Lanka for over several decades. The term microfinance refers to the provision of financial services including deposits, credits, payment services, insurance, money transfers to poor and low-income households, and also to their micro enterprises (Asian Development Bank, 2000).

During the past few decades, microfinance institutions have followed two approaches in providing microfinance to poor rural households; namely minimalist approach and credit- plus approach (Herath, 2015). Minimalist approach provides financial services only in the form of savings and credit while credit-plus approach offers non- financial services (educational activities, skill development, training, marketing assistance, enterprise development services, supply of inputs, etc.) in addition to financial services. Minimalist approach does not ensure the productive usage of money by credit recipients. Therefore, offering non-financial services with or prior to the provision of credit facilities is important as it provides a guidance to the entrepreneurs to develop and expand their businesses. Further Tilakaratna, Wickramasinghe, and Kumara (2015) also identified that it is important for microfinance institutions to involve in credit- plus approach to develop sustainable micro- enterprises since financial services alone are insufficient to upgrade the livelihoods of the poor.

The findings of the recent studies conducted in developing countries around the world have revealed that microfinance could reduce poverty significantly by diversifying income- earning opportunities, enhancing risk-coping mechanisms, increasing financial and other physical assets, improving socio- economic condition of poor (Khandker and Pitt, 2005; Swain, Sanh and Tuan, 2008; Hashemi, Schuler and Riley, 1996). Referring to Sri Lankan context, although many institutions provide microfinance facilities to poor rural households, there are limited evidences on the impact of microfinance on welfare of households (Tilakaratna, Wickramasinghe, and Kumara, 2015). Therefore, efforts have been made through this study to find out the impact of microfinance facilities on socio economic empowerment of poor rural households.

This study was conducted with reference to Berendina Micro Investments Company Limited (BMIC); one of the major microfinance institutions in Sri Lanka focusing on poverty alleviation through providing necessary financial and non-financial assistance to poor communities to uplift their standard of living under the theme of “Doing things differently to make a difference.” BMIC has adopted the credit plus approach in microfinance and dedicated for poverty reduction while operating in highly commercialized microfinance environment providing evidence of mission drift. BMIC

performed well in its basic indicators such as having lowest Portfolio at Risk (PAR 30 days) amounts 0.57% and profitability; Operational Self Sufficiency (OSS) and Financial Self Sufficiency (FSS) 120% and 106% respectively while charging the lowest interest rate among non- governmental organizations (NGO) and private sector lenders (Berendina Micro Investments Company Limited, 2017).

Microfinance services of BMIC assist the clients in establishing new businesses, expanding and diversifying the existing businesses and building up the family assets, improving their knowledge on financial and non-financial aspects. BMIC selects poor families in need of assistance based on the criteria of progress out of poverty index and per head family income indicators and disburse small-sized, medium-tenured loans at low interest rates to fund different types of purposes including development and expansion of microenterprises, dairy farming, agriculture, construction and renovation of houses and latrines, and emergency incidents. Enterprise Development Services (EDS) is the credit plus component of BMIC which focuses on providing a variety of skills to its clients that will facilitate long- term development and sustainability of their communities. EDS programs provide technical skills, business management skills, financial literacy and leadership training; and also provide inspiration and motivational training to underprivileged people in rural and plantation communities. Business counselling services and market linkages are provided by the BMIC staff to the clients in need of such services and also activities to reduce environmental pollution by small enterprises. BMIC is committed to ensure that organization is in line with its original mission of poverty alleviation as proved by the findings of this paper.

The objectives of the study were to assess the impact of microfinance on micro enterprises, to assess the impact of microfinance on household improvement of clients and to identify the areas to be improved in BMIC credit program and EDS programs.

2. Literature Review

Most of the poor rural households are susceptible to socio- economic vulnerabilities due to lack of access to market, knowledge, capital information (Todaro and Smith, 2003). As mentioned in the report of United Nations Development Program (1996), lack of choices and opportunities are the main reasons for poverty; in which lack of choices occurs due to lack of access to productive resources such as credit, land, information, skills as a result of exclusion and marginalization. The lack of access to productive resources leads to low economic productivity accelerating the vulnerability of the poor.

During the past years, efforts have been made to uplift low income groups from “below poverty line” to “above poverty line”. Provision of financial services in the form of “credit” is one of the main strategies adopted to raise poor people’s income generation through self-employment opportunities. This led low income groups to involve in entrepreneurial activities which were considered as risky by them before (Hulme and Mosley, 1996).

According to Chang (2010), it has been identified that microfinance permitted the poor to escape from poverty and also to realize their entrepreneurial potential. It has been evident that microfinance is a powerful poverty reduction tool (Morduch and Haley, 2002) with empowering poor women (Chang, 2010) and also reflecting that poor are bankable showing a very high payback ratio (Remenyi, 1997). Clients received a large number of socio-economic benefits via microfinance including income generation, vulnerability reduction (McCulloch and Bob, 2000; Otero and Rhyne, 1994). Holcombe (1995) mentioned that there is a strong demand for financial services from economically active poor in developing countries in order to start and develop small-scale enterprises.

Referring to Sri Lankan studies, some have argued that impact of microfinance on poor are positive while some have argued that those are negative. Dias (2001) stated that microfinance had significant positive impact on household income by analyzing the Women’s Development Federation’s progress in Hambantota District. Wickrama (1998) also observed a significant positive impact of microfinance on poor household’s socio-economic conditions. But, Colombage (2004) stated that although microfinance has positively impacted on livelihood development of poor in several ways, their socio-economic conditions have been negatively affected by the factors such as small size of loans, limited product diversification, continuation of investing in less value added programs, low-quality infrastructure. According to Gunathilake and de Silva (2010), women were empowered significantly and positively because after obtaining a loan, woman’s control over the loan assisted project increased. In contrast, it has been recorded by De Mel, McKenzie and Woodruff (2008) that male-owned microenterprises were successful than female-owned microenterprises when comparing the returns to capital in both types. Colombage, Ahmad, and Chandrabose (2008) revealed that microfinance positively affected on socio-economic development of clients at various levels; individual, business, family, community.

While these positive impacts were documented historically, there were many negative impacts emerging from the recent past due to oversupply of microfinance resulting from commercialization of microfinance in Sri Lanka and many other countries. Immediate symptoms are multiple loans from

multiple microfinance institutions, loan defaulting, over indebtedness leading to many negative social impacts in extreme situations and suicides of borrowers. Constantinou and Ashta (2011) noted a calamity in microfinance sector that occurred in Latin America as a result of immoral practices adopted by microfinance institutions. They have also identified that existing competition between different microfinance institutions leading to the over indebtedness of clients, which has become an emerging crisis in India.

This can be further supported by the findings from Bhaskar (2015) stating that around 80- 120 suicides have been reported from Andhra Pradesh in India, which were directly related to microfinance loans. The particular borrowers were pressured relentlessly by the higher interest rates, obtaining multiple loans which were impossible to repay, harassments made by the microfinance institutions to repay the loans on time which led them to commit suicide by drinking pesticides and jumping into wells. Evidences from Sri Lanka also confirmed the fact that behavior of microfinance institutions causes the clients to suicide.

According to Kadiragamar (2017), microfinance institutions have been identified as one of the current worst exploiters in the war-affected regions in Sri Lanka; imposing unusual and unbearable interest rates on the clients attempting to grab all their assets during loan payback. Familial and community relationships of the clients were disrupted by the unfair and aggressive behavior of the microfinance institutions and that was the reason for the Women Federations in Jaffna and Kilinochchi Districts requesting the respective government authorities to take necessary actions to ban microfinance schemes operating in their regions. Also, the number of suicides and attempted suicides directly related to microfinance indebtedness in Northern and Eastern Provinces in Sri Lanka are increasing (Kadiragamar, 2017).

According to the above mentioned studies, it is revealed that many of them reflected that microfinance has either positive or negative impact on poverty reduction; but they rarely focused on the ways in which it affected on the people or the impact of credit-plus approach. This can be further supported by Banerjee et al. (2009) stating that though microcredit schemes had been developed and expanded at an increasing rate during the last few decades, the magnitude of assistance to the poor provided by microfinance are yet to be discussed more.

3. Methodology

The study was conducted with reference to BMIC, and Galigamuwa BMIC Branch from Kegalle District was selected as the study area. The study adopted multi stage cluster random sampling technique. The total population consisted of 589 clients borrowed loans from BMIC. A sample of 126 clients was

selected from the total population of 589 through “Rao soft” sample size calculator at 5% margin of error and 95% confidence level. Galigamuwa branch consists of five field operational areas. Each field operational area has approximately 30 clusters each consisting 25 to 30 clients. In selecting the clients sample, clusters were selected randomly from all five field operational areas. The respondents were randomly selected from those clusters that were selected on random basis. The sample was drawn as follows.

Table 1: Selection of the Sample

Cluster Area	Cluster Group Number	Number of Clients Selected
Arandara	GL/AR/01	16
	GL/AR/03	9
	GL/AR/05	7
Asadeniya	GL/AS/01	16
	GL/AS/03	11
Ballapana Udabage	GL/BU/01	16
	GL/BU/05	20
Hathuhinna	GL/HM/03	10
	GL/HM/04	11
Veragoda	GL/VG/01	2
	GL/VG/03	8
Total		126

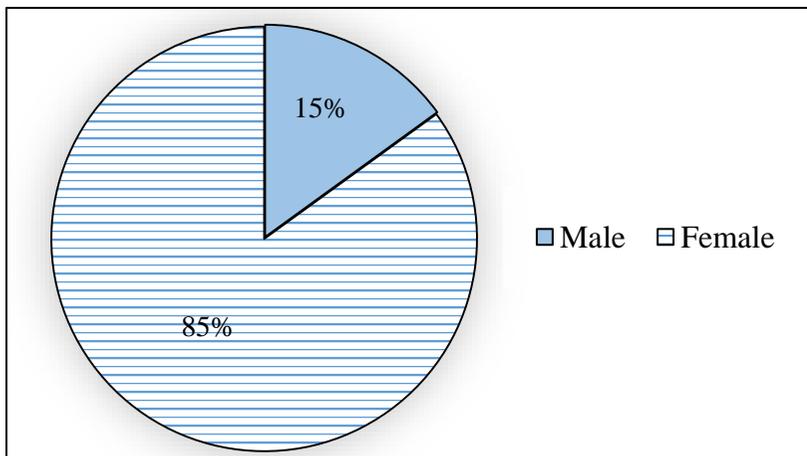
Source: BMIC Operational Database, 2018.

The data were collected using a pre-structured questionnaire and the clients were interviewed by an independent team of researchers from University of Peradeniya, Sri Lanka. The questionnaire consisted of six sections to identify the demographic characteristics of the respondents, micro credit facilities received by the respondents, EDS programs received by the respondents, impact of microfinance on microenterprises, impact of microfinance on household improvement, areas to be improved in BMIC credit program and EDS program. The collected data were analyzed descriptively.

4. Results and Discussion

4.1 Demographic Characteristics of the Respondents

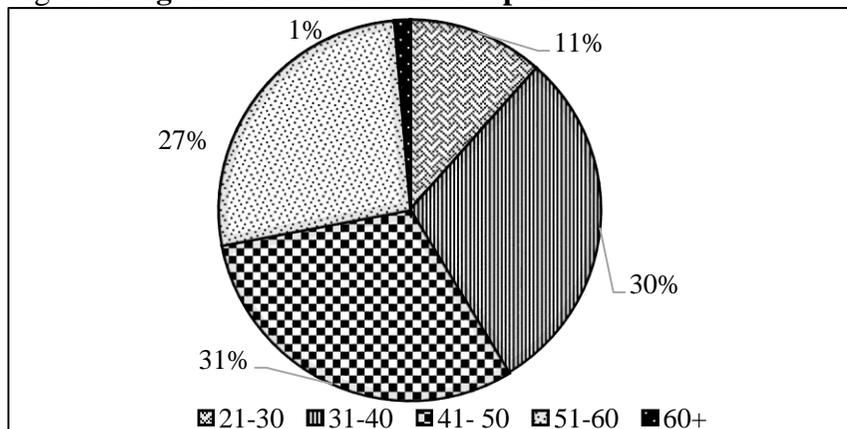
Figure 1: **Gender Distribution of the Respondents**



Source: Questionnaire Survey, 2018.

According to Figure 1, majority of the microfinance clients were women (85%) while few were men (15%). The reason for women being the main partners in microfinance could be that they are highly keen on the welfare of household members; and try to involve in income generating activities which will aid to cover their daily expenditures including food, health, education etc. The same finding has been indicated by Goodland et al (1999) that women had a remarkable position in the provision of microfinance.

Figure 2: **Age Distribution of the Respondents**



Source: Questionnaire Survey, 2018.

As shown in Figure 2 above, 31% of the microfinance clients were in the range of 41- 50 years old while 30% of the clients were in the range of 31- 40 years old. Considerable number of clients belonged to the age groups of 51- 60 and 21- 30 years old amounted 27% and 11% respectively while lowest (1%) were over 60 years old. Overall, majority of the clients were distributed between 31- 60 years old. This could be due to the fact that the clients belonging to this age group are responsible for income earning and taking care of their families by accomplishing the family members' needs. Therefore, when available funds are insufficient to meet their requirements, they tend to get the assistance from microfinance institutions in order to fulfil their requirements.

Table 2: Education Level of the Respondents

Level of Education	Percentage of the Respondents
No schooling	1%
Grade 1- 5	9%
Grade 6- G. C. E. Ordinary Level	66%
Up to G. C. E. Advanced Level	23%
Above G. C. E. Advanced Level	1%
Total	100%

Source: Questionnaire survey, 2018.

The information in Table 2 depicts that majority of the respondents (66%) were educated in the range of Grade 6- G. C. E. Ordinary Level and lowest (1%) did not attend school while another 1% attained the education level above G. C. E. Advanced Level. Also, 23.2% and 9% of the respondents attained education up to G. C. E. Advanced Level and Grade 1- 5 respectively.

4.2 Micro Credit Services Received by the Respondents

As mentioned above, BMIC provides two types of services to its clients; micro credit and EDS. Referring to micro credit facilities, BMIC provides different categories of loans to its clients; business loans, asset building loans, cultivation loans, dairy loans, senior citizen business loans for ultra-poor people. According to BMIC regulations, two categories of loans are not issued to the same client at once. The clients will be eligible for the second category of loan once the first category of loan is fully paid back.

According to the respondents of Galigamuwa branch, two categories of loans were obtained; business loans and asset building loans. 38.1% of the respondents borrowed asset building loans to improve their housing conditions. 43.7% of the respondents obtained business loans to start a new business or to expand the existing business. Clients interested in improving

their businesses as well as housing conditions obtaining both asset building loan and business loan amounted to 18.3%.

Six point three percent (6.3%) of clients mentioned that it had been difficult for them to repay the loan due to various reasons such as business failure, reduction of products' market prices, job uncertainty, emergency situations like death of a family member etc. In such incidents, one of the group members paid the relevant loan amount on behalf of the client.

4.3 Impact of Microfinance on Microenterprises

According to the survey results, it had been revealed that both business loans and EDS programs supported the clients to start new businesses or to develop the existing businesses. Thirty-seven percent (37%) of the respondents started new microenterprises with the financial support from business loans and 5% of the clients, initiated microenterprises using the guidance provided by the EDS programs. Considerably, a large number of clients (96%) developed, expanded and diversified the existing microenterprises using business loans while 19% of the respondents developed their existing microenterprises with the support of EDS programs. Therefore, it was clearly revealed that the business loan borrowers who had participated the EDS programs started and improved their businesses successfully.

The business loan borrowers participated in EDS programs invested their loans on different types of businesses such as trading, food processing, cultivation, livestock, production and manufacturing. Trade enterprises were highly supported (43%) while food processing businesses were least supported (8%). Twenty-seven percent (27%) of respondents started and developed businesses based on cultivation while 13% of clients invested on microenterprises related to livestock. Less number of clients (9%) initiated and developed businesses related to production and manufacturing. However, it is clear that BMIC clients were encouraged to involve in different types of microenterprises with the support of business loans and EDS programs.

As a result of these microenterprises, new employment opportunities emerged within the rural communities. Majority (75%) of the family members engaged in their enterprises full- time while few of them (8%) engaged in part-time basis (E.g., tea, rubber, spices cultivation). Some (6%) of the microenterprise owners (E.g., timber traders, block stone producers) hired employees from outside on full- time basis while some (6%) hired outside employees on part- time basis for microenterprises such as retail shops, timber trading, cultivation etc. Very few business owners (5%) hired outside employees seasonally for businesses such as tea cultivation, cloth sewing etc. Further, according to the overall perception of the clients, 15% of them mentioned that number of employees occupied in their microenterprises increased after the intervention of business loans and EDS programs.

Therefore, it is obvious that microenterprises generated different types of employment opportunities in different scales and microfinance has positively impacted to minimize the rate of unemployment in the society.

Impact of EDS on microenterprises were examined with reference to the clients' (participated for the EDS programs) perceptions. Among the interviewed clients, 41% of the respondents participated different EDS training programs including financial literacy, Vyapara Jaya, exposure visits, technical training in agriculture and non- agriculture related businesses and soft skills development. The impact of those training programs on microenterprises were mentioned in Table 3.

Table 3: The Impact of EDS on Microenterprises according to the Clients' Perception

Impact of EDS on Microenterprise	Percentage of Respondents
Increased enterprise income	85%
Increased extent of cultivation	79%
Increased the variety of products	77%
Increased the access to new markets	59%
Started to maintain bank accounts	56%
Increased the number of buyers	51%
Increased value added production	33%
Started record keeping	16%

Source: Questionnaire survey, 2018.

According to the clients of Galigamuwa branch, there was a significant positive impact on microenterprises after the intervention of EDS. Majority of the clients experienced increment in enterprise income, extent of cultivation, variety of products. As a result of the financial literacy trainings, 56% started to maintain bank accounts while 16% started to maintain record keeping of the enterprises. This trend among the clients reflects that they are gradually growing to become entrepreneurs using the assistance provided through EDS. 59% of the respondents mentioned that access to new markets was possible and 33% stated that the value added production had been increased with the effect of market linkages provided by EDS. Therefore, it is clearly revealed that EDS provided by BMIC positively affect poor rural households to upgrade their microenterprises and expose to new market ventures.

4.4 Impact of Microfinance on Household Improvement

According to the survey results, it had been revealed that asset building loan borrowers have used the loans for two purposes; for improving housing conditions and for investing in other household necessities.

Referring to improving the housing conditions, 87% of the respondents utilized asset building loans to renovate or repair the houses while 55% of the clients used the asset building loans to increase the floor area by adding a new section to the house such as a room, kitchen, verandah, etc. The number of clients used asset building loans to construct toilets, obtained piped water and obtained electricity were 15%, 11%, and 6% respectively. Therefore, it has been revealed that asset building loans were supportive to rural clients to improve their housing conditions, especially the essential infrastructure facilities such as toilets.

Also, some of the clients used asset building loans in other household requirements such as purchasing household assets, children education, family savings, health facilities etc. 10% of the respondents used asset building loans to purchase household assets while 8% invested in children education on the components such as paying tuition fees, purchasing stationaries, etc. Also, 7% of the clients used asset building loans for family savings while 6% spent them on health facilities of family members.

4.5 Areas to be Improved in BMIC Credit Program and EDS Program as per the Clients' Perception

Table 4: Loan Borrowers' Perception about BMIC Credit Program

Loan Borrowers' Perception	Percentage of Satisfied Respondents
Simple loan obtaining procedure	100%
Easy monthly loan repayment	100%
Adequate awareness before loan disbursement	100%
Relationship with loan officer	100%
Follow-up by staff after the loans are given	93%
EDS coupon system is very clear	91%
Group loan distribution procedure is convenient	83%
Loan amount is sufficient	59%
Loan interest rate is reasonable	50%

Source: Questionnaire survey, 2018.

According to Table 4, all the clients in Galigamuwa branch admitted that loan obtaining procedure and monthly repayment procedure were easy for them. Also, all of them were satisfied about the awareness provided by the branch staff prior to loan disbursement and about their relationship with the loan officer. Very few (7%) clients were dissatisfied about the follow up after loan disbursement in which they mentioned that though some filed officers inform about the follow up during the meetings, they never visited the clients'

residencies. 9% of clients did not have a proper understanding about the EDS coupon system.

Also, 17% of clients were dissatisfied about the group loan system because they complained it had created extra pressure on them. Also, some of them suggested that instead of making all group members participate the cluster meetings, it is better to rotate the participation among the group members. Fifty-nine percent (59%) and 50% of the respondents were dissatisfied about the loan amount and interest rate respectively. They suggested that it is better if BMIC can disburse loans with a declining balance rate of interest and also increase the loan sizes for the clients who have the capacity to repay.

Table 5: Clients’ Perception about EDS Program

Client’s Perception	Percentage of Satisfied Respondents
Training cost is reasonable	100%
Sufficient capacity of the resource persons	100%
Convenient training duration	91%
Offer relevant trainings at relevant time	90%
Follow-up of training program	60%
Support to develop microenterprises	42%
Creation of market interlinkages	29%

Source: Questionnaire survey (2018)

The results in Table 5 are based on the responses from EDS participants. All the EDS participants from Galigamuwa branch were satisfied about the training cost and the capacity of the resource persons to conduct the trainings. Nine percent (9%) of EDS participants were dissatisfied about the training duration and they pointed out that financial literacy program was lengthy and also it would be better if BMIC can increase the duration of technical trainings with inclusion of practical sessions. Majority (90%) of respondents of Galigamuwa branch mentioned that EDS services were delivered at the relevant time (demand- driven approach). Sixty percent (60%) of clients experienced follow-up of training programs which implied that follow-up had not been undertaken properly in the branch. Less than half of the clients (42%) were satisfied about the support given from EDS training programs to develop microenterprises and 29% of the clients were satisfied about creating market interlinkages.

5. Conclusion

The purpose of the study was to identify the impact of microfinance on empowering rural households. The results indicate that poor rural households were benefited by the credit-plus approach adopted by BMIC in the forms of credit and EDS. Micro financial services play a significant role in empowering poor rural households; mainly improving their microenterprises and household levels. With the support of loans and EDS, some rural people have started new microenterprises while some developed and expanded their existing microenterprises in different sectors generating different types of employment opportunities; providing a solution to the prevailing unemployment issues in the society to a certain extent. Also, rural people has improved their housing conditions including essential infrastructural facilities using the loans provided by BMIC. Therefore, it can be concluded that microfinance has created a significant positive impact on improving socio-economic conditions of poor rural households.

Referring to the clients' perception on BMIC credit program, it has been revealed that nearly half of the respondents suggested that it would be better if the loans are disbursed with a declining balance rate of interest and also to increase the loan sizes for the clients who possess the capacity to repay. Referring to the EDS program, attention should be focused on supporting to develop microenterprises and creation of market interlinkages. Therefore, through this study, it is recommended that microfinance institutions (BMIC) should focus their attention on the weaknesses of the current services and procedures and implement corrective measures to minimize them in order to provide a better service to people and upgrade their living standards further.

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