Impact of Granting Micro Finance Facilities on the Living Standards of the Rural Poor in Sri Lanka

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Abstract— This paper establishes facts to evaluate the impact of microfinance credit schemes in operation, on the actual living standards of beneficiaries of such schemes. In Sri Lanka, micro finance credit facilities are being granted to the rural poor intending the alleviation of poverty and achieving higher living standards. To accomplish same, the Government has tied up with numerous financial institutions and non-governmental organizations through which a substantial amount of capital has been granted to the poor despite the high levels of risk associated with same. Irrespective of the long history and the large number of institutions involved, only limited knowledge is available of its impact on living standards. No proper paper mechanism is in place for such post – credit evaluation. This study intends to fill this gap.

The study is carried out in the purposively selected geographical areas of Monaragala and Kegalle, among borrowers under various micro finance schemes. For the clarity of the population it has been confined to beneficiaries of facilities granted through licensed commercial banks. The study establishes three independent variables namely; timely utilization of micro finance funds, utilization of micro finance funds for intended purposes and the risk management ability of borrowers. Dependent variables in assessing the living standards are identified as the household assets, household savings and the household expenditure.

Study has utilized primary and secondary data. Primary data are gathered through a structured questionnaire administered to a stratified random sample. The questionnaire was designed to reveal general demographic details of the respondents, enabling more clarified analysis. Secondary data are extracted through documentary sources.

It is concluded, as evidenced in data, all factors identified relating to the micro finance schemes indicates a positive impact of varying degrees on the living standards of the beneficiaries cum borrowers, with the management of risk showing the weakest impact.

Keywords— Micro Finance, Standard of Living, Rural poor

I. INTRODUCTION

"Finance" plays a vital role in the economy of a country, which is well recognized. It covers from small to large scale funding for households and enterprises. Wijewardena (2007) states that Microfinance, its small and unseen brethren, too plays the same vital role, and perhaps much more, with respect to its clientele. The term "Microfinance", specifies small scale loan or credit facilities, which are offered to the poorest people, in order to ease poverty. Microfinance, covers a wide array of services, viz., credit, deposit, money transfer, insurance, market information etc. Microfinance presents a potent instrument for alleviating poverty and increasing living standards of the rural poor.

Few writers, who are pessimistic in their views, have identified microfinance to be in par with microcredit. Microfinance is much more than microcredit. These two words are used interchangeably in studies, but micro finance concerns itself with such key areas as empowerment of the poor, market developments and access, use of information profitably etc, in addition to the provision of miscellaneous financial services. Given the wider coverage of microfinance, the poor are in a position to derive benefits from microfinance, not only in generating an income, but in betterment of their standards.

Microfinance not only grants credit facilities to the poor, but also the financial literacy and training, technological know-how, programmes to develop skills, savings and insurance. In Sri Lanka there had

been numerous micro credit schemes introduced by the government over the past decades to alleviate poverty. Some of them are "Janasaviya","Suduneluma" and at present the Samurdhi Bank and societies.

Microfinance is expected to cater to a specific clientele, the poor, who are normally defined very broadly as those incapable of meeting even the day today basic requirements needed for a decent human life. This group is not homogeneous but depicts a wide diversity. Examination of the microfinance system in the country reveals that the country still lacks a well defined articulate strategy of assessing the impact of these schemes on the living standards. In this context, the system has largely been left to itself, and has stood the test of time. Hence, it is of importance that the country has a proper mechanism in place to identify the true impact of the micro facilities granted on the target constituent. This paper intends to present the perspective of evaluating the impact of such facilities, and provide a basic structure for the wide evaluation of such schemes.

The geographical areas of Monaragala and Kegalle has been purposively selected to obtain the sample due to the fact that it contains a large number of populations who are considered to be under or at par with the poverty lines, and the majority of lending institutions have focused in lending within the said geographical area. Atapattu (2009) , in his study on "Status of Micro Finance in Sri Lanka" states that the poverty levels in Sri Lanka are heterogeneous, which differs widely between Provinces and Districts. It further indicates that according to the data published by the department of Census and statistics in 2002, at the two extremes is Colombo District with 6% of the population living in poverty and Monaragala and Kegalle Districts which registers between 30% - 37% of the population living in poverty. This demonstrates the importance of disaggregating poverty statistics in Sri Lanka in order to get an accurate picture of where the poverty 'pockets' lie. Due to this factor, the sample selected is considered as representing the generalized characteristics of the rural poor of the country.

Since the introduction of formally accepted micro finance module by Prof. M Yunus in the seventies, the use of micro credit as a tool of poverty alleviation has been accepted around the world.

But the empirical evidence on the impact of micro facilities on standards of living using cross sectional data sets is very mixed. While some studies have found that the access to this type of facilities has a positive, large and a permanent effect on living standards, other studies have found that poverty is not reduced through micro facilities (Chawdry, 2007). These latter studies stated that through micro credit, the poor become poorer, due to the additional burden of debt. The drawback associated with impact assessment studies using one – period – cross- sectional data is that the result of such studies could get biased due to the problem of self selection. This study attempts to avoid such weakness by attempting to assess the impact of micro finance on living standards by gathering data prior to the disbursement of facilities. In the study more reliable estimations on the impact are expected by analyzing the same individual twice. Available secondary data on the living standards of the sample is used to compare the living standards of the same individuals after obtaining the micro finance facilities. The study has considered individuals who have availed themselves of such facilities between year 2010 – 2012 (inclusive of both years) in identifying the population and the sample due to the consideration that the effect of such schemes will take place with a minimum lapse of one year from the date of grant.

Considering the above this research was carried out with the intention of answering the research question of "What is the impact of micro finance facilities on the living standards of the rural poor in Sri Lanka"?,

II. THEORETICAL BACKGROUND

A. Micro Finance
Microfinance is the branch of finance, which helps the poorer segment of the society to keep afloat and helps them to gradually and progressively cross the poverty line and get them cohesively integrated into the rest of the society. The development of micro finance has taken a steep rise with the introduction of the Grameen Model by Prof.Mohamed Yunus in Bangaladesh in 1976. Charitonenko and Rahman (2009) have emphasized the significant factors of Grameen model which has added value to the lives of people. Despite the rates of interest payable, (whereas the rates of interest are comparatively high than average lending) this acts as an effective

mechanism to disseminate precious information on ways to improve the health, education, legal rights, sanitation and other living standards, which are of relevant concerns for the poor.

As Banuri (2006) pointed out microfinance is the lending of extremely small amounts of capital to poor entrepreneurs in order to create a mechanism to alleviate poverty by providing the poor and destitute with resources that are available to the wealthy, albeit at a smaller scale". He identifies that through alleviation of poverty the benefactors of such schemes would achieve high standards of living.

Adding to that, some writers (Murray & Boros, 2002; Ledgerwood,1998) stated in their books that microfinance consists of several main characteristics inclusive of advancement of living conditions. The fact that the micro finance facilities are collateral free, presents the lenders with an additional risk of default, emphasizing the fact that a proper mechanism of post – credit evaluation is needed to be adopted. Due to the presence of the default factor, the finance facilities does not work on a perfect market equilibrium like other commodities, with a positively corresponding demand and supply regimes.

Further, Wijewardena (2007) has stated that microfinance is to be reorganized as an important element in poverty alleviation system since its vital role in the overall financial system has created a systematic impact. Hence same need to be explicitly incorporated into the national development strategies. He further states that the failure of any national level micro finance scheme would bring a social cost to the society. Every level of the society has to be growing for a national development thus a "system that benefits a sizeable segment of the society" is important to be analysed for its actual impact.

Microfinance schemes, if left un- assessed, would work as a *safety net*- a normal strategy used to capture the poorest segment of the society, prior to them making a free fall to the ground. The objective is to provide some relief, to meet the very basic requirements (Brau, 2004). Adding to the above view of Brau (2004) it could be noted that the weaknesses in this type of strategies are well known. Economists have long named this problem as the "moral hazard" problem. It encourages poor

people to remain in the safety net forever. They have no incentive to move out of the net, because moving out would mean their having to work hard for a living. As a result, he increases the chance of the occurrence of the event which the helper desires to prevent. The consequence is that it imposes an additional burden on the helper. As a result, neither the helper nor the helped would be able to get out of the vicious circle in which the both parties would get trapped.

The moral hazard behaviour by people who get free goods is not a new phenomenon. It had been known for many centuries. The Buddha has preached in one of the discourses titled "Chakka Vatti Seehanaada Sutta" how the king of a country was duped by the people who were given free capital to commence self-employment projects.
Above theoretical background explicitly states that schemes which are targeting the alleviation of poverty have to be well monitored and evaluated in achieving its original objectives.

Some literature which is available in the area does not give conclusive evidence of the impact of micro finance schemes on the living standards. According to Thilakarathne and Wickramasinghe (2005) in a study conducted on the impact of micro finance scheme on the household income, covering 17 districts of Sri Lanka (except North and East), over 50% of the households have confirmed that there had been a significant improvement in their income levels, while a considerable amount had stated that they have not experienced a major improvement in the level of income. However the above research states that micro finance has played a vital role in increasing the level of income which is important for a developing country like Sri Lanka. It further states that micro finance is designed towards improving the standards of living and even a least improvement on the income of the selected segment of low income earned people will bring higher benefits rather than for people with good income levels, as it will have a major impact on the level of consumption, child education, savings, health, and many other aspects of living standards.

B. Status of Microfinance and Poverty in Sri Lanka
A sectorally disaggregated view given in available sources shows the highest levels of poverty occurring in the provinces of Southern, Uva and Sabaragamuwa. Overall, rural areas are poorest - 90% of the poor live in rural areas, but this statistic

must be understood in the context of urban/rural classification in Sri Lanka which classes the vast majority of the population as rural.

Further it could be noted that the poverty head count index in Sri Lanka is not uniform across provinces and districts. According to published data by the Department of Census and Statistics, seven (7) out of 25 districts (Badulla, Hambantota, Kegalle, Matale, Moneragala, Puttalam and Ratnapura) had between 30-37% of their populations in poverty. Of these only Hambantota and Puttalam have shown huge reductions in poverty during 2006 (nearly 20% less) while others show a marginal reduction in the proportion of poor.

In relation to the above stated income inequality, Atapattu (2009) states that the relative position of the poor has fallen over the past few decades. While Gross Domestic Production (GDP) may be rising in Sri Lanka, this growth is not being converted into poverty reduction as the poor's share of that growth is not large enough, and falling. He further states that no studies or research exist where this variable has been isolated and which shows microfinance's contribution to national poverty alleviation.

As reported by Steinwand and Bartocha (2008) on 'How microfinance improves lives in Sri Lanka, microfinance is a multifaceted benefactor that affords the poor to rebuild their lives, plan for their future and that of their children, empower them with self esteem, integrate in to social fabric by enjoying access to social networks and making contributions towards welfare of their families and that of the community. The impacts of microfinance are a mix in most cases where one impact leads to another.

Apart from the above, the most immediate impact of such facilities foreseen among their clients is the economic benefits such as increase in income. According to the project on "Empowerment of the poorest of the poor women and young girls in Sri Lanka Project" of Women's Development Foundation (WDF) in Hambantota (De Silva & Alles, 2008) it has been stated that 52 of the 73 microfinance borrowers (71%) report an increase in sales and profits. According to the study "Microfinance in Sri Lanka: A Household Level Analysis of Outreach and Impact on Poverty"

(Thilakarathne & Wickramasinghe, 2005) 44.2% of the microfinance clients have achieved an increase in income, whilst 53.6 % have not. This survey has further studied on income earning by clients at different income levels by dividing the clients in to 5 quintiles according their income levels.

Banuri (2006) , in his research to identify the impact of granting microfinance in order to alleviate poverty states that with a higher amount of microfinance lending the poverty will decrease due to the decrease in income inequality and increase in entrepreneurial capacity. Further developments of the study under the topics of "The increase in microfinance towards decreasing of poverty", "Decrease of poverty towards reducing income inequality" and " Granting of higher amount of MF loans to experience a higher level of entrepreneurship " the impact of microfinance on income inequality, poverty and entrepreneurial activity shows a positive relationship. Households of the developing countries (inclusive of Sri Lanka) were used as the benchmark unit in achieving the above results.

III. CONCEPTUALIZATION AND RESEARCH METHODOLOGY

This study establishes Micro Finance Facilities as the independent variable, with three sub variables namely; timely utilization of funds deployed through micro finance schemes, utilization of microfinance funds for the intended purpose (Thilakarathne & Wickramasinghe, 2005) and the risk management ability of the borrowers (Banuri, 2006). The impact of these three variables is tested against the dependent variables of household assets, household savings and household expenditure which have been identified as contributory factors in measuring the standard of living (Banuri,2006)- (See Figure 1).
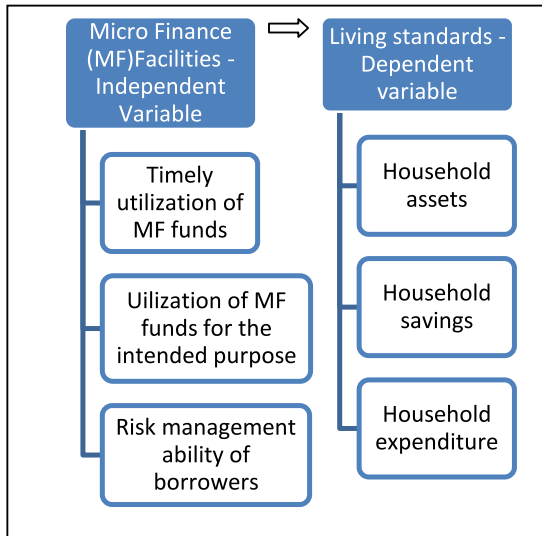
Figure 1. Conceptual framework

A. Study design and participants

Pre and post study design has been adopted where the data in relations to the living standards of the beneficiaries of the micro finance schemes under consideration, prior to disbursement of such facilities, has been collected through secondary data provided by the lenders of such schemes.

The secondary data collected has been compared and contrasted with the data collected in the study, to access the impact of micro finance schemes on the living standards. This allowed the same individual to be assessed twice, avoiding the biasness of using one –time cross sectional data to analyse the impact of such schemes. The total population of the research are the people who have obtained micro finance facilities in the selected geographical areas of Monaragala and Kegalle within the period from 2010 – 2012. For the purpose of clarity, this population has been confined to the beneficiaries of such schemes granted through licensed commercial banks within the area. As per the records, total population is identified as 465 and the sample size has been decided as 115, by adopting a confidence level of 95% with a confidence interval of 8%.

Stratified random sampling technique has been adopted in the study, where the population has been divided to three stratums according to the pre – micro finance income levels in order to achieve sampling homogeneity. The stratums are identified according to the monthly income groups of A – less

than Rs 5,000/-, B – between Rs 5,000/- to Rs 8,000/- and C – between Rs 8,000/- to Rs10,000/-.

B.The instrument

The instrument utilized for primary data gathering is a questionnaire, comprising of 21 close ended questions, structured to measure the impact of the micro finance facilities on identified determinants of living standards. The first part of the questionnaire was structured in a way to gather basic demographic details of the respondents, in order to have more classification on analysis. Same was designed bilingually. (Sinhala and English)

C.Data collection and analysis

Participant were approached in an effort to engage in a discussion, and depending on the interest demonstrated in the initial stages, they were asked to complete the questionnaire, and a small incentive was used to gain more interest from respondents. Once the data collection was completed, it was coded and analysed using the statistical package for social sciences (SPSS) – Version 16.

Data was analysed to understand the demographic details of the respondents, to establish the relationship between individual sub variables and the two main variables. It was further analysed according to the identified stratums in order to understand the income pocket which is mostly benefited from such schemes.

D. Hypotheses, Objectives and Significance

In the study, the following hypotheses were tested;

H_0 – Micro finance facilities does not have a positive impact over the living standards of borrowers

H_1 – Micro finance facilities does have a positive impact on the living standards of the borrowers.

Objectives - The foremost objective of this study is to assess the impact of micro finance facilities on the living standards of the rural poor while analyzing the improvement in the household assets, savings and expenditure has been identified as the sub objectives.

IV. DATA PRESENTATION AND ANALYSIS

A. Demographics
The selected sample consisted of 82% of males, and the majority of the sample (53%) had between 3-4 members in their families. 54% of the sample population has stated that they have been engaged in the similar employment for the past 6-10 years, while 43% has declared that the period of their current employment is more than 10 years. And the majority of them are engaged in agricultural and trading activities.

B. Analysis of relationship between independent and dependent variables
1) Timely utilization of funds: The correlation for this variable stands at 0.387, which shows an average positive relationship according to the Pearson correlation analysis. The correlation is significant at 0.01. (See Table 1)

Table 1. Correlations between Standard of living and Timely utilization of funds

		St_of_living	Timely_Utiliz
St_of_living	Pearson Correlation	1	.387**
	Sig. (2-tailed)		.000
	N	115	115
Timely_Utiliz	Pearson Correlation	.387**	1
	Sig. (2-tailed)	.000	
	N	115	115

**. Correlation is significant at the 0.01 level (2-tailed).

It is evident through the collected data that the timely utilization of funds deployed through micro finance facilities is positively impacting the living standards of the rural poor.

The R^2 linear value of the above two variables has been identified as 0.150 as illustrated in the below graph.
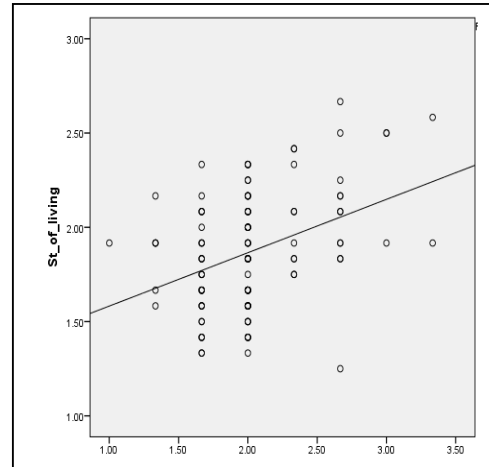

Figure 2. Linear regression between timely utilization of funds and the response variable (living standards)

2) Utilization of funds for the intended purpose: The correlation for this variable stands at 0.558, indicating a strong positive relationship between the said variable and the standard of living. (See Table 2)

Through the below data analysis, it is evident that there is a strong "positive relationship" between the two variables, indicating that it has a positive impact in improving living standards.

Table 2. Correlations between Standard of living and utilization of funds for the intended purpose

		St_of_living	Intended purpose
St_of_living	Pearson Correlation	1	.558**
	Sig. (2-tailed)		.000
	N	115	115
Intended purpose	Pearson Correlation	.558**	1
	Sig. (2-tailed)	.000	
	N	115	115

**. Correlation is significant at the 0.01 level (2-tailed).

Upon reviewing the ideas expressed by the lenders of these schemes, it denotes that they consider the fact "utilization of money for the intended purpose" as a requirement in considering further credit facilities. This could have been the contributory factor for the positive relationship but the study has not collected necessary data in order

to establish a relationship with the lenders initiative and the above independent variable. The linear value (R^2) for utilization of funds for the intended purpose and the living standards were calculated at 0.311.
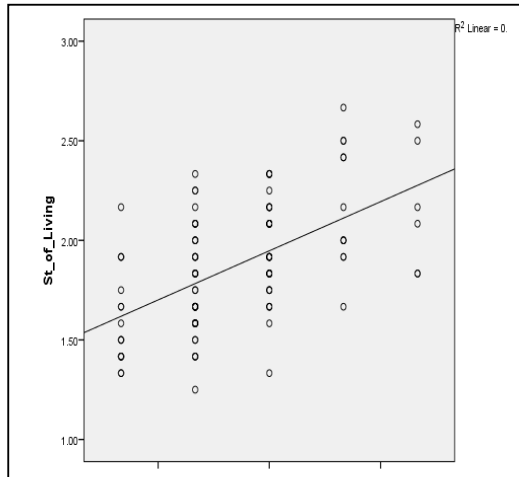

Figure 3. Linear regression between utilization of funds for the intended purpose and the response variable (living standards)

3) Risk management ability of the borrower: The Pearson correlation for this variable is calculated as 0.149, which indicates a positive relationship, but comparatively to the previous variables the relationship is weaker (See Table 3) The linear regression value between the two variables is calculated at 0.022 (See Figure 3)

Table 3. Correlations between Standard of living and risk management ability of borrowers

		St_of_Living	Risk_Mgmt
St_of_Living	Pearson Correlation	1	.149
	Sig. (2-tailed)		.112
	N	115	115
Risk_Mgmt	Pearson Correlation	.149	1
	Sig. (2-tailed)	.112	
	N	115	115

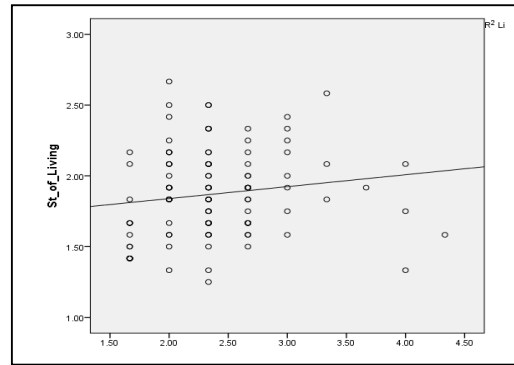**. Correlation is significant at the 0.01 level (2-tailed).

Figure 4. Linear regression between risk management ability of borrowers and the response variable (living standards)

Most of the participants of the study found that this area is intriguing as they were trying to provide an overview of the knowledge provided by the lending institutions along with the funds in managing their enterprises. The respondent's experience with regard to this learning process varied, indicating an inconsistency within the system of imparting such knowledge. Nevertheless, as proven by data, the risk management ability of the borrowers has a positive impact on their living standards.

4) Relationships indicated within sub variables: in analysing the relationship between the sub variables, it was indicated that the correlation value between each of the sub variables indicate a positive relationship, having a correlation value varying from 0.122 to 0.326, when identified at the significance level of 0.01. This indicates that even with an indicative positive relationship between sub variable, the relationships are only weakly positive. With regard to the increase in household savings and household assets, two interesting points were revealed in the process of data gathering. Most of the respondents could not assure that they have a significant increase in household savings due to the micro finance loans, but none of the responses were affirmatively negative.

Household savings of the micro finance borrowers plays a vital role in increasing their living standards. This could lead to building up of a capital which could be utilized as additional capital in investment projects. This would result in higher returns as a *scale effect* (Stiglitz, 1974) thus increasing their living standards.

Table 4.Correlations between utilization of funds for the intended purpose and household savings

		Savings Habit	Int_Purpose
House hold Saving s_	Pearson Correlation	1	.326**
	Sig. (2-tailed)		.000
	N	115	115
Int_Pu rpose	Pearson Correlation	.326**	1
	Sig. (2-tailed)	.000	
	N	115	115

**.Correlation is significant at the 0.01 level (2-tailed)

The above table indicates the relationship between utilizing the micro finance funds for the intended purpose and household savings. The relationship is positive with an indicative correlation value of 0.326. When the household savings is tested against the other two independent sub variables, a correlation value of 0.211 and 0.174 was indicated for the timely utilization of money and risk management ability respectively. This indicates that the household savings is indicating the strongest positive relationship with utilization of funds for the intended purpose.

In analysing the relationship between household assets and the identified independent variables, it was revealed that the most important factor affecting household assets is the utilization of funds for the intended purpose. In calculating the Pearson correlation between the variables it was proven with a correlation value of 0.352 between household assets and utilizing micro finance funds for the intended purpose. Timely utilization of funds and Risk management ability indicated correlation values of 0.300 and 0.122 respectively with the household assets.

Table 5.Correlations between utilization of funds for the intended purpose and household assets

		HH_assets	Int_Purp
HH_Ass ets	Pearson Correlation	1	.352**
	Sig. (2-tailed)		.000
	N	115	115
Int_Pur p	Pearson Correlation	.352**	1
	Sig. (2-tailed)	.000	
	N	115	115

**. Correlation is significant at the 0.01 level (2-tailed).

In relations to the household assets, it was revealed that even when an increase in household assets have taken place due to micro financing, if a time of depression arises, the respondents are of the habit of disposing same in order to raise emergency funds. The researcher identifies this as a possible consequence arising from the non availability of household savings.

In analysing the relationship between household expenditure and the independent sub variables, the most significant relationship was indicated between household expenditure and utilizing the funds for the intended purpose at the correlation value of 0.366.

5) Findings according to identified stratums: the collected data was analysed separately according to the identified stratums prior to arriving at the final findings indicated above. It was revealed that the positive impact of the macro finance facilities in improvement of living standards were more strongly indicative in the income group "C" with a pre credit income level of Rs 8,000/- to Rs 10,000/-. This indicates that compared to the lowest level of income earners, the average income earners gain more benefits in increasing their living standards as a result of receiving micro finance facilities. For further precision, the individual variables were also analysed for income stratums, and it was indicated that within the income group C, the risk management ability shows a stronger relationship with living standards in comparison to the group A and B. This could be the reason for the higher improvement of living standards within the members of group "C", and it could be identified that they have developed the ability of managing risk better than the other income groups. This indicates a contrasting finding to the study undertaken by Thilakarathne and Wickramasinghe in 2005, where it has been stated that the lowest level of income generators reap the highest benefits of such schemes. Nevertheless in that study the impact of micro finance facilities are analysed on the income levels of the selected segments, but not on the living standards. Apart from the above findings, it has also been identified that only 18% of the sample has been females and the balance was represented by males. The main two areas funded by the micro facilities are agriculture and trading. There are no negative relationships identified during the analysis of data collected through the study.

6) Hypotheses testing: According to the data gathered and analysed, hypotheses testing proves that the null hypotheses of "Micro finance facilities does not have a positive impact over the living standards of borrowers" could be rejected and the alternative hypotheses of "Microfinance facilities does have a positive impact on the living standards of the borrowers" is accepted.

V. CONCLUSION

As per the statistically analysed data gathered through the research, it is evident that the variables identified as contributory factors of micro finance facilities; timely utilization of micro finance funds, utilization of funds for the intended purpose and the risk management ability of the borrower, is proven to have a positive impact on the living standards of the rural poor. Among the identified factors, utilization of funds for the intended purpose deployed through such facilities has indicated the highest positive correlation value with the living standards. This is indicated in relation to all three dependent variables identified namely; household saving, household assts and household expenditure. Although a positive relationship has been established, the increase in the household savings and the household assets indicated a weaker relationship with the independent variables when compared to household expenditure, thus indicating the increase in the income of the borrowers has been utilized for spending rather than savings.

The improvement of the living standard by availing of micro finance funds is mostly evident in the pre – credit income group of Rs 8,000/- to Rs 10,000/- per month. It further indicates that, although micro finance desires the improvement of the living standards of the lowest income level; the required development is lacking at the bottom layer of the development pyramid; the lowest income pocket. Further, the demographic analysis indicates that the micro finance method adopted by the Sri Lankan commercial banks, do not consider a gender preference, which is not in accord with the Grameen model developed by Prof. Mohammed Yunus giving priority to women borrowers.

In analysing data it was revealed that 64% of the clients reported a financial relationship between 6 - 10 years with their respective lenders. This indicates that the majority of the micro finance borrowers are engaged in the borrowing activities for a longer period of time, indicating that they have reaped repeated benefits out of the schemes and their repayments have been in order, as it is evident that the lenders have willingly continued the relationships.

In analysis of the individual variable the weakest positive relationship was indicated with the independent variable of risk management ability of the borrowers. This emphasises the fact that though the auxiliary service of micro financing, steps should be taken to educate borrowers on risk management capabilities and adaptation of risk mitigating methods.

It could be concluded that there certainly exists a positive impact of the micro level development initiatives in the form of micro finance facilities granted by the commercial banking system organizations on the upliftment of the living standard of the rural poor in Sri Lanka.

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