



## IMPACT OF MICROFINANCE OF DEBT TRAP OF RURAL POOR IN SRI LANKA

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### AUTHOR'S CONTRIBUTION

The sole author designed, analyzed, interpreted and prepared the manuscript.

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### ABSTRACT

Microfinance, a widely regarded instrument for poverty alleviation around the world, has been employed in Sri Lanka for decades. Despite the country's lengthy history and huge number of organizations providing microfinance services, little is known about the influence of microfinance on poverty alleviation in Sri Lanka. It is a well-known fact now that due to this limited knowledge of microfinance has been surpassed and rural poor has been negatively affected by the debt trap. Although microfinance programs have been enforced with the aim of uplifting the living norms of the poor, their negative impact has increased nearly. But while the positive impact of microfinance can be seen in numerous studies, there seems to be little studies on the negative impact of microfinance on the poor, similar as debt trap. This study seeks to give an overview of microfinance and the problem of debt trapping.

**Keywords:** Microfinance; poverty; debt trap; poor; microfinance services.

### 1. INTRODUCTION

Microfinance includes the delivery of fiscal services to the poor. Historically, microfinance substantially refers to microcredit. The core principal under the operation of microfinance is to give loan to group of borrowers.

Microfinance is a type of banking service furnishing to unemployed or low-income groups who have no other access to fiscal services.

According to Muhammad Yunus,

“(microcredit) is grounded on the premise that the poor chops which remain unutilized. It is surely not the lack of chops which make poor people poor... charity is not the answer to poverty. It only helps poverty to continue. It creates reliance and takes down

the existent's action to break through the wall of poverty. Unleashing of energy and creativity in each human being is the answer to poverty” (Muhammad Yunus, increasing microcredit outreach to attain renaissance development aspirations, Dhaka, Bangladesh, January 2003, transnational forum on attacking poverty with microcredit)

And also according to Gert Van Maanen microfinance is;

“microcredit or microfinance is banking the unbankables, bringing credit services and other essential financial services within the reach of millions of people who are too poor to be served by regular bank, utmost cases because they're unfit unable to offer sufficient collateral. In general, banks are for people with money, not for people without”

(Microcredit is an excellent business or development tool, according to Gert van Maanen Oikocredit, 2004).

The supply of fiscal services to the impoverished is included in microfinance. Microfinance's basic assumption is to advance to a group of peer-reviewed peers without relying on tangible assurances, similar to traditional financing, which is commonly utilized elsewhere in the money sector [1,2].

The addition of the poor, boosting profitable growth, eliminating poverty, and the growth of social capital are all well-known benefits of microfinance, but they are not the only ones. Giving microfinance to the poor to develop small enterprises is "the result, not the problem," according to former UN Secretary-General Kofi Annan. It's a method to capitalize on their ideas... to build profitable businesses, and hence allow communities to thrive" [3]. Microfinance is a vital tool for controlling the lives of the poor, rather than a cause of global poverty. It's also worth noting that many microfinance institutions cater to female customers, as women are disproportionately excluded from financial requests and appear to be at risk of bad credit. Women account for 76 percent of global microfinance customers, according to the United Nations (Bordrox, 2008). (From Addition to Commission: Microfinance Political Counter-Accusations) (KateriR. Ciccaglione).

Many studies have explored about the positive impact of microfinance on rural households. However, only a few studies have studied why those microfinance programs affect the debt trap of the rural poor.

## **2. SRI LANKAN MICROFINANCE**

Sri Lanka has a long history of basic microfinance systems, with the 'cheetu' system operating in Sri Lanka at least before the twentieth century, according to a central bank report. Although it is a non-formal method, it is utilized to save money.

Microfinance is also expected to grow and improve the income generation conditioning and capacities of low-income people, according to the central bank of Sri Lanka [4,5]. Thus, it is envisaged that microfinance will improve the living conditions of low-income people while also allowing them to participate actively in the country's economic development.

Microfinance in Sri Lanka dates from the early twentieth century, as previously stated. The Providence and Credit United Societies (TCCSS) were pioneers in providing microfinance in the country, having been founded in 1906 [6]. Following

independence in 1948, the government adjusted its policies haphazardly in order to strengthen the rural fiscal sector's intervention. The formation of a rural fiscal sector. The first original technique was the founding of the multipurpose United societies (MPCSS) in 1957 and the United rural banks (CRBS) as the MPCSS's bank windows in 1964 [7,8].

In addition, the three-tier growth of the thrift and credit cooperative movement (often known as the SANASA movement) in 1978, which brought all of the previously isolated TCCSSs into operation, was an important development in Sri Lanka's microfinance evolution (Hulme & Mosley, 1996; Hulme & Mosley, 1996; Hulme & Mos).

The 1980s and 1990s were key years for Sri Lanka's microfinance sector, which experienced tremendous expansion. Microfinance has become a mainstream development tool, with the number of new microfinance institutions in the country rapidly increasing. It is widely regarded as a means of alleviating poverty. The formation of the Janasaviya Trust Fund (now known as the National Development Trust Fund or NDTF) in 1991 as an advanced lending institution for the microfinance industry was one of the government's major initiatives during this time. In 1986, the Regional Rural Development Banks were established, and in 1991, the Central Bank of Sri Lanka (CBSL) began the Small Farmers and Landless Lone program.

It also houses the Samurdhi Savings and Loan Program, which has over two million members and is the country's largest microfinance institution. The government established it in 1997 [9,10,11].

## **3. SRI LANKA'S CURRENT SITUATION**

Provision of financial services to low-income households has a long history in Sri Lanka, reaching back to the twentieth century. The earliest settlers in providing fiscal installations to the needy were Providence and Credit Cooperative Societies (TCCSSs), which were founded in 1911. Nonetheless, it wasn't until the late 1980s, when the government's Janasaviya program was implemented, that microfinance became widely recognized in Sri Lanka as a key tool for alleviating poverty and empowering the poor. The rise of microfinance activity in the 1990s embraced all sectors, including governmental and collaborative sectors. Another watershed moment in Sri Lanka's microfinance sector was the establishment of the National Development Trust Fund (NDTF) in 1991 as an apex lending institution [12,13].

There are currently a variety of institutions involved in providing microfinance services to low-income populations. Cooperative Societies (e.g., TCCSs), hundreds of original and international Non-Governmental Organizations (NGOs), commercial banks, and development banks like to the Regional Development Banks (RDBs) and the Sanasa Development Bank are examples of these (SDB). Furthermore, the government's Samurdhi Service and Credit Scheme, which was founded in 1996, is now one of Sri Lanka's major social rallying programs, with over 32000 village level organizations and over 1000 bank branches functioning throughout the

country. In addition, the Central Bank of Sri Lanka (CBSL) is a crucial role, as it is the execution agency for a variety of rural credit programs supported by various donor organizations and the Sri Lankan government.

### 3.1 Debt Trap

The microfinance effort can be split according to loan size, according to Gant. In this regard, loan effort has been divided into circumstances based on type and operation Gant, Silva, Atapattu, and Durrant [8].

Items	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 <sup>(a)</sup>
<b>ASSETS</b>										
Cash in Hand	39,104	50,342	66,522	75,164	87,469	103,643	123,276	158,658	167,876	183,759
Due from Central Bank	107,705	149,711	169,466	151,200	164,428	199,646	308,671	341,828	336,267	280,549
Due from Domestic Banks	11,474	51,390	40,840	25,548	43,810	80,582	74,813	78,804	78,638	87,748
Cash Items in Process of Collection	6,066	21,866	35,890	25,762	14,831	17,591	20,289	24,048	28,255	31,687
Foreign Currency on Hand and Balances due from Banks Abroad	193,240	158,567	155,013	108,503	196,950	359,740	432,933	525,901	772,110	497,561
Investments	538,474	517,045	648,725	880,866	1,081,637	1,189,962	1,282,031	1,567,654	1,586,548	1,921,778
Treasury bills	205,405	175,644	200,718	388,194	262,049	325,001	227,517	428,452	447,299	621,607
Government Securities	198,195	283,750	389,824	514,241	718,972	741,493	937,305	1,022,461	1,008,509	1,200,887
Other	134,874	57,651	58,183	68,231	82,616	123,468	117,209	116,741	110,740	99,484
Loans and Advances	1,454,618	1,905,732	2,305,613	2,547,642	2,776,488	3,477,653	4,205,719	4,890,778	5,755,754	6,014,952
Bills Purchased and Discounted	20,574	31,021	34,655	45,008	42,580	39,029	20,063	24,711	33,385	26,885
Overdrafts	338,357	373,762	495,978	489,183	531,878	605,893	707,018	864,011	1,037,776	996,307
Loans	1,086,687	1,500,949	1,774,985	2,013,271	2,202,030	2,852,731	3,478,638	4,002,056	4,684,393	4,991,760
Fixed and Other Assets	218,055	302,005	326,301	413,542	508,326	260,706	234,850	237,169	340,216	722,664
<b>Total</b>	<b>2,566,737</b>	<b>3,157,677</b>	<b>3,757,370</b>	<b>4,328,246</b>	<b>4,855,940</b>	<b>5,698,522</b>	<b>6,682,581</b>	<b>7,824,839</b>	<b>9,045,664</b>	<b>9,741,099</b>
<b>LIABILITIES</b>										
Paid-up Capital, Reserve Funds and Undistributed Profits	237,814	313,334	375,920	444,945	528,661	608,898	716,963	850,931	1,002,594	1,126,850
Demand Deposits	235,981	243,451	243,735	272,753	339,458	380,293	405,152	425,822	461,547	442,407
Inter Banks	6,920	9,856	14,865	22,321	11,629	9,539	8,923	16,193	22,497	19,040
Government of Sri Lanka	34,607	33,691	25,398	24,754	34,441	44,182	41,661	46,843	45,295	43,876
Residents	190,637	195,835	198,496	219,946	282,722	326,926	347,005	353,876	357,680	371,203
Non-Residents	3,817	4,069	4,976	5,713	10,667	6,645	7,563	8,910	36,075	10,287
Time and Savings Deposits	1,718,996	2,117,734	2,554,485	2,980,394	3,301,517	3,901,124	4,872,937	5,566,871	6,432,866	6,902,028
Government of Sri Lanka	14,851	30,840	54,401	26,422	30,513	20,150	16,419	27,973	75,433	71,846
Residents	1,405,808	1,753,896	2,143,136	2,574,215	2,848,402	3,342,124	4,046,935	4,872,014	5,596,536	6,047,243
Non-Residents	298,337	332,998	356,948	379,757	422,601	529,750	609,584	666,884	760,696	782,939
Borrowings	112,825	167,017	217,952	230,441	283,758	377,930	418,504	417,328	442,585	481,785
Domestic Inter Banks	99,473	147,275	142,492	127,460	145,315	182,212	206,131	254,942	268,771	294,479
Foreign	13,351	19,742	75,460	111,981	138,443	195,717	212,374	162,385	173,813	187,305
Other Liabilities	261,121	316,141	365,278	390,732	402,545	421,277	469,025	563,888	706,274	788,030
<b>Total</b>	<b>2,566,737</b>	<b>3,157,677</b>	<b>3,757,370</b>	<b>4,328,246</b>	<b>4,855,940</b>	<b>5,698,522</b>	<b>6,682,581</b>	<b>7,824,839</b>	<b>9,045,664</b>	<b>9,741,099</b>

(a) Provisional  
 Note: Data refer to operations of domestic banking units only.  
 Source: Central Bank of Sri Lanka

Fig. 1. 2010-2019 Assets and Liabilities of Licensed Commercial Banks



Fig. 2. Indicators of financial progress in Sri Lanka in comparison to South Asia

**Table 01. Loan amounts and usage in microfinance**

Level	Level of Loan (SLR)	Loan Utilization
1	0-3,000	Consumption
2	3,000 – 7,500	Consumption & income subsistence
3	7,500 – 30,000	Micro enterprise start up
4	30,000 – 100,000	Micro enterprises expansion & housing
5	100,000 – 500,000	Small business formalization & start up

*Source: National microfinance study of Sri Lanka survey of practices and policy, AusAID and GTZ, 2002*

*Source: Data from the World Bank's Global FINDEX Indicators in 2014. Only people aged 15 and up are included in the population figures.*

Although the end of the microfinance program was to hoist the poor, it can be seen that at present the rural poor, especially women, are trapped in a debt trap through repeated borrowing due to their incapacity to repay the loans. According to activists in Sri Lanka, an estimated 28 million individuals are trapped in debt, with over 200 compelled to commit suicide as a result.

Microfinance had promised to increase impoverished people's income generation both globally and in Sri Lanka. It developed quickly in the 1980s, reaching over 100 million donors in 80 countries by 2006. This was microfinance's golden age, with aging Nobel Laureate Muhammad Yunus declaring at the Washington Micro-credit Summit in 1997 that microfinance could deliver a world free of poverty. Microfinance has a lengthy history in Sri Lanka, providing management solutions for the poor during economic shocks and specific issues. It picked up speed after 2005, with studies showing that it increased 400 percent in Sri Lanka from 20000 to 2018. By the same year, over 2.8 million citizens were enrolled in microfinance programs, with 2.4 million (or 84 percent) of them being women.

According to the Central Bank (CB), microfinance is provided in Sri Lanka by a variety of institutions, including certificated banks, certificated finance companies, United Rural Bank (URB), Thrift and Credit Co-Operatives Societies (TCCS), divineguma banks, microfinance companies, and Non-Governmental Organizations (NGOs) (NGO). These are supposed to help those who need collateral to get a loan from a traditional bank [14,15,16]. As a result, services aren't a prerequisite for obtaining credit, and no background checks are performed. To acquire loans, borrowers merely need to show their National Identity Card (NIC). This leads to multiple borrowings and debt accumulation, which inevitably exceeds household income. Raptorial lending follows, with a focus on borrowing rather than saving. The motive is high interest rates with high-frequency inaugurations, shifting microfinance from an

investment model to a consumption model. The extremity has seen numerous borrowers to pay off their debt, like pledging their debt, like pledging their gold and jewelry.

## 4. RESEARCH OBJECTIVES

### 4.1 Main Objective

Identify how microfinance programmes affect to rural poor trap into debt.

### 4.2 Sub Objectives

- Identify the importance of microfinance and its weaknesses.
- Make some solutions for the debt trap.

## 5. RESEARCH METHODOLOGY

In this study questionnaire survey, and quizzes are used to gather primary data. Secondary data gathered from Divisional Secretariat Office, books, articles, annual reports, and other relevant documents from internet accordingly, mixed methods has been used here.

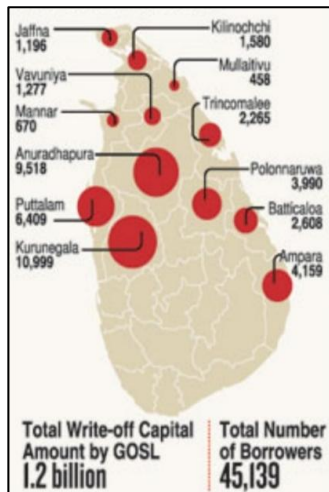
## 6. RESULTS AND DISCUSSION

According to an article first published on CADTM, one of women has explains the extremity faced by rural women Sri Lanka;

“heavily promoted in the global south since the 1980s, microfinance seemed to offer the simplest formula for poverty alleviation a small loan for generating self-employment, which could range from raising chickens to running a small village boutique. These initiatives were expected to generate incomes large enough to bring the poor out to poverty. This narrow vision of development has made microfinance synonymous with ‘poverty alleviation’.

Women in rural areas are the target of similar predatory loans. 'Empowering' women through tone – employment was the rationale.

Sri Lanka's rural poor including women are to be saved from micro finance debt trap under a special loan scheme of the present government Finance Ministry blazoned. United Rural Banks, Providence and Credit United Societies have implemented this lending scheme to help low-income people who have taken out loans from colorful microfinance providers. This debt sickness is reported to be so critical that the vulnerable rural husbandry community, especially women who were mercilessly exploited by the MFCs, have been urged to vend their properties as a last resort. Several self-murders have been reported in rural areas in the North owing to pressure wielded by MFCs to recover their debts without valuing the lives of the people. It's a revolving fund that the Treasury has released for Rs. 542 million. The government has chosen to keep the loan program going, increasing the maximum credit ceiling to \$60,000 per person. The low interest loans are being handed to obliged people in North and North Central businesses. The general treasury has formerly allocated Rs. 292 million for Northern fiefdom and a sum of Rs250 million for North Central fiefdom to United Rural Banks and Providence and Credit United Societies. It has been estimated that around people in the North Central fiefdom are suffering as they've fallen into the micro finance debt trap. Ony227 people in the fiefdom have been entered the government loan installation up to the outside of Rs. 40, 000. The periodic interest rate has been brought down to 9 percent from 14 percent [17].



**Fig.3. Debt Relief for Drought-Affected Districts - Summary Report - Number of Borrowers**

Source: progressive agrarian association.

Micro loan companies developed a list of women in need families who had not paid three months' worth of installments by June 2018 and reported it to the Treasury for refund.

The model appears to demand unsustainable payback periods and interest rates from the start. "It takes months for chickens to lay eggs and for cash to be made," one woman noted. They, on the other hand, expect us to pay off the loan within the first week. Until then, where will we get the money to feed the hens and ourselves?" As a result, many women find themselves borrowing again to pay off their first loan.

Even if a woman with exceptional business talents makes a 100% profit selling eggs, she will not be able to pay the microfinance organizations' interest rates, which range from 40% to 220 percent. How can such high interest rates be justified when market interest rates are still at 14% and credit card interest rates are at 28%?

Indeed, it is the high interest rates that have drawn non-banking financing companies into the arena of 'assisting' poor women. The lavish profits declared in their accounts, as well as the rapid expansion of Sri Lankan microfinance enterprises into Bangladesh, Myanmar, Cambodia, and Vietnam, demonstrate who has genuinely benefited from microfinance.

## 7. CONCLUSION

Microfinance grew 400 percent from 2000 to 2018 and only four (1. Berendina Micro Investment Company Limited, 2. Lak Jaya Micro Finance Limited, 3. Dumbara Micro Credit Limited, 4. Sejaya Micro Credit Limited.

The Microfinance Act has 13 NGOs and a Microfinance Company registered. Since the country's independence in 1948, successive governments have implemented several poverty alleviation programs such as Janasaviya, Samurdhi, Gami Diriya, Grama Shakthi, Gamperaliya, Diwineguma, Gmaneguma, and arunalu. These programs have typically targeted Sri Lanka's rural population, which continues to be the largest in the country, with the most recent data from 2011 showing that 77 percent of the population lives outside of civil areas. Similarly, based on its per capita income of above 4000 US dollars, the World Bank has classified Sri Lanka as an advanced middle-income country. Even if Sri Lanka were an advanced middle-income country, the majority of its population still lives in rural regions, and most government programs have aimed at rural upliftment. However, this is not the case. The deception of rural communities, particularly rural women, in a vicious debt cycle created by thousands of small microfinance organizations has reached pandemic proportions, affecting over three million people across the island [18-25]. Microfinance loans, formerly considered as a tool for rural development, are now known for

encouraging numerous borrowings and charging exorbitant interest rates ranging from 40% to 220 percent.

## COMPETING INTERESTS

Author has declared that no competing interests exist.

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