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THE EFFECT OF MICROFINANCE SERVICES ON POVERTY REDUCTION: ANALYSIS OF EMPIRICAL EVIDENCE IN SRI LANKAN PERSPECTIVES

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Abstract:
Microfinance has been identified as a powerful tool for reducing poverty in the developing counties after won the Nobel Prize for Grameen microcredit program, Bangladesh in 1986. With the rapidly spared of microfinance in the world, the researcher also paid attention to microfinance related studies. There are positive and negative impacts of microfinance on alleviating poverty in the world. This article presents the review of empirical studies that have conducted to identify the impact of microfinance on reducing poverty in the world and Sri Lanka. The review revealed that the majority of existing studies were recognized the positive relationship between microfinance and poverty and most of these studies summarized outcomes that microfinance‘s potential in reducing poverty. Few of them were realized that there were mixed effects of microfinance on poverty reduction. Furthermore, the wealth of empirical evidence available to investigate the relationship of microcredit and micro-savings on poverty alleviation while few studies had identified the impact of all elements of microfinance on poverty reduction.

JEL: G2; G21

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1. Introduction

Microfinance can be defined as a provision of a wide range of financial services such as credit, savings, insurance, and payment services to poor and low-income people (ADB, 2000; Ledgerwood, 1999; Robinson, 2001). The poor deprived of reaching into formal financial institutes because they fail to offer collaterals. Microfinance has been identified as a useful tool to combat poverty and fulfill the poor's basic needs independently and consistently. It is providing the small ratio of interest credit services to the poor will have the ability for exploiting the employment opportunities and participating in the market through engage new small-medium businesses and extending current business activities (Samer at el., 2015).

The history of microfinance goes back to the late of five centuries with established the financial cooperatives for providing microcredit to rural poor in Germany. The modern microfinance industry rapidly growth with the Nobel Prize to Mohmmad Yunus for Grameen Bank microcredit programs in Bangladesh. Hereafter, the concept of microfinance for poverty reduction has introduced in many other countries in the world. The 1980s has identified as a significant decade for microfinance institutes for providing credit facilities to poor in large scale (Robinson, 2001). Microfinance came to prominence tool for alleviating poverty with the significant impact of economically empowering low-income households. As a result, rapidly spared the government and nongovernment microfinance institutes in Asian and African countries to serve their clients. The 1990s decade named the "decade of microfinance" and Microcredit Summit launched in 1997 for developing the small business to empower the poor (Dichter, 1999). 175 million poorest households and women in their families have aimed to reach the microcredit summit (UNCDF, 2005). United Nations has declared the year 2005 as the International Year of Microfinance due to the significant contribution of microfinance for reducing the vulnerability of poverty in the world.

According to the Asian Development Bank (2000), there are three types of sources providing microfinance to poor as formal, semiformal and informal institutes. Rural Banks and Cooperatives have being playing a significant role in the formal microfinance sector in developing countries. The majority of microfinance institutions state their key objective as fascinating microcredit to poor which unable to offer the collateral to formal financial institutions. Most of the microfinance providers appreciating poor borrowers who want to develop their small-scale business and replay their loan on time; MFI offers wide financial and non-financial services that suit the poor's needs and capacity with the particular characteristics of microfinance.

According to World Bank, several main traditional characteristics can be identified with microfinance services such as small transaction credits for entrepreneurial development, free credits, Group lending, Target poor community and female, the simple application process for loans, provision of services in underserved communities, low-interest rates. There are key elements in microfinance that have been used to serve their clients. Financial services such as microcredit saving and repayment services are the main services of microfinance institutions while they are providing nonfinancial services and social intermediation services as well. Microcredit, micro-savings, nonfinancial service, social intermediation service, and insurance service are the key services providing by MFIs in the world today.

Microfinance Barometers, (2019) stated that Microfinance institutes have provides hundreds of billions of dollars loans to their clients with 11.5 percent annual growth. Also, the number of clients has increased from 7 percent annual growth rate in 2000 to 20 percent in 2012. End of 2018, MFIs have lent to 139.9 million borrowers and of this 80 % of clients are women and 65% are from rural areas. The following table presents the top ten countries and the number of borrowers at the end of 2017.

Table 1: Top ten countries and number of borrowers in 2017

Rank	Country	Borrowers FY 2017 & growth since 2016	Loan Portfolio (dollars) & growth since 2016
1	India	50.9 M (+5.8%)	17.1 B (+26.3%)
2	Bangladesh	25.6 M (3.5%)	7.8 B (+17.0%)
3	Vietnam	7.4 M (+2.8%)	7.9 B (+18.9%)
4	Mexico	6.8 M (-3.8%)	4.4 B (+5.5%)
5	Philippines	5.8 M (+16.3%)	1.3 B (+17.5%)
6	Pakistan	5.7 M (+25.9%)	1.8 B (+39.6%)
7	Peru	5.1 M (+9.5%)	12.6 B (+17.0%)
8	Brazil	3.5 M (+1.1%)	2.6 B (+2.7 %)
9	Colombia	2.8 M (-0.7%)	6.3 B (+5.6%)
10	Cambodia	2.4 M (+4.7%)	8.1 B (+21.6%)

Microfinance barometers, 2018, retrieved from http://www.convergences.org/wp-content/uploads/2018/09/BMF_2018_EN_VFINALE.pdf.

2. Empirical Studies of the Impact of Microfinance on Poverty Alleviation in a Global Context

With the popularity of microfinance, it has enjoyed a wealth of empirical studies recently and seen as one of the significant instruments to alleviating the poverty of the poor in the world. The empirical reviews were pointed out several specific findings about the impact of microfinance on poverty alleviation and many of them were highlighted the socio-economics influence of microfinance (Shamim, 2018; Mtamakaya et al., 2018; Terano & Mohamed 2017; Hassan & Saleem, 2017; Kasali et al., 2015; Boateng et al, 2015; Banerjee et al., Al Shami et al., 2014; Kabeer, 2005; Park 2001; Copestake et al., 2001; Coleman, 1999 ; Pitt and Khandker, 1998). Previous evidence shows the positive impact of microfinance on combat poverty as increases in household income and reduction of vulnerability (Pimhidzai et al., 2019; Han et al., 2019; Wright 2000; Khandker). Few studies paid attention to the impact of microfinance on health, education nutritional status among the poor (Rosenberg, 2019; Gichuru et al., 2019).

Microfinance has been using mainly in developing countries for eradicating poverty. Sri Lanka, India, Bangladesh, Pakistan, Indonesia, Zimbabwe, and Uganda had successful experiences on microfinance to increase income and assets while reducing the level of poverty. However recent past, the significant of microfinance to combat poverty has been questioned. Some researchers argue that the impact of microfinance on poverty is divergent between positive and negative impacts (Boachie, 2019; Kabasakal & Malik, 2019). The literature states that the impact of microfinance work differently in deferent context and different population. Kandker, (2005) stated that the use of microcredit as a tool for alleviating poverty depends on local circumstances.

Many previous studies identified that microfinance has been positively affecting to reducing poverty in the world (Shamim, 2018; Awojobi, 2011). They found that microfinance has a positive impact on enhancing the living standard of households, business performance, economic and social empowerment. The past studies have identified microfinance as an effective tool for improvement of the human wellbeing of poor (Shamim, 2018; Ebimobowei et al., 2012; Bakhtiari, 2006; Johnson & Rogaly, 1997; Ledgerwood, 1999). Many studies based on identifying the practical implication of microfinance and they realized government and NGO microfinance enabled to work on alleviating poverty and uplift the household wellbeing of poor.

The modern concept of microfinance came after won the Nobel Prize for Grameen Bank Microcredit Program by Mohammad Youngs in Bangladesh. Many previous studies have been identified as the impact of the Grameen Micro Credit Program and analyzed the different impacts of this program on the poor in the country. Most of them compared the impact by using a control group to identify the comparative implication of the program (Bisai, & Mazumdar, 2019; Khandker, 2001). The Grameen Bank believes that 5% of microcredit browsers exit poverty annually with a significant contribution to empowering the poor in Bangladesh (Economist, July 2009). The income of borrowers of Grameen Bank was about 28 percent higher than non-borrowers in the control village (Hossain, 1988). There is much evidence for the family income of participant households was significantly higher than for comparable nonparticipant households. Hashemi and Morshed (1997) revealed that Grameen microcredit not only for poverty reduction and it has improved the household sustainability over time. According to Khandker, Shahid (2001) beneficiaries of microfinance performed higher than non-beneficiaries in the year 1992 and the year 1999. This study was recognized that per capita income and expenditure among beneficiaries are higher than non-beneficiaries and poverty level lower among participants of the program in the above two years. The drop-out percentage increased from 5% to 10% from 91/92 to 98/99 (Khandker, 2001, p. 8).

Ramenyi (2000) stated that in the same country a 29.3 percent annual income average rise among participants while 22 percent annual income average rise among non-participants. The study was indicated the income increases among borrowers and non-borrowers differently in the country. Morduch & Haley, (2002) analyze the similar conclusions as findings of the previous study in Bangladesh as "higher rates of per capita income among microcredit borrowers compared to those who did not borrow". The recent past studies based on Grameen Bank also proved that there is a significant contribution to the poor through microfinance programs in Bangladesh. Shamim, (2018) reveals that his study there was a positive impact between microcredit program and savings, average monthly income, monthly household expenditure, property, education of participant households

With the popularity of microfinance, there was much evidence of the implication of microfinance on poverty in other developing countries as well. The literature states that the impact of microfinance work differently in deferent context and different population in the world. The usefulness of microfinance also depends on the local circumstance (Kandker, 1998). In India, 46 percent annual average income had increased among participants of microfinance while 24 percent increases reported among non-participant. Microfinance had an impact on the income of poor in the same way in Sri Lanka as well it indicated a 15.6 percent income rises of borrowers and 9 percent income was raised among non-borrowers. In Indonesia, a 12.9 percent annual income average was raised in beneficiaries while only a 3 percent rise had shown among non-beneficiaries (Remenyi et al., 2000). This evidence proved that microfinance has been influenced by the poor move in and out of poverty a great deal. Furthermore, it seems the significance of microfinance to the existence of poverty in the developing country.

According to the SHARE microfinance project in India records 50 percent of borrowers reached out of poverty while 75 percent was able to improve their living stand. Noted researchers were stated that microfinance can reach to increase the poor's income level (Kebede & Regassa, 2019; Wright, 2000; UNICEF, 1997). Many studies were revealed that microfinance has been reduced the vulnerability of the poor (Berg& Shahe Emran, 2018; Wright, 2000; Zaman 2000; McCulloch and Baulch, 2000). The increase of productive capital is one of the main ways to reduce poverty of low-income earners, microfinance able to create human capital, social capital and physical capital to poor and this can help to enhance the economic and social empowerment of poor (Otero,1999). The evidence supports that microfinance serves the poor for achieving financial sustainability.

Many noted studies have identified the impact of microfinance on women and those were indicated that microfinance was helped to increase the household income and expenses by enhancing personality affects, least up-gradation of the social and financial situation of women (Patel et al., 2018). There were many studies on microfinance on women empowerment in different countries. Sinha et al., (2019) conduct research to identify the Impact of microfinance access on three dimensions of women empowerment, which make influence upon decision making on the issues of credit, expenditure, and children. They conduct a primary survey on about eight hundred respondents of women borrowers from different microfinance institutions and apply multivariate profit estimation. Their findings imply that the greater access to microfinance credit negatively impacts economic empowerment i.e. decisions on credit and expenditure related issues.

2.1 Negative Impact of Microfinance on Poverty Alleviation

Some studies argued that there is a negative impact of microfinance on poverty alleviation while many researchers proved the positive relationship between microfinance and reduction of poverty. Previous studies have proved that there is a negative impact of the Grameen Bank micro-credit program on borrowers. Rahman, (p. 75, 1999) stated that "*more than 60% of women's loans were used by men and approx. 78% of total loans are used for different purposes than sanctioned by the project*". On the other hand, there is some social impact of Grameen microcredit programs on their households. The same author emphasis that "*out of 120 women participants, 70% agreed with an increase in aggressive behavior and violence in the household because of their involvement with the Bank*" (p. 74). Some previous literature confirms that most microfinance programs do not serve the poorest. According to Garson, (2001), there are mainly two limitations to the usage of microcredit for eradicating poverty. The first reason was microcredit cannot easily reach the poor and the second one was the majority of poor people, are the poorest of the poor, and they unable to make use of credit as they were in a hard situation to undertake a business activity. Khandker, (1998) stated that all the poor are unable to success from microfinance programs and he was mentioned that the sources of microcredit are the reasons for success and its weaknesses. Lack of entrepreneurial skills, lack of capital are the main reasons for failing too many microcredit programs. According to his view, targeted food programs and wage employment may be appropriate for the poor as the majority of rural poor are unable to become self-employed. According to Parker& Pearce, (2001) microcredit may not produce the benefits as some precondition for lending to the poor. Immediately after emergencies chronically destitute areas, lacking infrastructure, dispersed population, dependence on one economic activity, uncertain condition (war, famine) lack of services or access to markets, illness such as HIV/AIDS are the main disadvantages to produce the tangible benefit by microcredit programs.

3. Microfinance on poverty reduction in Sri Lanka

The history of the microfinance sector in Sri Lanka Goes back to 1906 with the establishment of Thrift and Credit Co-operatives Societies (TCCSs). This institute plaid a wider role as the first credit co-operatives under the British administration in the country. (Microfinance Industry Report, 2010). In 1940 Multi-Purpose Co-operative Societies (MPCSs) were eventually taken that role in 1940 and it was renamed Multi-Purpose Co-operative in 1950. Since the weak performance of TCCs, It was restructured as SANASA in 1970. Private Commercial Banks were provided limited credits to the rural sector since the lack of repayment ability of the poor. Hence, the government was established Regional Rural Development banks (RRDBs) to accessing rural people who lacked reached financial assistant from commercial banks and 1998-1999 RRD banks were restructured into six Regional Development Banks for enhancing the sound lending capability and establish the monitoring policies.

The late 1980 decade was identified as a significant era for the microfinance industry of Sri Lanka. Several national and international nongovernmental organizations have engaged in the microfinance industry and microfinance services and community development activities were the main roles of these MFs. Hereafter, the 1990 Decade was the golden era for the microfinance history of Sri Lanka since established major government and international microcredit organizations for accessing the poor smallholders in the country. The Samurdh microfinance program was established by the government as part of the Samurdhi poverty alleviation program in 1994. It was the largest microfinance and poverty reduction program after the Janasaviya program which introduced in 1986 by the UNP government.

In the middle of 2000 decade, increased the microfinance outlets to over 14, 000 in the country and those included by a different range of government and international organizations such as rural banks, NGO-MFIs, government microfinance programs (Samurdhi), etc.

During the past few decades microfinance has been playing a vibrant role in alleviating poverty and empowers the low-income earners economically and socially in Sri Lanka. Microfinance industry closely connected with the rural economy by providing micro-credits to small businesses, and nonfinancial services to poor households. With the rapid growth of microfinance activities, it has available a wealth of studies in the recent past for identifying the effects of microfinance programs on poverty reduction. Most of the studies were emphasized on analysis of the impact of microcredit and saving service on the poor's living standard. Few studies were identified for analyzing the impact of non-financial service, social intermediation service and insurance service on poverty alleviation of poor. Following section analyses the selected empirical evidence on the impact of microfinance on poverty in Sri Lankan perspectives.

The majority of previous studies summarized their outcomes that microfinance has been playing a significant role in poverty reduction in Sri Lanka. It used as a key instrument to enhance living stands of poor in the world. Microcredit facilities are helping to maintain small scale businesses to increase the family income of low-income households. Many previous studies identified the microfinance as the crucial tools for reduction of poverty and socioeconomic wellbeing and it helps to poor for increasing the income, smoothen the monthly family expenses and courage them to cope with financial shocks (Perera & Wijekoon, 2019; Rathnayake et al., 2019; Chandradasa, 2019).

The recent studies have identified as microfinance is a significant tool for poverty reduction during the last decade. Perera & Wijekoon, (2019) were conducted a study to evaluate the Berendina microfinance program on poverty reduction in Sri Lanka. The study was concluded as the Berendina program introduced the credit-plus approach in microfinance to serve its borrowers and they were empowered socio-economically through the beginning and expanding a small business in different sectors generating employment opportunities. Rathnayake et al., (2019) stated that there is a positive relationship between microfinance services and the development of Micro Small and Medium Scale Enterprise (MSMEs). Furthermore, the study suggested that to government introduce convenient tax policies for the MSME sector and increase the investment in infrastructure in rural areas. Chandradasa, (2019) was conducted a study to investigate the impact of microfinance on developing the shelter conditions of borrowers in the southern province and it was found that microfinance has helped to the borrowing households to improve their shelter conditions in terms of all the indicators of housing standards.

According to Thilakarathne et al., (2005) there is a mixed impact of microfinance on poor households in Sri Lanka. They revealed that microfinance has used to increase the income level and assets in middle-income households while enhancing the consumption expenditure of very poor households. Furthermore, microfinance has helped to the social and economic empowerment of women. Thibbotuwawa et al., (2012) have conducted a study to identify the impact of Samurdhi microfinance on household welfare in Sri Lanka. The finding of the study revealed that the Samurdhi microfinance program had a significant impact on increasing the income, consumption and education level of the poor to achieve household welfare. Silva, (2012) was conducted research using a Quasi-experimental approach to evaluating the impact of microfinance on savings and income. The research findings were recognized that microfinance has helped to increase the household per capita income and savings of participants and the overall program has benefited to indeed pro-poor.

Herath (2015) was investigated the impact of microfinance on poverty and the socio-economic vulnerability of women and the ability to form social capital through group-based microloans. They used four variables to analyses the impact of microfinance on poverty namely, access, creation of private resources, decision making, socio-economic activities. The analyses of the study were recognized that disaggregated and overall Women Empowerment Indices (WEIs) clearly show considerable development after taken loans from microfinance institutions (MFIs).

Few researchers emphasized some weaknesses of the microfinance program on poverty in Sri Lanka. Thilakarathne et al., (2005) stated that microfinance in Sri Lanka has spread wider geographical areas but NGOs and commercial Banks were limited to the extent of the outreach of microfinance activities in rural areas. The outcome of this study recognized that financial services alone were not sufficient to enhance the standard of living of the poor households. The study was suggested that MFI should be provided 'credit–plus' servicers to poor for creating strong small scale business and other economic activities. Furthermore, they emphasized the development of rural infrastructure facilities for encouraging microfinance programs by NGO –MFIs. Silva, (2012) was emphasized the effect of microfinance less on poorer households the impact of the intervention compared to richer households. According to this study, the availability of program micro credits and savings opportunities maybe not sufficient for creating sustainable income-generating projects and microfinance not being effective to increase of savings of poor participants.

Several researchers have revealed that government microfinance programs had political interference. Thibbotuwawa, et al., (2012) stressed that the inefficiencies and political interferences associated with the distribution of intended services of government Samurdhi microfinance program. (Sangjeli, S., & Mustafa, 2019; Pathirage, 2015) have found that the Janasaviya program had always been hindered by political patronage and misallocation of the resources.

4. Conclusion

Microfinance has been playing a vibrant role in eradicating poverty in Sri Lanka after the 1990 decades. There is a wider range of microfinance providers engaged in microfinance activities in the country. With the rapid growth of microfinance programs, it has available a wealth of studies in Sri Lankan context, However, the majority of study widely analyze the impact of microcredit and saving service on the poverty reduction and few of them were paid attention to other non-financial services and their impact on poverty alleviation. Many researchers were identified that microfinance has been plating a significant tool to enhance the income savings schemas, creating small business and women empowerment. Few studies have identified the mixed impact of microfinance and they stressed the political interference of government microfinance programs. This study will be useful to identify the valid knowledge gap to further researchers to their future studies.

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