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An Appraisal of MFIs in Sri Lanka

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Abstract- Small and Medium Scale Enterprises (SMEs) comprise essential elements in the lubrication and development of any economy. In Sri Lanka, the story makes no remarkable difference as SMEs outnumber the large business in the economy. Over the years the government of Sri Lanka has devised a number of policies aimed at developing SMEs. While most policies actually failed due to poor implementation, others however, succeeded. Few studies have been made in the past to identify the role of SMEs to the development of Sri Lanka's economy, its problems and prospects which created a vacuum on the role of government and other financial institutions in the development of SMEs. This article evaluates the role of Micro Finance Institutions (MFIs) as a powerful tool for the poverty alleviation and entrepreneurial development in Sri Lanka. The paper reviews the existing literature. The findings of the literature reveal that Sri Lankan SMEs face many domestic challenges in achieving economies of scale. The challenges are question marks on the viability of the MFIs, absence of a cohesive regulatory and supervisory system for the micro finance, shortage human capital, inadequacy of IT knowledge, difficulty in up-to-date services access by the sub urban practitioners, and entrepreneurs' personal shortcomings. Hence there is a need exist for a development of fully fledged micro finance industry. This paper attempts to identify the challenges as a positive step toward formulating a workable framework for the SMEs to overcome them.

Index Terms- Challenges, Employment generation, MFIs, Small Businesses

I. INTRODUCTION

The growing concern on employment generation in Sri Lanka poses a challenge not only to individuals but also to the government. At the individual level, the establishment of business enterprises particularly Small or Medium Enterprises in their own has been an alternative to lucrative employment (Muktar, 2009). Unfortunately, several problems have presented as limitations to most of the business which not only affects the growth of the enterprises but also survival susceptible. Among these numerous limitations are the problems of readily access to capital, lack of managerial expertise, poor or absence of infrastructural facilities–especially power to support smooth, effective and efficient operations.

According to Bharti and Shylendra (2011) access to capital is critical in the promotion of entrepreneurship development particularly microenterprises. Similarly, Simtowe and Phiri (2007) and Muktar (2009) stated credit as a precondition to the growth of enterprises/entrepreneurship. To enhance the growth and development of the nation and control redundancy, various efforts had been made by the government of Sri Lanka such efforts include the promulgation and establishment of Microfinance Institutions (MFIs).

Microfinance refers to all types of financial intermediation services (savings, credit funds transfer, insurance, pension remittances, etc.) provided to low-income households and enterprises in both urban and rural areas, including employees in the public and private sectors and the self-employed (Robinson, 2003). Hence it is the provision of credit and other financial services to the low-income group and micro entrepreneurs to enable them build sustainable enterprises.

In Sri Lanka, Small and Medium Enterprises have played a great role. It has been a significant provider of employment. It is estimated that in terms of value, the sector accounts for about 25 per cent of the manufacturing output. The sector is estimated to employ about 15 lakh persons in over 20 thousand enterprises throughout the country. Further, this sector has consistently registered a higher growth rate than the rest of the industrial sector. There are over 1000 products ranging from traditional to high-tech items (SMEDeF, 2010-11). It is well known that the MSMEs provide good opportunities for both of poverty alleviation and to reduce the social ills associated with unemployment in the economy. It provides the raw materials needed by the manufacturing sector hence vehicle for industrialization. Its role in the local supply of raw materials has twin positive effects of cost–saving to the manufacturing firms as well as moderation of tendency of balance of payment deficit.

Due to low assets base, bank demand for collateral denies most SMEs access to capital. Kanak and Iiguni (2007) explains that the poor who often engage in SMEs produce at subsistence level have difficulty to increase their savings or assets that could guarantee access to credit from formal finance. The contribution of MF to SME's growth lies in its support to overcome their capital problem. MFIs type of loans are usually small size and collateral is de-emphasized, greater access is avail SMEs to capital. The report by Dirk Steinwand and David Bartocha on 'How microfinance improves lives in Sri Lanka (2008) states that microfinance is a multifaceted benefactor that affords them the means to rebuild livelihood, plan for client future and that of their children, empower women 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.

II. CONTRIBUTION OF MFIs TO THE SOCIETY

A. Establish livelihood and Income Generation

The most important impact the MFIs foresee among their clients is the increase of income. Dulan de Silva and SunimalAlles (2008) found that 71% of microfinance borrowers interviewed report an increase their sales and profits via microfinance support. The study by Tilakaratna, G., Wickramasinghe, U., & Kumara, T in (2005) found that high income clients have greater potential to have increased income from microfinance than those who have less income. Outreach of Financial Services in Sri Lanka (2008) a nation-wide "demand side" survey conducted among 2,945 households in all districts except war torn districts of Killinochi, Mullaittivu and Manner reveals that 36.9% of the microfinance clients enhanced their income whilst 2 % stated it increased substantially as a result of taking credit. This portrays that microfinance is a better tool for income augmentation for poor in peaceful areas than war torn areas.

The most widespread objective among MFIs was to establish micro enterprise livelihood opportunities for poor. Aheeyar (2005) stated that the size of the loan had an effect on success rate of the business. Loans less than Rs.10,000 had less chance of success with less than 50% succeeding. Furthermore, Dulan de Silva and SunimalAlles (2008) found that more than 90% of those who borrowed from Janshakthi for the first time to start a business had succeeded in the business while only 10% percent has failed. Hence the microfinance is well-proved as an effective tool for micro enterprise development; the tool should be used in a right manner to accomplish desired results as is common to any tool people use in their life.

B. Improving Housing Conditions

Quality of life goes hand in hand with the quality of living conditions and both are a part of a value added future for poor. Improved housing conditions strongly impact the physical and emotional wellbeing of a family and microfinance has played its part in maintaining this wellbeing of thousands of Sri Lankan families. Either through direct housing or related loans for the improvement of living condition or indirectly through an increased household income, which is then invested in to improving housing conditions microfinance has been instrumental in adding value to the lives of microfinance clients. Tilakaratna, G., Wickramasinghe, U., & Kumara, T (2005) have shown in their study that 38.3% of microfinance borrowers reported an improvement in housing whilst only 21% of those in the control group who had not taken microfinance showed an improvement in housing.

C. Empowering Women (Gender Impact)

Tilakaratna, G found that women play an active role in microfinance: they borrow as well as save. The loans they have borrowed have mainly been used in self employment, cultivation and other productive activities. The findings reveals that while the provision of microcredit can enhance a woman's status within a household as she is a source of an important resource to the household, the social intermediation process of many MFIs in conjunction with microcredit, is likely to have a higher significant effect than credit alone.

D. Saving Habit

MFIs have played a crucial role in including savings habits among their members, particularly those from the poorest categories. A significant proportion of households do not have savings in any institutions before joining in a MFI.

III. CHALLENGES TO MFIs IN SRI LANKA

Although the variety of MFIs provides many benefits to the clients across the country the challenges face by the sector are many and they exist at all levels, macro and micro.

A. Absence of a cohesive Regulatory System

This is a key barrier to transformation and scaling-up of many MFIs. Sathis De Mel (2009) illustrates that savings has been recognized as a key financial product required by the poor. Savings was seen as the tool to enhance one's own resources as well as confidence on his/her way out of indebtedness and poverty. Savings used as a form of informal collateral as well as an indicator of financial discipline. The savings is a strong capital base for MFIs. Although the acts of parliament within which most of the MFIs are registered do not provide legal power, savings mobilization were promoted among MFIs by donors as well as government managed poverty alleviation projects. The need for a comprehensive regulatory system was recognized by the MahindaChintana which stated that "the absence of a unique supervisory and policy framework for microfinance has allowed the proliferation of fundamentally unsustainable MFIs…..". Though this issue was highlighted in many studies indicating that the government fails to enforce laws against microfinance NGOs in mobilizing savings deposits, there is no clear legal path has been offered for those institutions subject to cautious supervision.

B. Poor Quality of human resources

The quality and skill levels of MFI staff seem to be issues that cut across the institutional types. In the MFI survey, staff issues ranked among the top 5 challenges faced by most MFIs. The cause of the problem however, differs across institutional types. The Samurdhi Bank Societies face overstaffing as they are frequently used to achieve political objectives by providing employment for political supporters. The Sanasa societies work through a large number of voluntary staff. Qualified individuals usually seek better paid jobs as permanent job elsewhere, hence less qualified individuals volunteering for positions in the societies. Relatively poor remuneration and difficult working conditions for microfinance providers working in remote rural areas are also contributory factors in the issue of attracting and retaining qualified staff. In the NGO-MFIs most of which originated as social service organizations, the staff still have a more "development and social welfare" approach and are unsuited to the task of managing a financial services business since the basic knowledge of accounting, IT and human resource management is very low. This has resulted in weak organizations, especially at middle management level.

C. Involvement of government in retail credit provision

Participation of government in retail credit provision is common as more than half of microfinance clients are with government owned or controlled institutions. This lay concrete on the way for political interference in these institutions and a mixing of social, political and financial objectives to the damage the name of the institution.

D. Inadequacy of IT Knowledge

The use of information technology in the microfinance sector is still very limited. Over the past 6 years that computerized systems were introduced with the installation of the MicroBanker. The need of ICT, in improving delivery technologies and reducing transaction costs is now being explored by an increasing number of institutions. However, very low IT knowledge among the staff of MFIs, particularly in the NGO sector, has been a preventive factor to get into the full potential use of technology to improve basic information and monitoring systems.

E. Lack of transparency and standardization

There is an overall lack of transparency and reluctance to share even the most basic, nonfinancial operational information among MFIs, even those who are not direct competitors. This is due in part to manual systems being used, resulting in unreliable operational and financial information.

Lack of standardized information is also an issue. Different MFIs have different indicators for monitoring their performance, measuring portfolio quality, etc. Some MFIs, particularly unregulated institutions in the NGO sector, are unaware of what information should be collected and which indicators should be used to monitor their performance.

IV. CONCLUSION

Reviews of the existing literature find out the influence of MFIs on SMEs. The existing reviews confirm the favorable contributions of MFIs loans/insurance/services towards promoting its clients' market share, production efficiencies and competitiveness. Although the viability of MFIs in Sri Lanka are faced with many challenges such as absence of a cohesive regulatory and supervisory system for the micro finance, shortage human capital, inadequacy of IT knowledge, and difficulty in up-to-date services access by the sub urban practitioners.

V. RECOMMENDATIONS

- Introduce academic programmes in microfinance through universities and recognized institutions.
- Monetary rewards and increased compensation flexibility to retain qualified employees.
- Initiate Quality Oriented Position Management System in MFI – NGOs.
- Impose legislation for Personnel Ceiling.
- Government should limit their interference in activities of MFIs.
- Government of Sri Lanka should introduce regulatory and supervisory framework for microfinance.

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