Literature Review on the Gendered Dynamics of Household Indebtedness: Local and Global Perspectives

Prepared By:

Vagisha Gunasekera – Senior Economist, UNDP Sri Lanka

Lihini Ratwatte – Gender Specialist, UNDP Sri Lanka

Jayani Jeerasinghe – Junior Economist, UNDP Sri Lanka

Janethree Kulawardhana – Gender Programme Assistant, UNDP Sri Lanka

Global Literature

Author: Maria Floro & John Messier

Title: Is there a link between quality of employment and indebtedness? The case of urban low-income households in Ecuador

Source: Cambridge Journal of Economics

Year: 2010

Pages: 28

Research Questions:

The study investigates the relationship between employment quality and indebtedness among low-income urban households in Ecuador. The key research questions include:

1. **What is the link between the quality of employment and the level of indebtedness in urban, low-income households?**
2. **How do gender and employment patterns affect debt servicing and financial stress?**
3. **What role do informal employment and job precarity play in increasing financial vulnerability?**

Methodology:

The study is based on **2002 sample survey data** collected from urban poor communities in Ecuador. The survey includes data from **194 households** across six urban communities in Quito and Guayaquil, involving **379 individuals** (both household heads and spouses). The study constructs a **Job Quality Index (JQI)** to measure the quality of employment and a **Debt Service Ratio (DSR)** to assess financial stress related to debt servicing.

- **Data Collection**: Information was gathered on household characteristics, employment, credit, savings, and household decision-making.
- **Statistical Analysis**: Ordinary least squares (OLS) and Heckman two-step regression analyses were employed to examine the relationship between employment quality and debt servicing. Separate analyses were conducted for men and women to explore gender differences.

Sample:

The sample consists of urban poor households where at least one family member is engaged in informal work. The study focuses on households from marginal urban neighborhoods where informal employment is prevalent.

Key Findings:

1. **Job Quality and Debt Servicing**:
    - There is a significant relationship between low job quality and higher debt servicing among the urban poor. Individuals with lower quality jobs, characterized by insecure and precarious employment, are more likely to experience higher levels of debt and financial stress.

- **Women** tend to work in lower-quality jobs compared to men, and this gender disparity is reflected in higher levels of debt servicing among female workers.

2. **Gender Differences in Employment and Debt**:
   - The study finds significant gender differences in both employment quality and debt servicing patterns. **Women** are concentrated in lower-paying, less secure jobs, such as domestic work and petty trading, which result in higher financial vulnerability and a greater debt burden.
   - Women also tend to rely on **informal credit** sources, such as loans from family and friends, at lower interest rates but smaller loan sizes. However, their debt service ratio (DSR) remains significantly higher than that of men, with 49.3% of women carrying a DSR exceeding 40% of their income.
3. **Impact of Job Precariousness and Informal Employment**:
   - Workers in precarious, informal jobs face greater income volatility and higher risks of indebtedness. Informal sector workers are more vulnerable to financial shocks, such as illness, which often force them to borrow for consumption rather than investment.
   - **Low job quality** amplifies financial stress, particularly when workers face consumption shocks (e.g., a child's illness), which disproportionately affect female borrowers.
4. **Consumption Shocks and Financial Vulnerability**:
   - The study highlights the impact of **consumption shocks**, such as health-related expenses, on indebtedness. These shocks significantly increase debt servicing obligations, particularly among women, who are more likely to borrow to cover immediate consumption needs rather than investment.

Key Analytical Messages:

1. **Employment Quality and Financial Stress**:
   - The quality of employment plays a crucial role in determining financial vulnerability. Workers in lower-quality jobs have higher debt service burdens, which exacerbate financial stress and increase the risk of poverty traps. This relationship is particularly pronounced for women.
2. **Gendered Vulnerability to Debt**:
   - The study reveals stark gender disparities in debt servicing, with women in low-quality jobs facing greater financial stress. Gender norms, household roles, and employment patterns contribute to the unequal distribution of debt burden, with women disproportionately shouldering the responsibility for household debts.
3. **Policy Implications**:
   - The findings call for **targeted policies** to improve job quality, particularly for women in informal employment. Strengthening access to stable, secure employment and providing

support for financial literacy and debt management could help mitigate the financial risks faced by urban poor households.

- The study also suggests the need for **social protection mechanisms** to reduce the impact of consumption shocks, such as health crises, which drive indebtedness and financial stress among vulnerable populations.

Conclusion:

The study concludes that there is a strong link between employment quality and indebtedness among urban low-income households in Ecuador. Workers in precarious, low-quality jobs are more likely to experience higher levels of financial stress due to increased debt servicing obligations, particularly women who bear a disproportionate debt burden. Addressing employment quality and providing financial protection mechanisms are critical for reducing financial vulnerability and improving the livelihoods of the urban poor.

Publisher: Oxford University Press

Location: Department of Economics

Author: Nathalie Girouard, Mike Kennedy, and Christophe André

Title: Has the Rise in Debt Made Households More Vulnerable?

Source: Working Papers No. 535

Year: 2006

Pages: 40

Research Questions:

The study examines the rise in household debt across OECD countries and addresses the following key research questions:

1. **What are the macroeconomic trends in household debt over the past two decades?**
2. **How have favorable financial conditions and housing market dynamics contributed to rising debt levels?**
3. **Have increased debt levels made households more vulnerable to interest rate changes, asset price shifts, and income fluctuations?**
4. **What are the micro-level risks associated with debt, especially for lower-income households?**

Methodology:

The study adopts a two-pronged approach:

- **Macroeconomic Analysis**: It reviews household balance sheets and debt trends over two decades across several OECD countries, examining key indicators such as debt-to-GDP ratios, mortgage debt, and household net wealth.
- **Micro-level Analysis**: The paper also analyzes household survey data to explore how debt is distributed across age and income groups, providing insights into which households are most vulnerable to financial shocks.

Sample:

The analysis covers **15 OECD countries**, including the United States, the United Kingdom, Germany, France, Italy, Japan, and Australia. It combines macroeconomic data on household balance sheets and micro-level survey data on debt distribution.

Key Findings:

1. **Rising Debt Levels**:
    - Household debt, particularly **mortgage debt**, has risen to historical highs in many OECD countries, driven by **favorable financial conditions** and **buoyant housing markets**. For example, in countries like the UK, Netherlands, and Denmark, household debt exceeded 100% of GDP by 2005.
    - Innovations in credit markets, such as easier access to credit and the introduction of new financial products, have helped lower-income borrowers enter the housing market and increased overall indebtedness.
2. **Household Wealth as a Cushion**:
    - Despite the rise in debt, **household net wealth** has also increased due to sharp increases in property values and equity market recoveries. This increase in wealth has provided households with a financial cushion, mitigating the impact of rising debt levels on vulnerability.
    - However, in some countries, households have leveraged their balance sheets, making them more sensitive to interest rate and house price fluctuations.
3. **Debt Servicing and Risk**:
    - **Debt servicing ratios** (the proportion of income devoted to debt repayment) have increased as households take on more debt, especially for home mortgages. First-time homebuyers and younger households (under 35 years of age) tend to have the highest debt-servicing burdens.
    - Despite higher debt levels, **mortgage delinquency rates** have generally declined over the past decade, suggesting that most households have been able to manage their debt obligations, partly due to declining interest rates and longer loan maturities.
4. **Income and Debt Vulnerability**:

- Micro-level data indicate that most debt is held by higher-income households, who are better able to manage it. Lower-income households, although less indebted in absolute terms, face greater vulnerability due to their lower capacity to service debt.
- Households in the **lower-income brackets** and **younger households** face the highest risk of financial stress due to rising debt levels. Their ability to cope with financial shocks, such as income loss or rising interest rates, is more limited.

5. **Interest Rate Sensitivity**:
    - The study highlights the potential risks posed by **rising interest rates**. An unexpected and significant increase in interest rates could strain household finances, particularly in countries where **adjustable-rate mortgages** are common, such as Australia, Spain, and Italy.
    - In such cases, households may need to divert a larger share of their income toward debt servicing, which could reduce consumption and slow economic growth.

Key Analytical Messages:

1. **Macroeconomic Trends Mask Vulnerability**:
    - While aggregate debt levels and household wealth have increased, macroeconomic indicators may hide the vulnerability of certain segments, especially **lower-income and younger households** who carry disproportionately high debt burdens relative to their income.
2. **Wealth Effects and Savings**:
    - The study finds a negative relationship between rising household wealth and savings rates. Households have tended to save less as their net wealth increases, particularly in countries with strong housing markets. This reliance on wealth gains rather than active savings increases the risk of financial instability in the event of **asset price corrections**.
3. **Micro-level Risks**:
    - The micro-level analysis shows that **debt distribution matters**. While higher-income households hold the majority of debt, the impact of rising debt is more acutely felt by lower-income households. These households are more susceptible to economic shocks, as they have lower financial buffers.
4. **Future Vulnerabilities**:
    - Whether households remain financially secure depends on future developments in **interest rates, house prices, and incomes**. A significant economic shock in any of these areas could trigger increased debt-servicing burdens, leading to reduced consumption, higher savings, and potential economic slowdowns.

Conclusion:

The study concludes that while most households have been able to manage their rising debt levels due to favorable financial conditions and wealth accumulation, there are growing vulnerabilities, particularly among **younger and lower-income households**. Policymakers need to monitor household debt closely, particularly in light of the potential for interest rate increases and asset price corrections, which could expose fragile households to financial stress.

Publisher: OECD Publishing

Location: OECD Economics Department

Author: Mark Jickling

Title: Consumer Bankruptcy and Household Debt

Source: Congressional Research Service

Year: 2005

Pages: 5

Research Questions:

This report, prepared for the U.S. Congress, examines the rising incidence of consumer bankruptcy filings in the United States and the relationship between household debt and financial distress. The key research questions include:

1. **Why have consumer bankruptcy filings increased so dramatically in recent decades?**
2. **What role does household debt play in driving bankruptcy filings?**
3. **How do income distribution and debt burden impact financial distress among families?**
4. **What policy reforms can address the growing problem of consumer bankruptcy?**

Methodology:

The study utilizes data from multiple sources, including the **Federal Reserve's Survey of Consumer Finances** and the **Administrative Office of the U.S. Courts**, to analyze trends in bankruptcy filings, household debt, and the financial burden on U.S. families. The report examines macroeconomic data on debt levels and micro-level data on the distribution of debt across income groups.

Sample:

The analysis focuses on U.S. household data from 1980 to 2004, tracking trends in both **consumer credit** and **mortgage debt**. The study includes a breakdown of household debt by income percentile, examining the financial distress experienced by families in different income brackets.

Key Findings:

1. **Dramatic Increase in Bankruptcy Filings**:

- Between 1980 and 2004, the number of consumer bankruptcy filings in the U.S. increased more than fivefold. While business bankruptcy filings peaked in the late 1980s and declined thereafter, consumer filings continued to rise, setting new records year after year, particularly between 2001 and 2003.
- In 2004, however, there was a slight decline in consumer filings by 3.8% compared to the previous year.

2. **Household Debt Growth**:
   - Household debt, particularly **mortgage debt**, has risen sharply over the same period. By 2004, total household debt had reached **$7.5 trillion**, with mortgage debt accounting for the bulk of this figure. Consumer credit, which includes **revolving credit** (mainly credit card debt) and **non-revolving credit** (e.g., auto loans), also grew significantly.
   - Despite rising debt levels, the **debt burden** (the percentage of household income used to repay debts) remained relatively stable between 1990 and 2004, fluctuating between **10.8% and 13.3%** of disposable income. This stability was due to historically low interest rates, which allowed households to take on more debt without increasing their debt service costs significantly.
3. **Financial Distress and Income Distribution**:
   - The burden of debt does not fall equally on all households. **Lower-income families** are much more likely to experience financial distress. In 2001, **27%** of families in the bottom quintile of the income distribution devoted more than 40% of their income to debt service, compared to just **2%** of families in the top quintile.
   - Although aggregate debt burdens remained stable, the incidence of financial distress (defined as devoting over 40% of income to debt service) was disproportionately concentrated among lower-income households.
4. **Income Distribution and Bankruptcy Filings**:
   - The report suggests that the rise in consumer bankruptcy filings is more closely linked to the financial struggles of specific demographic groups, particularly **low-income families**, rather than macroeconomic factors like interest rates or overall debt levels. Many lower-income households take on high levels of debt relative to their incomes and are more vulnerable to financial shocks, such as job loss, illness, or divorce.
5. **Bankruptcy Reform Proposals**:
   - In 2005, the U.S. Senate passed bankruptcy reform legislation (S. 256), which sought to make it more difficult for some consumers to discharge their debts through bankruptcy. The reform was driven by concerns over rising bankruptcy rates and a perception that the current system was too **debtor-friendly**, encouraging consumers to borrow irresponsibly.
   - Proponents of reform argued that many individuals were taking advantage of the system by filing for bankruptcy even though they could repay their debts. Critics, however,

pointed out that most bankruptcy filers were in financial distress due to circumstances beyond their control, such as medical bills or unemployment.

Key Analytical Messages:

1. **Unequal Distribution of Debt Burden**:
    - The study highlights that the growing household debt burden is not distributed equally across income groups. Lower-income families face significantly higher debt servicing burdens, which contributes to their financial vulnerability and increases the likelihood of bankruptcy filings.
2. **Impact of Low Interest Rates**:
    - The stability in the overall debt burden, despite rising debt levels, can be attributed to historically low interest rates, particularly on mortgages. However, this trend could reverse if interest rates rise, potentially leading to increased financial strain on indebted households.
3. **Financial Distress among Vulnerable Populations**:
    - The report emphasizes that consumer bankruptcy filings are primarily driven by financial distress among **low- and middle-income households**. Vulnerable populations, such as the uninsured, divorced individuals, and those living in states without mandatory uninsured motorist coverage, are more likely to experience financial hardship and file for bankruptcy.
4. **Policy Implications**:
    - The findings suggest that addressing the rise in bankruptcy filings requires a focus on the underlying causes of financial distress, particularly among lower-income households. Policies aimed at improving access to affordable credit, providing better social safety nets, and addressing health care costs could help reduce the number of bankruptcy filings in the future.

Conclusion:

The study concludes that rising household debt has made lower-income families particularly vulnerable to financial distress and bankruptcy. While macroeconomic conditions, such as low interest rates, have helped keep debt burdens stable for most households, the growing inequality in debt distribution poses significant risks. Policymakers need to address the root causes of financial distress among vulnerable populations to prevent further increases in consumer bankruptcy filings.

Publisher: Library of Congress

Location: Government and Finance Division

Author: Orla May, Merxe Tudela, and Garry Young

Title: British Household Indebtedness and Financial Stress: A Household-Level Picture

Source: Quarterly Bulletin

Year: 2004

Pages: 2

Research Questions:

This study, conducted by the **Bank of England**, aims to provide a detailed picture of British household indebtedness and the financial stress experienced by different groups. The key research questions include:

1. **What are the levels of household debt in Britain, and how is debt distributed across income groups and housing tenures?**
2. **What proportion of households are experiencing financial stress as a result of their debt levels?**
3. **How do factors like homeownership, income, and expenditure patterns affect financial stress?**

Methodology:

The study is based on data from a **household survey** conducted in **September 2004**. The survey gathered information on household borrowing, housing wealth, and attitudes toward debt. It includes detailed questions about debt levels, debt servicing obligations, and financial stress indicators, such as difficulty making payments and falling behind on bills.

- **Data Collection**: The survey was designed to provide up-to-date insights into British household indebtedness and identify the characteristics of households facing financial stress.
- **Analysis**: The report examines both aggregate debt levels and disaggregated data to identify differences across **homeowners**, **renters**, and **income groups**.

Sample:

The survey included **British households** across a broad spectrum of income levels, housing tenures, and debt types. Particular attention was paid to the distinction between homeowners (who hold the majority of household debt) and renters (who, while having smaller absolute debt levels, are more likely to experience financial difficulties).

Key Findings:

1. **Household Debt Distribution**:
    - The study found that the vast majority of household debt in Britain is owed by **homeowners**. In contrast, **renters** are more likely to face debt-related problems, but their share of total household debt is small.

- A significant portion of household debt is tied to **housing wealth**, with mortgages accounting for the bulk of total indebtedness. The survey found that **40%** of total household debt was owed by households spending more than **25% of their gross income** on debt servicing.

2. **Financial Stress and Debt Servicing**:
   - **Renters** were found to be more vulnerable to financial stress than homeowners. They were more likely to report difficulties meeting debt payments and falling behind on bills. However, renters' total share of household debt was much smaller compared to homeowners, who held most of the mortgage-related debt.
   - **Homeowners**, while accounting for a larger proportion of debt, showed fewer signs of financial distress compared to previous decades, due in part to **lower interest rates** and relatively stable house prices during the survey period.
3. **Income and Debt Service Burden**:
   - Financial stress was closely linked to the **debt service burden** (the proportion of income spent on debt payments). Households with higher debt service burdens (those spending more than 25% of their income on debt repayments) were more likely to experience financial difficulties, though the report notes that overall financial stress levels had declined compared to the 1990s.
   - The survey revealed that low-income households, particularly those with high debt service burdens, were disproportionately likely to experience **financial distress**.
4. **Debt Problems Over Time**:
   - Compared to a decade earlier, the percentage of households with debt problems had decreased. While 40% of debt was owed by households spending a significant portion of their income on servicing debt, the share of households currently in financial distress was lower than in the early 1990s.
   - The report attributes this trend to **favorable economic conditions**, including low unemployment and interest rates, which helped households manage their debt obligations more effectively.
5. **Attitudes Toward Debt**:
   - The survey found that most households were not overly concerned about their debt levels. Many homeowners viewed their **mortgage debt** as manageable, given the long-term appreciation of housing wealth. However, some respondents, particularly among renters and low-income groups, expressed concerns about their ability to meet future financial obligations, especially if interest rates were to rise.

Key Analytical Messages:

1. **Homeowners Hold Most Debt, But Are Less Stressed**:

- The majority of British household debt is concentrated among homeowners, primarily due to mortgage obligations. However, due to favorable economic conditions, homeowners are less likely to report financial distress compared to previous periods. **Low interest rates** and rising property values have helped mitigate the burden of mortgage debt for many.

2. **Renters Face Greater Financial Stress**:
   - While renters hold less overall debt than homeowners, they are more likely to experience financial stress. The study highlights the **disparity in financial resilience** between homeowners and renters, with renters more vulnerable to economic shocks and difficulties meeting debt obligations.

3. **Income Disparities in Debt Burden**:
   - Households with lower incomes are more likely to face financial difficulties, particularly if they have high debt service ratios. The study points out that debt servicing costs, relative to income, are a key predictor of financial stress, particularly among low-income and renter households.

4. **Debt Service Ratios as Indicators of Financial Stress**:
   - The report underscores the importance of **debt service ratios** as a key indicator of financial vulnerability. Households with a high proportion of income devoted to debt repayments are more likely to experience financial stress, especially if economic conditions (such as interest rates) change unfavorably.

5. **Policy Implications**:
   - The findings suggest that policymakers should focus on providing **support to vulnerable households**, particularly renters and low-income families, to mitigate the risks of financial stress. Policies aimed at promoting **financial literacy**, ensuring **affordable housing**, and managing **interest rate volatility** could help reduce household vulnerability to debt-related problems.

Conclusion:

The study concludes that while British household debt levels are high, financial stress is concentrated among specific groups, particularly renters and low-income households with high debt service burdens. Homeowners, despite holding the majority of household debt, show fewer signs of financial distress due to favorable economic conditions, such as low interest rates. Policymakers should focus on addressing the financial vulnerabilities of renters and low-income households to ensure broader financial stability in the face of potential economic changes.

Publisher: Bank of England

Location: Macro Prudential Risks Division

Author: F. J. A. Bouman and R. Houtman

Title: Pawnbroking as an Instrument of Rural Banking in the Third World

Source: *Economic Development and Cultural change*, October 1988, Volume 37. No 1 (October 1988) pp 69 – 89

Year: 1988

Pages: 20

Research Questions:

The primary research questions addressed by the study are:

1. How can pawnbroking be utilized as an instrument of rural banking in developing economies, particularly in Sri Lanka?
2. What are the transaction costs and risks involved in pawnbroking, and how do they compare to those of formal lending institutions?
3. What are the advantages and disadvantages of pawnbroking for rural clients compared to formal and informal lending alternatives?
4. Can pawnbroking help overcome the barriers faced by formal financial institutions in serving low-income rural populations?

Methodology:

The study is based on fieldwork and data collection in Sri Lanka, with additional analysis of informal and formal financial systems across various developing countries. The authors conducted qualitative assessments of pawnbroking operations, focusing on transaction costs, borrower behavior, and the economic viability of pawnbroking in rural financial markets.

Data was gathered through visits to pawnshops in Colombo and Kandy, along with a review of pawnbroking in Sri Lanka's rural banking sector. The study uses both primary field observations and secondary sources from existing literature and economic reports.

Sample:

The research includes detailed observations from two main cases: a registered pawnshop in Kandy and an unregistered pawnshop-cum-jewelry store in Colombo. Both establishments cater to low-income rural and urban clients. Additionally, the study compares these operations with rural banking institutions offering pawnbroking services.

Findings:

1. **Transaction Costs and Efficiency**: Pawnbroking offers significantly lower transaction costs than formal banking, particularly in rural areas. The simplicity of the process—requiring no collateral beyond the pledged item and no extensive credit checks—makes it accessible and fast. Loans are often processed within minutes, whereas formal institutions require lengthy procedures.

2. **Risk Mitigation**: Pawnbroking minimizes risk for lenders because the pawnbroker already holds the pledged item, typically gold jewelry, as collateral. This contrasts with formal lending institutions that face higher risks from unsecured loans. As a result, pawnbroking offers a secure form of credit with minimal default risk.
3. **Rural Accessibility**: In rural Sri Lanka, informal financial systems, including pawnbroking, have historically played a significant role in providing credit to small farmers and low-income households. The study shows that pawnbroking has been more effective in reaching rural clients than formal banking institutions, which often exclude small borrowers due to high transaction costs and collateral requirements.
4. **Interest Rates**: While pawnbroking charges interest rates higher than formal banks, they are lower than other informal lending sources, such as moneylenders. In rural Sri Lanka, private pawnbrokers offer loans at monthly rates of 4%-7%, while formal banks charge an annual rate of 30%. Despite higher interest rates, the ease and speed of access to pawnbroking make it an attractive option for short-term credit needs.
5. **Cultural Significance of Gold**: The study highlights the cultural importance of gold in Sri Lanka, where gold jewelry serves as both a store of wealth and a form of collateral. This cultural factor makes pawnbroking particularly appealing, as it allows borrowers to unlock liquidity from their gold assets without having to sell them permanently.
6. **Competition Between Private and Public Pawnbrokers**: People's Bank (PB), a state-run bank, introduced pawnbroking services in its rural branches to compete with private pawnbrokers. However, private brokers, especially unregistered ones, offer higher loan-to-value ratios (up to 80% of the gold's market value), making them more attractive to borrowers despite charging higher interest rates.
7. **Profitability of Pawnbroking**: The study demonstrates that pawnbroking is highly profitable for both private and public lenders. In both case studies, the pawnshops generated significant returns on capital due to the low risk and high demand for pawn loans. People's Bank, which introduced pawnbroking services in its rural branches, found that pawnbroking helped turn many of its loss-making branches profitable.

Key Analytical Messages:

1. **Pawnbroking as a Bridge Between Formal and Informal Finance**: The study argues that pawnbroking can serve as a bridge between formal and informal financial markets, helping to provide credit to low-income clients who are excluded from formal banking. Its low transaction costs and risk mitigation make it an efficient tool for rural financial systems.
2. **Competition with Informal Lenders**: The study highlights the need for formal institutions like People's Bank to improve their pawnbroking services to compete with private pawnbrokers. This includes increasing loan-to-value ratios and offering more flexible loan terms to attract clients away from the informal sector.
3. **Cultural and Economic Relevance**: Gold-based pawnbroking is deeply embedded in the socio-economic fabric of Sri Lanka. It provides a viable financial safety net for families, especially in

rural areas, where formal financial services are less accessible. By leveraging the cultural importance of gold, pawnbroking meets the liquidity needs of low-income clients without forcing them to sell their assets.

4. **Policy Implications**: The study suggests that policymakers should focus on enhancing the role of pawnbroking within formal banking systems to improve financial inclusion. Rather than stigmatizing or eliminating informal lenders, governments should encourage competition by improving the efficiency and customer service of formal pawnbroking services.

Conclusion:

"Pawnbroking as an Instrument of Rural Banking" underscores the importance of pawnbroking in rural financial markets, particularly in developing countries like Sri Lanka. The study concludes that pawnbroking, with its low transaction costs, minimal risk, and cultural relevance, offers a viable solution to the challenge of providing credit to low-income rural populations. To enhance financial inclusion, formal institutions should incorporate pawnbroking as a core part of their rural banking services.

Publisher: University of Chicago Press

Location: University of Chicago

Author: John Caskey

Title: Fringe Banking and the Rise of Payday Lending

Source: Presentation for Conference "Credit Markets for the Poor"

Year: 2003

Pages: 37

Research Questions:

The key research questions of the study include:

1. What factors have contributed to the explosive growth of payday lending in the United States?
2. Who are the primary users of payday loans, and why do they prefer this form of high-cost lending?
3. How has the rise of payday lending affected traditional fringe banking services such as pawnshops and check-cashing outlets?
4. What are the broader implications of payday lending for financial inclusion and consumer welfare?

Methodology:

The study uses both primary and secondary data to explore the payday lending industry. It draws on surveys of payday loan customers, data from state regulators, and a review of the economic and legal landscape affecting payday lenders. The research also incorporates time-series data to assess the growth of the payday lending industry and its competition with other fringe banking services.

Sample:

The data used in the study include:

- Surveys of payday loan customers conducted by the author and other researchers.
- Time-series data from states such as Wisconsin and North Carolina, which track the number of payday loan transactions and the frequency of customer borrowing.
- Information from payday lenders about their customer profiles and loan-loss experiences.
- Financial reports from publicly traded companies in the payday lending and pawnbroking sectors.

Findings:

1. **Rise of Payday Lending**: The study documents the rapid growth of payday lending in the United States during the 1990s and early 2000s. By 2003, payday lending had become one of the largest segments of fringe banking, rivaling pawnbroking. Payday lenders typically charge between $15 and $25 per $100 advanced, resulting in annual percentage rates (APRs) between 350% and 1,000%. Payday loans are small, short-term loans usually given to customers with steady employment and checking accounts.
2. **Customer Profile**: Payday loan customers tend to have household incomes between $15,000 and $60,000. Most are under the age of 40, employed, and have children in their households. Although they are relatively low-income, many payday loan users have checking accounts and even credit cards, but they turn to payday loans due to immediate liquidity needs and poor credit histories that exclude them from mainstream credit options.
3. **Competition with Pawnshops**: The study finds that the growth of payday lending has slowed or reversed the growth of pawnbroking. Many customers who would traditionally use pawnshops now turn to payday lenders, as payday loans are seen as more convenient and do not require leaving personal property as collateral. Payday loans also offer larger sums than pawnshop loans, which average around $75 compared to $250 for payday advances.
4. **Impact on Check-Cashing Outlets**: Check-cashing outlets (CCOs), which traditionally provided payment services, have also entered the payday lending business, especially in states with permissive lending laws. In many cases, revenues from payday lending now make up a significant portion of CCO earnings, helping them maintain profitability as the demand for check-cashing services declines due to the rise of electronic payments.
5. **Frequent Use of Payday Loans**: A significant portion of payday loan customers are repeat borrowers. Data from state regulators in Wisconsin and North Carolina show that many customers take out multiple loans each year, often renewing or rolling over their loans. In Wisconsin, 31.4% of payday loan customers took out between 11 and 20 loans in a year, while 18% took out more than 20 loans. This frequent use raises concerns about whether payday loans are truly short-term solutions or lead to long-term debt cycles.

Key Analytical Messages:

1. **High-Cost Credit as a Necessity for Some Consumers**: Payday lending provides essential liquidity for consumers with limited access to mainstream credit. Despite its high cost, many borrowers view payday loans as preferable to alternatives like bouncing checks or incurring late payment fees, which can be even more expensive.
2. **The Dangers of Repeat Borrowing**: Although payday loans are marketed as short-term credit, many borrowers become trapped in cycles of debt by frequently renewing their loans. The high cost of borrowing and the lack of regulatory caps on loan renewals in some states exacerbate this problem.
3. **Impact on Fringe Banking Services**: The rise of payday lending has reshaped the landscape of fringe banking. Pawnshops have lost lower-risk customers to payday lenders, and check-cashing outlets have become increasingly reliant on payday loan revenue. This shift demonstrates the evolving nature of fringe banking and the adaptability of these services in response to consumer demand.
4. **Regulatory Challenges**: The growth of payday lending has attracted regulatory scrutiny, particularly with regard to the high interest rates and the potential for consumer exploitation. The study highlights the role of state regulations in shaping the payday lending industry and discusses ongoing debates about the need for greater consumer protections.

Conclusion:

John P. Caskey's study on fringe banking and payday loans provides a comprehensive look at the payday lending industry and its effects on consumers and fringe banking services. The findings underscore the tension between providing accessible short-term credit to underserved populations and the risks associated with high-cost lending. The study calls for further research into consumer behavior and regulatory reforms to better protect vulnerable borrowers from debt traps.

Publisher: Princeton University

Location: Swarthmore College

Sri Lankan Literature

Author: IOM & Centre for Equality and Justice

Title: Burden Upon Burden: Report on Socio-Economic Impact of Micro Finance and Covid-19 On Women Affected by War and Political Violence and Their Access to Reparations (Hambantota, Ampara and Kilinochchi)

Source: Report

Year: 2022

Pages: 42

Research Questions:

1. Impact of Microfinance: The study explores how microfinance schemes have affected war-affected women and their socio-economic conditions, highlighting the gender-specific challenges.
2. Effects of COVID-19: The study assesses how the pandemic exacerbated existing vulnerabilities and added new challenges to these women's economic stability.
3. Reparations: The study investigates the need for a reparations program tailored to the experiences of these women, understanding how their experiences with war, political violence, and microfinance can be linked to reparations.

Methodology:

The research uses a qualitative approach, drawing on interviews, focus group discussions, and stakeholder consultations with local government officials, civil society organizations, and ground-level field workers. A mixed-methods questionnaire was used to gather quantitative and qualitative data from 30 women borrowers (10 from each district) and 15 stakeholders. This small sample aims to provide anecdotal evidence on the impact of microfinance, COVID-19, and reparations.

Sample:

- Primary Participants: 30 women from Kilinochchi, Ampara, and Hambantota, all of whom had experience with microfinance institutions (MFIs), were impacted by COVID-19, and had some perspective on wartime reparations.
- Stakeholders: 15 stakeholders including local government officials, lawyers, and civil society workers participated, offering insights into the systemic issues surrounding microfinance and reparations.

Key Findings:

1. Impact of Microfinance: The report found that microfinance has led to a cycle of debt for many women, particularly those who took loans for non-income-generating purposes. High-interest rates, frequent repayment schedules, and unethical debt collection practices have intensified the financial burden on these women. Many borrowers were unaware of loan terms due to language barriers, with some signing loan documents in English without understanding them.

    - Women in all three districts reported facing harassment from MFI debt collectors, including home visits and inappropriate language. In extreme cases, loan repayment issues contributed to domestic violence and marital breakdowns.
    - The findings highlight the lack of proper regulatory oversight, with many women taking out multiple loans to repay previous debts, trapping them in cycles of borrowing and repayment.

2. Gendered Effects: Women, especially those heading households, faced unique challenges due to gendered roles and responsibilities. Some felt pressured to take loans to support their families, yet the absence of adequate safeguards from MFIs left them vulnerable to exploitation.
    - Women reported preference for microfinance over traditional banks due to fewer formalities (e.g., no need for guarantors), though they acknowledged this lack of scrutiny contributed to poor financial decision-making.

3. COVID-19: The pandemic significantly impacted women's ability to repay loans, as small businesses collapsed and income-generating activities were disrupted. COVID-19 exacerbated the vulnerabilities created by microfinance, with many women forced to take on new loans to service pre-existing debts.

4. Reparations: The study found that the interviewees had limited knowledge or experience with formal reparations programs. However, the women linked their current financial struggles, partly caused by microfinance, to the broader context of war and political violence. The need for reparations that account for economic justice, alongside compensation for wartime abuses, was emphasized. The report suggests that recognizing microfinance as a post-war concern is critical for any reparations program.

Key Analytical Messages:

- Microfinance as a Double-Edged Sword: While microfinance is meant to empower women economically, the study reveals that it often deepens poverty, particularly for war-affected women, due to its exploitative nature.
- Regulatory Gaps: There is a significant lack of regulatory oversight in Sri Lanka's microfinance sector. Women are not protected against unethical lending practices, and the Central Bank's Microfinance Act (2016) has failed to curb these issues effectively.
- COVID-19 as a Catalyst: The pandemic accelerated the financial instability of war-affected women, who were already struggling with the burdens of microfinance. The report calls for more comprehensive social safety nets to mitigate the combined effects of COVID-19 and financial exploitation.
- Reparations and Economic Justice: The research advocates for reparations programs that integrate economic justice into their frameworks, recognizing microfinance as a post-war burden. It argues that reparations should address the compounded socio-economic challenges these women face.

Conclusion:

The study concludes that microfinance has imposed a significant socio-economic burden on women already marginalized by war and political violence, exacerbated further by the COVID-19 pandemic. The findings call for a reformed regulatory framework for microfinance and an inclusive reparations program that addresses both war-related injustices and economic hardships.

Publisher: IOM and CEJ

Location: CEJ

Author: Anupama Ranawana & Atarah Senn

Title: "We do what we have to do": Cultures Of Indebtedness Among Women Entrepreneurs In the East Of Sri Lanka

Source: Working Paper 74

Year: 2019

Pages: 28

Research Questions:

The study seeks to understand the intersection of entrepreneurship, debt, and post-war survival in the lives of women entrepreneurs in the Eastern Province of Sri Lanka. Key questions include:

1. What do the life-worlds of entrepreneurs reveal about secure post-war livelihoods?
2. How does entrepreneurship contribute to livelihood instability in post-conflict situations?
3. What role do institutions, rules, and norms play in promoting entrepreneurship in these contexts?

Methodology:

The research was conducted over an eight-month period and utilized a qualitative approach, focusing on in-depth biographical histories, participant observations, informal interactions, and semi-structured interviews. The study worked with a panel of 20 households from two districts: Trincomalee and Batticaloa, representing communities with different levels of external support for entrepreneurial activities. This iterative method allowed the researchers to adapt the fieldwork as they gained more insight into the participants' lives.

Sample:

The study focused on 20 households of women entrepreneurs from two locations:

- Trincomalee: A port city with significant external support for entrepreneurship.
- Batticaloa: A Muslim-dominated trade hub with less external funding for entrepreneurship. Additionally, the study captured the voices of other stakeholders, including development officers, credit suppliers, and members of community organizations.

Key Findings:

1. Entrepreneurship as Survival: The study revealed that many women entrepreneurs engage in entrepreneurial activities out of necessity rather than choice or innovation. Entrepreneurship, in this context, is not driven by the desire to build businesses but is a strategy for basic survival in a precarious post-war economy.

2. Multiple Jobs: Many women juggle several jobs to maintain their livelihoods, highlighting the financial strain they face. They do not solely rely on entrepreneurship but engage in diverse forms of labor, from seamstress work to selling food, to manage household expenses.

3. Microfinance and Debt: Microfinance loans are prevalent, but they have created a culture of debt rather than providing economic relief. High-interest rates (often as high as 28%) and multiple loan commitments trap women in a cycle of borrowing and repayment, making debt a daily reality. Microfinance is used not only for business needs but for basic household expenses, blurring the lines between personal survival and entrepreneurial efforts.

4. Lack of Market Access: One of the primary challenges faced by women entrepreneurs is limited access to markets. Even when they produce goods, they struggle to sell them due to competition from larger, externally supported traders and delayed payments from vendors.

5. Spaces of Debt Resistance: In response to their debt burdens, women entrepreneurs have created informal cooperatives and community networks to share resources, market access, and financial burdens. These "spaces of debt resistance" are essential for survival, offering women a way to navigate the challenges posed by microfinance and poor market integration.

Key Analytical Messages:

- Entrepreneurship in Post-War Sri Lanka: The study critiques the narrative that entrepreneurship is a pathway to economic stability in post-war settings. It highlights how entrepreneurship is tied to a culture of debt and survival, not innovation and wealth creation, as development discourse often suggests.

- The Burden of Financialization: The post-war financialization drive, coupled with the promotion of consumer culture, has left women entrepreneurs heavily indebted. Microfinance, while theoretically a tool for empowerment, has instead deepened financial vulnerability, with many women taking out multiple loans just to meet daily needs.

- Community-Based Solutions: The study points to the importance of community-driven approaches to economic recovery. Cooperatives, local solidarity networks, and informal financial systems, such as the Muslim practice of zakath (charitable giving), provide critical support for indebted women, allowing them to resist formal microfinance debt cycles.

Conclusion:

The study concludes that current approaches to promoting entrepreneurship in post-war Sri Lanka do not adequately address the socio-economic realities faced by women entrepreneurs. Entrepreneurship is not providing a secure livelihood for these women; rather, it has created a cycle of debt and survival. The research calls for a shift in policy to recognize and support community-based, long-term livelihood strategies that prioritize economic stability over entrepreneurship-driven development.

Publisher: Secure livelihoods research Consortium (SLRC)

Location: Overseas Development Institute (ODI)

Author: Champika Dharmadasa & MM Gunathilake

Title: Determinants of household credit behavior of low-income households in Sri Lanka

Source: Asian Economic and Financial Review Vol. 13, No 10, 715 - 726

Year: 2023

Pages: 12

Research Questions:

The study aims to investigate household borrowing behavior in low-income households in Sri Lanka with three main objectives:

1. **Understanding Savings and Credit Behavior**: To analyze the savings patterns and credit behavior of low-income households.
2. **Identifying Reasons for Credit Demand**: To determine the underlying reasons why low-income households borrow.
3. **Exploring the Significance of Demographic and Socioeconomic Factors**: To assess the impact of factors such as family size, age, education, and dependents on household credit demand.

Methodology:

The study uses a **thematic analysis** and a **multinomial logistic regression analysis**. Primary data were collected from 1,500 households across six districts in Sri Lanka, selected based on criteria like poverty rates, informal sector employment, and natural disaster threats. The households represent urban, rural, and estate sectors.

- **Data Collection**: The survey took place between March and May 2021 using a semi-structured questionnaire, with 439 out of the 1,500 households identified as Samurdhi beneficiaries, while the others received assistance from government social programs.
- **Analytical Approach**: Thematic analysis was used to categorize reasons for borrowing, while multinomial logistic regression was applied to explore the influence of demographic and socioeconomic factors on credit demand.

Sample:

The sample consisted of **1,500 households** from six districts: Colombo, Anuradhapura, Puttalam, Nuwara-Eliya, Ratnapura, and Batticaloa. The households included urban, rural, and estate sectors, providing a broad representation of low-income households in Sri Lanka.

Findings:

1. **Savings Behavior**:
    - Only **439 households** reported having savings, with **66%** maintaining savings in state banks such as People's Bank and Bank of Ceylon.
    - Private banks were used by **10%** of the sample, and another **10%** used informal saving methods.
    - Reasons for preferring state banks included security and convenience, though financial literacy in Sri Lanka remains low, around **35%**, contributing to poor financial management.
2. **Credit Behavior**:
    - About **35.5%** of households reported being in debt. State and private banks accounted for **66%** of total household debt, while other deposit-taking institutions and informal money lenders accounted for **12%** each.
    - The usage of modern credit instruments like credit cards was virtually non-existent in the sample, reflecting limited adoption of financial technologies among low-income households.
    - Reasons for borrowing included house repairs (35%), income-generating activities (23%), consumption (10%), and emergencies (9%).
3. **Regression Analysis**:
    - **Key demographic factors** such as family size, number of young dependents, and school-going children were found to significantly influence credit demand. Specifically:
        - Larger family size and more young dependents increased the likelihood of borrowing.
        - Households with more elderly members were less likely to borrow.
    - The **most common reason for borrowing** was for house repairs, followed by income generation and consumption.
    - Education level was positively associated with borrowing, with households led by more educated individuals more likely to borrow.
4. **Patterns of Indebtedness**:
    - Households frequently borrowed not for productive investment but to meet daily needs or repair homes, which exacerbates their vulnerability to debt.
    - Having young dependents (children) was a critical factor driving borrowing behavior, as families with young children faced higher daily expenses, leading to reliance on loans to cover these costs.

Key Analytical Messages:

1. **Indebtedness Driven by Household Needs**: Borrowing in low-income households is largely driven by necessity rather than investment. The most common reasons for borrowing are home repairs and consumption needs, indicating that debt is primarily used to meet basic household requirements rather than to generate income.
2. **Impact of Young Dependents**: The presence of young children significantly increases a household's likelihood of borrowing. Families with young dependents face higher expenses and are more likely to take out loans to meet these needs.
3. **Limited Productive Borrowing**: Only a minority of households borrow for income-generating purposes, indicating a reliance on loans for non-productive activities, which may contribute to cyclical indebtedness.
4. **Policy Implications**: The findings suggest a need for strengthened social assistance programs, particularly targeting families with young dependents. Providing financial support to these households can help reduce their reliance on borrowing and protect them from falling into debt traps.

Conclusion:

The study concludes that low-income households in Sri Lanka tend to borrow mainly for non-productive purposes, driven by immediate household needs rather than investment. The key demographic factors influencing borrowing behavior include family size, the presence of young dependents, and the education level of household heads. To mitigate indebtedness among low-income families, the study recommends enhanced social support, particularly for households with young children, to reduce their reliance on loans for daily expenses.

Publisher: AESS publications

Location: Department of Economics, University of Kelaniya

Author: K. Romeshun; Vagisha Gunasekera; Mohammed Munas

Title: Life and Debt: An Assessment of Indebtedness and Socio-economic Conditions of Conflict-Affected Housing Beneficiaries in Jaffna, Kilinochchi, and Mullaitivu Districts

Source: Study Series No. 7

Year: 2014

Pages: 110

Research Questions:

The study focuses on understanding the role of the **Owner-Driven Housing Assistance (ODHA)** program in increasing household indebtedness among conflict-affected families in Northern Sri Lanka. It specifically explores:

1. **Does the ODHA program contribute to household indebtedness?**
2. **What are the socio-economic factors that exacerbate debt among housing beneficiaries?**
3. **How does indebtedness affect the socio-economic well-being of these households in the post-war context?**

Methodology:

The study employed a mixed-methods approach, combining **quantitative surveys** and **qualitative interviews**.

- **Quantitative Component**: A survey was conducted across **347 households** in three districts—Jaffna, Kilinochchi, and Mullaitivu. The survey gathered data on household debt levels, income, expenditures, and the reasons for borrowing.
- **Qualitative Component**: In-depth interviews were conducted with selected households and local officials to better understand the socio-economic context and triangulate the findings from the quantitative data.

Sample:

The sample consisted of 347 households that had received support through the ODHA program in Jaffna, Kilinochchi, and Mullaitivu districts. These districts were chosen due to their significant populations of internally displaced persons (IDPs) resettled after the end of the civil conflict.

Key Findings:

1. **High Levels of Indebtedness**:
    - **86%** of the surveyed households were in debt. The average debt per household was **LKR 152,489**.
    - Jaffna had the highest average household debt at **LKR 255,294**, significantly higher than the debt levels in Kilinochchi and Mullaitivu.
2. **Reasons for Borrowing**:
    - Borrowing for **livelihood activities** and **housing construction** were the top two reasons for debt accumulation.
    - Many households borrowed additional funds to cover costs that exceeded the ODHA grant. This was partly driven by aspirations to build larger homes or homes with improved features (such as compliance with cultural norms like *vaasthu*).
3. **Socio-economic Factors and Debt**:

- Households with low or irregular incomes, often relying on casual labor, were more likely to accumulate debt.
- **Female-headed households** and those with **disabled members** faced disproportionate challenges in managing construction work and financial responsibilities, contributing to higher debt burdens.

4. **Impact of Debt**:
    - The majority of households struggled to repay their loans, with **50%** of indebted households unable to make regular payments. **70%** of these households reported that their income was insufficient to cover loan payments.
    - Some households had resorted to borrowing money for basic needs, such as food, indicating severe financial distress.
5. **ODHA's Role in Indebtedness**:
    - The study concludes that the ODHA program, while not directly responsible for causing indebtedness, acted as a **catalyst**. Households were already financially vulnerable, and the additional costs related to housing construction exacerbated their debt situations.
    - The **avoidable costs**—due to aspirations for larger homes—played a significant role in increasing debt levels. On average, households that adhered to standard housing designs still incurred additional costs of **LKR 210,000**, while those that built larger or modified homes spent an additional **LKR 352,000**.

Key Analytical Messages:

1. **Owner-Driven Housing Programs and Indebtedness**:
    - The study emphasizes that the housing program itself is not the root cause of indebtedness. Instead, the lack of **sustainable livelihoods** and the aspirational choices of beneficiaries to build larger homes are the main drivers.
2. **Vulnerability and Debt**:
    - Vulnerable groups, such as female-headed households and those with disabled members, were particularly affected. These households struggled to contribute labor to the housing process and faced greater financial pressure.
3. **Financial Literacy**:
    - The study highlights a **lack of financial literacy** among beneficiaries. Many households were unaware of loan terms, interest rates, and the full financial consequences of their borrowing decisions, further complicating their ability to manage debt.
4. **Sustainable Livelihoods as a Solution**:
    - The findings point to the need for **sustainable livelihoods** as a solution to the debt crisis. Without stable income sources, households will remain trapped in a cycle of debt. The

study suggests that livelihood restoration should be prioritized alongside housing assistance.

5. **Policy Recommendations**:
   - **Tailored Support**: The study recommends tailoring housing assistance to the needs of more vulnerable households, especially female-headed households and those with disabled members.
   - **Financial Literacy Programs**: Introducing mandatory financial literacy and grant management programs as prerequisites for receiving housing grants could help beneficiaries better manage their finances and avoid debt traps.
   - **Sustainable Economic Development**: The government, in collaboration with private sector and donor organizations, should focus on creating sustainable livelihood opportunities in conflict-affected areas to reduce financial vulnerability and reliance on debt.

Conclusion:

The study concludes that while the Owner-Driven Housing Assistance program provided much-needed support for conflict-affected households, the socio-economic vulnerability of these families, coupled with aspirational housing goals and inadequate financial literacy, led to high levels of indebtedness. The primary recommendation is for greater emphasis on creating sustainable livelihoods and improving financial literacy to reduce future debt burdens.

Publisher: Centre for Poverty Analysis (CEPA)

Location: Study Commission by the Swiss Agency for Development and Corperation (SDC)

Author: Chandima Arambepola & K. Romeshun

Title: Debt at My Doorstep: Microfinance Practices and Effects on Women in Sri Lanka

Source: Working Paper Series No 30, 2019

Year: 2019

Pages: 60

Research Questions:

The study seeks to explore the impact of microfinance on women in Sri Lanka, focusing on:

1. **How do microfinance practices affect the lives of female borrowers?**
2. **What are the socio-economic consequences of debt accrued through microfinance for these women?**

3. **What mechanisms or practices do Microfinance Institutions (MFIs) employ, and how do this influence borrower behavior?**

Methodology:

This study employs a **qualitative research approach**, with data gathered through **in-depth interviews**. The research was conducted in three districts: **Monaragala, Batticaloa, and Mullaitivu**, each representing different geographic and socio-economic contexts in Sri Lanka. The interviews targeted **female borrowers** and relevant stakeholders, including **government officials** and **representatives of MFIs**.

Sample:

The sample includes **female borrowers** from three districts (Monaragala, Batticaloa, and Mullaitivu), where microfinance is prevalent. These women are predominantly from low-income households and have been targeted by MFIs offering loans for various purposes.

Key Findings:

1. **Prevalence of Microfinance and Borrowing Behavior**:
   - Microfinance has become a significant financial tool in Sri Lanka, with over **2.8 million active borrowers**, of which **2.4 million are women**.
   - Many women resort to microfinance for household needs, education, health expenses, and emergencies rather than for entrepreneurial activities. The loans are often used for **non-productive purposes**, contributing to a cycle of debt.
2. **Practices of MFIs**:
   - MFIs often lack transparency, with women borrowers receiving little information about the terms of their loans. Many women did not fully understand the **interest rates** or conditions attached to their loans.
   - The loans are approved quickly, sometimes within **three days**, without significant checks on the borrower's ability to repay. This easy access leads to **multiple borrowings** from various MFIs, compounding the debt problem.
   - Group liability is a common practice, where women form groups to collectively guarantee each other's loans. However, this often results in social tensions when one member defaults, affecting the entire group.
3. **Impact on Women's Socio-Economic Lives**:
   - Women reported significant **social and familial stress** due to debt. MFI debt collectors use aggressive methods to ensure repayment, such as **verbal harassment** and **refusing to leave a woman's house until a payment is made**.
   - Many women pawn their **gold jewelry** or borrow from **informal lenders** to repay their microfinance loans, further entrenching them in debt.

- The pressure to repay loans has led to **social discord** within communities, as women defaulting on loans affects group dynamics, leading to breakdowns in **community solidarity**.

4. **Weakening of Women's Solidarity and Economic Independence**:
   - The study found that microfinance practices contribute to the erosion of **women's solidarity**. The group lending model, which was intended to foster collective responsibility, instead created **tensions and blame** among women when repayments were not made on time.
   - Women who were initially involved in **microenterprise development** were discouraged by the difficulty in meeting **loan repayment schedules**, pushing many back into informal labor or subsistence agriculture.
5. **Preference for Microfinance**:
   - Despite the challenges, women continue to borrow from MFIs because they face difficulties accessing **state-run banking systems**, which are often their preferred financial institutions due to more favorable terms.
   - The lack of alternative community-based financial services or local NGOs providing microcredit leaves private MFIs as the dominant financial option for many low-income women.

Key Analytical Messages:

1. **Microfinance's Role in Debt Creation**:
   - Rather than being a tool for **economic empowerment**, microfinance has often led to **indebtedness** for Sri Lankan women. The study found that many loans were used for **immediate household needs**, not for income generation, which compounded the debt burden.
2. **Aggressive Lending Practices**:
   - MFIs' aggressive lending and collection practices exacerbate the financial instability of women borrowers. The use of **intimidation and social pressure** to ensure repayment has had a profoundly negative effect on the borrowers' well-being and social standing within their communities.
3. **The Need for Better Regulation**:
   - The study calls for stronger **regulatory oversight** of MFIs to protect borrowers from exploitative lending practices. Despite the introduction of the **Microfinance Act** in 2016, many MFIs operate without adequate regulatory control, leaving women borrowers vulnerable to **unsustainable lending**.
4. **Erosion of Economic and Social Resilience**:

- The debt incurred through microfinance has eroded women's **savings**, forced them to resort to **informal moneylenders**, and created **social conflicts** within communities. As a result, microfinance has weakened both women's economic resilience and their social networks.

5. **Recommendations for Policy Intervention**:
    - The study recommends **restructuring microfinance programs** to ensure they contribute to women's economic empowerment. This includes ensuring **greater transparency**, providing **financial literacy training** for borrowers, and **regulating interest rates** to prevent exploitative lending.

Conclusion:

"Debt at My Doorstep" highlights the challenges faced by women borrowers in Sri Lanka's microfinance sector. While microfinance is presented as a tool for empowering women, in practice, it has led to increased debt and social disintegration. The study calls for more robust regulations and community-driven solutions to address the socio-economic vulnerabilities of female borrowers and ensure that microfinance fulfills its promise of improving livelihoods rather than perpetuating cycles of debt.

Publisher: Canter for Poverty Analysis (CEPA)

Location: Ministry of Foreign Affairs of the Netherlands

Author: Richard Gant; Dulan de Silva; Anura Atapattu; Steve Durrant

Title: National Microfinance Study of Sri Lanka: Survey of Practices and Policies

Source: Australian Government's Overseas Aid Programme

Year: 2002

Pages: 294

Research Questions:

The study, co-sponsored by AusAID and GTZ, investigates the landscape of microfinance in Sri Lanka, addressing key questions:

1. **What are the practices and policies of microfinance actors in Sri Lanka?**
2. **How do different actors (funders, practitioners, etc.) interact with microfinance and impact its outcomes?**
3. **What are the challenges and gaps in microfinance provision, particularly in conflict-affected areas?**
4. **What role do government and international actors play in shaping the microfinance sector?**

Methodology:

The study utilized a **mixed-methods approach**, gathering data from surveys, semi-structured interviews, formal documentation, and informal discussions. Four distinct surveys were conducted:

- **Actor Survey**: Examined the roles of key players in the microfinance sector, categorizing them as funders, practitioners, or a combination of both.
- **Commercial Banking Survey**: Focused on commercial banks' involvement in microfinance, identifying challenges in reporting and transparency.
- **North and East Region Survey**: Evaluated the microfinance landscape in conflict-affected regions, assessing the role of microfinance in economic recovery.
- **Activity Survey**: Mapped district-level microfinance activity, detailing savings and credit services throughout the country.

Sample:

The study covered a wide array of actors, including **local NGOs**, **government programs**, **international donors**, and **commercial banks**. It drew from both qualitative and quantitative data sources, focusing on the activities of national, regional, and local-level microfinance providers.

Key Findings:

1. **Microfinance Landscape**:
    - **Broad-based Coverage**: Microfinance is practiced by a wide range of actors, including government, international agencies, NGOs, and co-operatives, serving various objectives like poverty alleviation, social development, and post-conflict recovery.
    - **High Supply in Southern Regions**: Districts like **Polonnaruwa, Hambantota, Kurunegala, and Matara** exhibited high levels of both microfinance loans and savings. In contrast, the **North and East regions** saw significantly lower levels of service due to conflict.
    - **Traditional and Emergency Tool**: Microfinance is used both as a traditional community-based activity and as an intervention tool for economic recovery, particularly in conflict zones.
2. **Role of Actors**:
    - **Government and International Funders**: Government bodies like the **Samurdhi Authority** and international agencies (e.g., **ADB, World Bank, AusAID**) play pivotal roles in funding microfinance programs. There has been a recent shift from hard financial instruments (like revolving loan funds) to softer tools like training and capacity-building.
    - **Political Capture and Subsidization**: Many government microfinance initiatives, such as **Samurdhi**, suffer from political influence, lack transparency, and are heavily subsidized, raising concerns about their long-term sustainability.
3. **Challenges in the North and East**:

- The **North and East regions**, heavily affected by civil conflict, present unique challenges for microfinance. Access to credit is limited, and existing co-operatives have become defunct in many areas. International NGOs play a critical role in these regions, providing much of the available microfinance services.
- Microfinance in these regions is seen as a flexible tool that aids relief efforts and supports basic needs while helping to regenerate local economies.

4. **Microfinance and Economic Recovery**:
   - Microfinance is identified as an essential component of post-conflict economic recovery, particularly in providing financial services to the poorest communities. However, the study emphasizes the need for **longer-term development planning** over short-term relief-based interventions.
5. **Sustainability and Regulatory Issues**:
   - Many microfinance programs in Sri Lanka are **unsustainable** in the long run due to high levels of subsidization, inadequate financial management, and the absence of a regulatory framework. Local NGOs and co-operatives, especially, lack the necessary financial oversight, risking the savings of poor communities.

Key Analytical Messages:

1. **Sustainability vs. Poverty Targeting**:
   - The study reveals a widespread belief among microfinance actors that **poverty targeting** and **financial sustainability** are incompatible. Many programs prioritize reaching the poorest without a clear plan for long-term financial viability.
2. **Political Influence in Microfinance**:
   - Microfinance in Sri Lanka is susceptible to **political capture**, particularly in government-managed schemes like Samurdhi. This undermines transparency and accountability, leading to inefficiencies and unequal distribution of services.
3. **Need for Regulation and Capacity Building**:
   - The study calls for a stronger **regulatory framework** and improved **financial management** in the microfinance sector. Training programs and capacity-building initiatives are essential for ensuring that microfinance institutions operate sustainably and effectively.
4. **Regional Disparities**:
   - There is a stark contrast in microfinance provision between the well-served **Southern districts** and the conflict-affected **North and East**. The latter requires targeted interventions, including **economic recovery initiatives** and enterprise development programs, to rebuild its financial infrastructure.
5. **Donor and Government Strategies**:

- Both **donors** and the **Government of Sri Lanka** need to shift from short-term funding models to medium- and long-term strategies that focus on enterprise development and financial sustainability. The report recommends that donors fund specialized microfinance activities rather than bundling them with larger development projects.

Conclusion:

The "National Microfinance Study of Sri Lanka" highlights the importance of microfinance in poverty alleviation and economic recovery, especially in post-conflict areas. However, challenges such as sustainability, political influence, and inadequate regulation threaten the long-term viability of microfinance services. The study advocates for regulatory reform, capacity-building, and a shift towards sustainable, market-driven microfinance practices to ensure continued access to financial services for the poor.

Publication: GTZ

Location: AusAid

Author: Thelipan & Thiruchelvam

Title: Microfinance and Livelihood Development in Poor Coastal Communities in Eastern Sri Lanka

Source: Journal: Tropical Agricultural Research, Vol 22 (3)

Year: 2011

Pages: 330-336

Research Questions:

This study focuses on assessing the impact of microfinance on the livelihood development of poor coastal communities in Eastern Sri Lanka, particularly those affected by the 2004 tsunami. The key research questions include:

1. **How has microfinance supported livelihood improvements in these coastal communities?**
2. **What is the effectiveness of revolving funds managed by Community-Based Organizations (CBOs)?**
3. **What factors influence the revolving fund efficiency (RFE) and the success of microfinance interventions?**

Methodology:

- **Location**: The study was conducted in three villages within the Kinniya Divisional Secretary Division (DSD) of Trincomalee District.
- **Sample**: The sample comprised 99 households that received microfinance assistance. Stratified random sampling was used, and data were collected on the socio-demographic characteristics of

the beneficiaries, their income, and the sectors in which they worked (farming, livestock, and fishery).

- **Data Collection**: Both quantitative and qualitative data were collected. Key informant interviews were conducted with Community-Based Organizations (CBOs), rural development officers, and Grama Sevaka Officers (GSOs).
- **Analysis**: A multiple linear regression model was employed to analyze the factors determining revolving fund efficiency (RFE). A paired t-test was used to compare income and savings before and after receiving microfinance.

Key Findings:

1. **Microfinance Access**:
    - The majority of microfinance beneficiaries received support through CBOs, with 64% of their credit coming from these organizations. Other sources included People's Bank, Bank of Ceylon, and the Cooperative Rural Bank.
    - Interest rates on loans averaged 14%, with an average revolving period of 12.56 months. Most beneficiaries received microfinance amounts of less than Rs. 30,000, with only 2% obtaining more than Rs. 45,000.
2. **Livelihood Improvements**:
    - **Agriculture**: The study found a 230% increase in net income from paddy cultivation, attributed to an increase in cultivation areas. Other field crops also saw a 75% rise in income.
    - **Livestock**: In the livestock sector, poultry and goat rearing showed significant income improvements of 90% and 38%, respectively.
    - **Fishery**: Fishermen benefited from an increase in net income by 77%, due to the shift from traditional fishing methods to modern ones, such as using nets and one-day boats.
    - Overall, traditional sectors showed a significant income increase of 67% after the implementation of microfinance.
3. **Challenges in Non-Traditional Sectors**:
    - The study identified gaps in the provision of training and support for non-traditional livelihoods. Young people, in particular, lacked access to vocational training in marketable skills, such as motorcycle repair, agro-machinery, electrical work, and carpentry. This lack of opportunities contributed to high unemployment among the youth in the region.
4. **Revolving Fund Efficiency (RFE)**:
    - The RFE was found to be low, with an average efficiency of 0.32%, indicating that the revolving fund mechanism was not well adopted in practice. The low efficiency was

attributed to weak management by CBOs and a lack of awareness about the benefits of microfinance within the community.

- Factors such as age, education, and family income significantly influenced the revolving fund efficiency. Higher levels of education and income were associated with better RFE, while savings had a negative impact on RFE, suggesting that beneficiaries preferred to save privately rather than contribute to the fund's sustainability.

5. **Regression Analysis**:
    - The regression model used in the study had an adjusted R^2 of 54.5%, indicating that the model explained a moderate amount of the variance in revolving fund efficiency. Family size, education, age, family income, and repayment amounts were significant predictors of RFE, while savings negatively affected it.

Key Analytical Messages:

1. **Effectiveness of Microfinance**: The study concludes that microfinance had a significant positive impact on the traditional livelihoods of farming, livestock, and fishery, resulting in notable increases in income. However, the impact was less evident in non-traditional sectors, where gaps in training and support limited livelihood improvements.
2. **Challenges with Revolving Fund Mechanisms**: The low efficiency of revolving funds highlights the challenges faced by CBOs in managing these funds effectively. Weak capacity in fund management, coupled with low levels of community awareness, hindered the full potential of microfinance interventions.
3. **Importance of Capacity Building**: The study emphasizes the need for **capacity building** of CBOs to improve their ability to manage microfinance programs and revolving funds. This would help ensure the sustainability of microfinance interventions.
4. **Youth Employment and Skills Training**: A significant finding is the lack of support for youth employment through vocational training in marketable skills. Addressing this gap would enhance the long-term economic prospects of coastal communities.
5. **Policy Recommendations**:
    - Strengthening the capacity of CBOs to manage revolving funds and provide credit efficiently.
    - Providing vocational training and skill development opportunities for young people in non-traditional sectors.
    - Promoting market linkages and infrastructure improvements to enhance the effectiveness of microfinance interventions.

Conclusion:

The study highlights both the successes and limitations of microfinance in supporting the livelihoods of coastal communities in Eastern Sri Lanka. While microfinance has led to significant income gains in traditional sectors like agriculture and fishery, gaps in management and support for non-traditional livelihoods limit its broader impact. Improving CBO capacity and providing vocational training are key to addressing these challenges and ensuring that microfinance plays a transformative role in poverty alleviation and livelihood development in these communities.

Publication: Post graduate Institute of Agriculture (PGIA)

Location: Tropical Agricultural Research

Author: H.M.W.A. Herath; L.H.P. Gunarathne; Nimal Sanderatne

Title: Impact of Microfinance on Women's Empowerment: A Case Study on Two Microfinance Institutions in Sri Lanka

Source: Sri Lanka Journal of Social Science, Vol 38 (1)

Year: 2015

Pages: 51-61

Research Questions:

This study aims to evaluate the impact of microfinance on women's empowerment and socio-economic vulnerability in Sri Lanka, with a specific focus on two microfinance institutions: **Sarvodaya Economic Enterprise Development Services (SEEDS)** and **Thrift and Credit Cooperative Societies (TCCSs)**. The main research questions include:

1. **How does microfinance influence women's empowerment?**
2. **How does microfinance affect the socio-economic vulnerability of women borrowers?**
3. **What role does social capital play in enhancing women's empowerment through group-based microfinance loans?**

Methodology:

- **Location**: The study was conducted in **Kandy District**, Sri Lanka, where both SEEDS and TCCSs operate microfinance programs.
- **Sample**: A total of 268 households were sampled, with 119 women borrowers selected for detailed analysis. The sample was proportionately selected from SEEDS and TCCSs based on the number of borrowers from each institution.
- **Data Collection**: Primary data were collected using structured questionnaires, focus group discussions, and interviews with local officials. Secondary data were also gathered from various institutional reports and publications from the Central Bank of Sri Lanka and other financial bodies.
- **Analysis Tools**: A **Women's Empowerment Index (WEI)** was constructed to measure empowerment in four domains—agricultural activities, domestic affairs, business, and social

affairs. Additionally, three binary logistic regression models were used to analyze the impact of microfinance on empowerment and socio-economic vulnerability reduction.

Key Findings:

1. **Microfinance and Empowerment**:
    - The overall WEI demonstrated an improvement in women's empowerment after they joined microfinance institutions. Women gained more decision-making power in agriculture, domestic affairs, business, and social interactions. Empowerment was highest in domestic affairs and business activities, with women actively involved in decision-making processes within their families and enterprises.
2. **Factors Influencing Empowerment**:
    - The study identified three key factors that significantly impacted women's empowerment:
        - **Household income before microfinance participation**: Households with higher pre-loan income levels were less likely to see significant empowerment gains.
        - **Age of the household head**: Older women tended to experience higher empowerment.
        - **Market availability**: Access to markets for products was a crucial factor, with women who had access to markets being 60% more likely to experience empowerment than those without market access.
3. **Social Capital Formation**:
    - Microfinance, especially through group lending models, helped women develop **social capital**. Group loans facilitated trust, reciprocity, and cooperation among women, which led to better economic and social outcomes. Women reported enhanced confidence, improved social networks, and greater community participation.
4. **Barriers to Empowerment**:
    - Despite improvements, several barriers hindered women's empowerment:
        - **Distance to microfinance institutions** and the **interest rates on loans** were negatively associated with empowerment.
        - **Family size** and the number of years involved in microfinance programs did not significantly contribute to empowerment, suggesting that longer involvement in microfinance alone was not sufficient to ensure better outcomes.
5. **Qualitative Insights**:
    - Before joining microfinance programs, women had limited participation in economic activities and lacked decision-making power within their families. However, after joining SEEDS or TCCSs, many women reported improved self-confidence, increased

participation in community activities, and greater independence in making household and business-related decisions.

6. **Impact on Business and Economic Mobility**:
    - Women who participated in microfinance programs were more likely to start small businesses, gain physical mobility, and expand their networks beyond their immediate families. Microfinance allowed them to travel for business purposes and attend training programs, which further boosted their entrepreneurial skills.

Key Analytical Messages:

1. **Microfinance as a Tool for Empowerment**:
    - The study concludes that microfinance plays a critical role in empowering women, particularly by enhancing their decision-making power within households and their ability to engage in income-generating activities. Access to financial services alone, however, is not enough; access to markets and economic opportunities is equally important for sustainable empowerment.
2. **Importance of Social Capital**:
    - Group-based lending not only provides financial resources but also fosters social capital among women. The formation of trust and networks through these group structures has a significant positive impact on women's confidence, social standing, and economic resilience.
3. **Market Access as a Key to Success**:
    - The availability of markets for products is the most significant factor driving empowerment. The study highlights the need for microfinance programs to incorporate market linkage strategies, ensuring that women can effectively sell their products and increase their income.
4. **Challenges and Policy Recommendations**:
    - The study identifies several areas for policy intervention, including the need to:
        - Improve access to markets for women's products.
        - Provide more training and business development services to enhance the sustainability of women's enterprises.
        - Address the high interest rates and long distances to financial institutions that act as barriers to women's participation in microfinance programs.

Conclusion:

The study finds that microfinance has significant potential to empower women in Sri Lanka by reducing their socio-economic vulnerability and increasing their decision-making power. However, challenges such as market access, financial literacy, and institutional barriers need to be addressed to ensure that microfinance achieves its full potential in empowering women. Enhanced social capital through group-based lending is identified as a key factor in driving sustainable empowerment outcomes. The findings suggest that policymakers and microfinance institutions should focus on integrating market linkages, training, and support services into their programs to ensure long-term success for women borrowers.

Publication: National Science Foundation of Sri Lanka

Location: Sri Lanka Journal of Social Sciences

Author: Nimal Fernando

Title: Understanding and Dealing with High Interest Rates on Microcredit: A Note to Policy Makers in the Asia and Pacific Region

Source: Asian Development Bank

Year: 2006

Pages: 18

Research Questions:

1. **Why are microcredit interest rates so high?**
2. **What are the implications of high interest rates for microfinance sustainability and access?**
3. **How can policymakers address the challenge of high microcredit interest rates without harming the microfinance industry?**

Methodology:

The study uses a qualitative analysis based on the operations of microfinance institutions (MFIs) across Asia and the Pacific. It examines empirical data on microfinance interest rates and policies from countries such as Bangladesh, Cambodia, India, Pakistan, Sri Lanka, and Vietnam, while also drawing from broader global microfinance experiences.

Key Findings:

1. **Reasons for High Microcredit Interest Rates**:
    - **Cost of Funds**: Microfinance institutions often borrow at high costs, particularly from non-concessional sources, which drives up the interest rates they charge borrowers. Even when concessional funds are available, they are temporary and limited, requiring MFIs to adopt market rates to sustain operations.
    - **High Operating Costs**: Microfinance is inherently labor-intensive due to small loan sizes and frequent repayment schedules. In regions with poor infrastructure and challenging geographic conditions, the cost of loan administration and recovery is significantly higher.

- **Loan Losses and Risk**: Higher risks associated with lending to low-income borrowers, who often lack collateral, result in increased costs for MFIs. Loan losses are factored into the interest rates to maintain institutional sustainability.
- **Profit for Expansion**: Profitable operations are necessary for MFIs to expand their outreach and services. Interest rates must account for profits to reinvest in growth.

2. **Inappropriate Comparisons**:
   - The paper argues that comparing microcredit interest rates to commercial bank rates or subsidized credit programs is inappropriate. Commercial banks typically lend larger amounts with lower per-unit costs, while many government and donor-driven microcredit programs offer unsustainable interest rates that do not reflect the true cost of lending. Thus, MFIs charging higher interest rates are necessary for long-term sustainability.
3. **Why Rate Ceilings Are Not the Solution**:
   - **Rate Ceilings Impact MFI Sustainability**: Imposing interest rate ceilings, as some governments in the region have proposed, can undermine the sustainability of MFIs. Rate ceilings would prevent MFIs from covering their costs, reducing their ability to lend and discouraging new entrants into the microfinance market.
   - **Reduced Outreach**: If MFIs are forced to operate at lower rates, they are likely to reduce their outreach to riskier, poorer borrowers. The unintended consequence of rate ceilings would be less access to credit for the most vulnerable populations, contrary to the goal of increasing financial inclusion.
4. **Empirical Evidence from the Region**:
   - **Liberal Interest Rate Policies Lead to Growth**: Countries such as Bangladesh, Cambodia, and Indonesia have demonstrated that liberal interest rate policies have contributed to the significant growth of microfinance, allowing millions of poor households to access credit. In contrast, countries with restrictive rate policies, such as Vietnam and China, have seen slower growth and reduced outreach.
   - **Positive Examples**: The study cites **ACLEDA Bank** in Cambodia and **Xac Bank** in Mongolia as examples of institutions that reduced interest rates over time by improving operational efficiency, scaling their services, and fostering competitive environments.
5. **The Case for Lower Interest Rates**:
   - While high interest rates have fueled the expansion of microfinance, there remains a portion of the population that cannot afford these rates. This is especially true for households engaged in low-margin economic activities like farming, where returns may not justify the cost of borrowing. Therefore, while interest rates should not be artificially capped, efforts should be made to lower them through efficiency improvements and competition.

Key Analytical Messages:

1. **High Operating Costs Drive High Interest Rates**: The core reason for high interest rates is the high operating cost of microfinance. The small size of loans, the need for frequent monitoring, and the challenging environments in which MFIs operate (poor infrastructure, rural settings) make microfinance inherently expensive.
2. **Competition and Efficiency as Solutions**: Policymakers should focus on promoting competition in the microfinance sector and improving the operational efficiency of MFIs. Rather than imposing rate ceilings, governments can create an enabling environment for MFIs by investing in physical infrastructure, human capital, and financial literacy programs.
3. **Innovation and Technology**: Innovation is key to reducing the cost of microfinance. Governments and MFIs should prioritize the adoption of new technologies, such as mobile banking and digital finance, which can significantly reduce transaction costs and improve service delivery in remote areas.
4. **Impact of Rate Ceilings**: Imposing rate ceilings would result in lower loan availability for the poor, increased reliance on informal moneylenders, and potential deterioration in service quality as MFIs attempt to cut costs. Instead of rate ceilings, policymakers should support sustainable strategies to lower interest rates.

Policy Recommendations:

- **Avoid Interest Rate Ceilings**: Policymakers should resist the temptation to impose ceilings on microcredit interest rates. Such measures will harm the industry by reducing the availability of credit to the poor.
- **Promote Market Competition**: Encouraging more players in the microfinance market will naturally bring down interest rates through competitive pressures.
- **Invest in Infrastructure**: Improving roads, telecommunications, and other infrastructure will reduce the operating costs of MFIs and allow them to pass these savings on to borrowers in the form of lower interest rates.
- **Support Financial Literacy**: Building financial literacy among poor households can improve their borrowing decisions and help reduce the risks associated with microfinance lending.

Conclusion:

The study concludes that high interest rates on microcredit are a result of the operational realities of the microfinance sector. Rather than addressing the symptoms (high rates) through rate ceilings, policymakers should focus on improving the underlying conditions—operational efficiency, market competition, and infrastructure development—that contribute to these high costs. A more competitive, efficient, and sustainable microfinance sector will ultimately provide affordable financial services to the poor in Asia and the Pacific.

Publication: Asian Development Bank

Location: Philippines

Author: Charitonenko & Dulan de Silva

Title: Commercialization of Microfinance: Sri Lanka

Source: Asian Development Bank

Year: 2002

Pages: 78

Research Questions:

This report by the **Asian Development Bank (ADB)** focuses on the evolution and commercialization of the microfinance sector in Sri Lanka. The key research questions addressed in the study include:

1. **What is the state of microfinance commercialization in Sri Lanka?**
2. **What are the key drivers and challenges for the commercialization of microfinance institutions (MFIs)?**
3. **How can commercialization enhance financial inclusion and sustainability in Sri Lanka's microfinance sector?**

Methodology:

The study uses a **qualitative approach**, gathering data through a combination of case studies, interviews, and analysis of the regulatory environment in Sri Lanka. It looks at different microfinance actors, including non-governmental organizations (NGOs), cooperatives, private sector entities, and government bodies.

Sample:

The sample includes various microfinance providers operating in Sri Lanka, ranging from **NGOs** and **community-based organizations (CBOs)** to **formal financial institutions** and **commercial banks**. The analysis spans across rural, urban, and conflict-affected areas to capture the diversity of the microfinance landscape in the country.

Key Findings:

1. **Stages of Microfinance Development**:
    - Microfinance in Sri Lanka has evolved from a **welfare-oriented approach** to a **commercial model**. Initially, microfinance institutions were largely dependent on donor funding and government subsidies, focusing on poverty alleviation and social welfare.
    - In recent years, there has been a shift towards **commercialization**, with more focus on financial sustainability, efficiency, and scalability. This shift is marked by the entry of private sector players and the adoption of market-based interest rates.
2. **Drivers of Commercialization**:

- **Sustainability Concerns**: Donor and government funding for microfinance has become less reliable, pushing MFIs to adopt more sustainable, market-driven approaches. Commercialization allows MFIs to cover their operational costs and reinvest in growth.
- **Access to Capital**: Commercialization enables MFIs to attract **private investment** and access formal capital markets, which is crucial for scaling operations and reaching a larger segment of the population.
- **Regulatory Changes**: The introduction of **regulatory frameworks** for microfinance has facilitated the transition towards commercialization. By formalizing the sector, the government has encouraged transparency and accountability, making it easier for commercial banks and other private entities to participate in microfinance.

3. **Challenges in Commercialization**:
    - **High Operating Costs**: Microfinance operations, particularly in rural and underserved areas, are labor-intensive and expensive. As MFIs commercialize, they must balance the need for sustainability with the imperative to serve low-income populations without pricing them out of the market.
    - **Interest Rate Dilemmas**: Commercial MFIs tend to charge higher interest rates to cover operational costs. This can create **tensions between profitability and social goals**, as high rates may deter low-income borrowers, undermining the sector's mission of financial inclusion.
    - **Social Mission vs. Commercial Viability**: As MFIs transition towards a commercial model, there is concern that they may lose sight of their **social mission**. Balancing profitability with the goal of poverty alleviation remains a key challenge.
4. **Impact of Commercialization**:
    - **Enhanced Outreach**: Commercialization has enabled some MFIs to **expand their outreach**, offering financial services to a broader population, including middle-income clients who were previously underserved.
    - **Innovation and Product Diversification**: The shift towards commercialization has spurred innovation in product offerings. MFIs have begun to introduce new financial products, such as **insurance, savings accounts**, and **remittance services**, catering to a more diverse set of clients.
    - **Improved Efficiency**: The focus on financial sustainability has led to improvements in **operational efficiency**. MFIs are adopting technology-driven solutions, such as **mobile banking**, to reduce costs and improve service delivery, particularly in remote areas.
5. **Regulatory Environment**:
    - The Sri Lankan government has introduced various regulatory measures aimed at fostering the growth of a sustainable microfinance sector. These include the establishment of **minimum capital requirements** for MFIs, mandatory **reporting standards**, and **consumer protection laws** to ensure fair treatment of borrowers.

- Despite these advancements, the regulatory framework is still evolving. Some MFIs, particularly smaller ones, struggle to comply with the new regulations, which can limit their ability to commercialize effectively.

Key Analytical Messages:

1. **Sustainability Through Commercialization**:
    - Commercialization is seen as a **necessary evolution** for the long-term sustainability of microfinance institutions in Sri Lanka. By adopting market-based approaches, MFIs can reduce their reliance on external funding and become self-sustaining, allowing them to serve more clients and grow over time.
2. **Balancing Profitability with Social Impact**:
    - While commercialization improves the financial health of MFIs, it raises questions about their commitment to social goals. Policymakers and MFIs must strike a balance between **profitability and financial inclusion**, ensuring that vulnerable populations are not excluded from the benefits of microfinance.
3. **Regulation as a Double-Edged Sword**:
    - Regulation plays a crucial role in ensuring the transparency and accountability of the microfinance sector. However, overly stringent regulations can stifle innovation and growth, particularly for smaller MFIs that may lack the resources to comply with complex regulatory requirements.
4. **The Role of Technology**:
    - Technology is identified as a key enabler for the commercialization of microfinance. Mobile banking, digital payments, and other tech-driven solutions can help MFIs **reduce operational costs**, increase outreach, and improve the client experience.
5. **Market Diversification**:
    - As MFIs commercialize, they are diversifying their client base. While this allows them to serve a wider range of clients, there is a risk that they may shift away from their traditional low-income borrowers. Ensuring that the poorest segments of society continue to have access to affordable financial services is essential for the sector's integrity.

Conclusion:

The commercialization of microfinance in Sri Lanka has brought both opportunities and challenges. On the one hand, it has enhanced the sustainability and outreach of MFIs, allowing them to scale and innovate. On the other hand, it has introduced tensions between social impact and profitability. Going forward, policymakers must ensure that the regulatory framework supports the continued growth of the sector while safeguarding its social mission. Furthermore, leveraging technology and promoting financial literacy will be key to ensuring that the benefits of commercialization are widely shared, particularly among low-income populations.

Publication: Asian Development Bank

Location: Philippines

Author: Anura Atapattu

Title: State of Microfinance in Sri Lanka

Source: As a project on state of microfinance in SAARC Countries

Year: 2009

Pages: 71

Research Questions:

The study, conducted as part of the **State of Microfinance in SAARC Countries** project, aims to analyze the microfinance landscape in Sri Lanka. The key research questions include:

1. **What are the microfinance models practiced in Sri Lanka?**
2. **What is the outreach and impact of microfinance in reducing poverty and supporting development?**
3. **How does the regulatory environment affect the microfinance sector?**
4. **What challenges are faced by microfinance institutions (MFIs) and the overall sector in Sri Lanka?**

Methodology:

The report draws on available data, surveys, and previous studies to offer a comprehensive overview of Sri Lanka's microfinance sector. It includes both quantitative data (e.g., outreach figures, loan amounts) and qualitative assessments (e.g., impact on poverty reduction, challenges faced by MFIs). The study covers 20 of the largest MFIs in Sri Lanka, based on criteria such as the percentage of unsecured loans and savings.

Sample:

The sample includes major microfinance actors, including **local, regional, and national MFIs**, **village banks**, **cooperative rural banks (CRBs)**, and **development banks**. The sample represents a diverse range of institutions serving urban, rural, and conflict-affected areas.

Key Findings:

1. **Microfinance Models**:
    - Several microfinance models operate in Sri Lanka, including **village banking**, **Grameen-type group lending**, **individual lending**, **self-help groups (SHGs)**, and **credit unions**. Village banking and Grameen-type models are widely used, particularly by NGOs and

community-based organizations (CBOs), while credit unions like **SANASA** are the most popular cooperative model.

2. **Outreach**:

    - As of 2008, the microfinance sector served approximately **2.8 million clients**, with significant outreach in rural areas. **Samurdhi Authority**, a government program, accounts for the largest share of clients, with **SEEDS** and **SANASA** also playing significant roles.
    - The number of active borrowers in the sector reached **1.06 million**, with women making up a majority of borrowers (around 67%). However, while the membership grew, loan disbursement growth slowed, indicating smaller loan sizes.

3. **Impact on Poverty**:

    - While no direct studies isolate microfinance's impact on poverty reduction, circumstantial evidence suggests that microfinance, especially through government programs like Samurdhi, has contributed to the reduction of poverty levels from **23% in 2003 to 15% in 2007**. However, poverty remains concentrated in rural areas and the estate sector, with significant disparities between districts.

4. **Challenges Facing the Sector**:

    - **Lack of Regulation**: MFIs in Sri Lanka operate under a variety of regulatory frameworks, often leading to inconsistencies and lack of oversight. Smaller NGOs and MFIs are particularly affected by inadequate regulatory structures.
    - **Weak Portfolio Quality**: Many MFIs face issues related to **loan recovery** and **portfolio quality**, partly due to the high costs of servicing small loans in rural and remote areas.
    - **Competition and Overlap**: The sector faces issues related to **overlapping membership**, where clients borrow from multiple MFIs, leading to over-indebtedness and difficulties in loan recovery.
    - **Public Sector Dominance**: The involvement of public sector institutions like **Samurdhi** in retail microfinance has created challenges for private MFIs, including competition for clients and distortions in the lending market due to subsidized loans.

5. **Financing Microfinance**:

    - The sector is primarily financed through savings mobilized by MFIs, with **CRBs** and **village banks** playing a key role. By 2008, the sector had mobilized approximately **Rs. 24.8 billion** in savings. However, MFIs face challenges in managing these savings and ensuring financial sustainability.

Key Analytical Messages:

1. **Diverse Microfinance Models**:

- Sri Lanka's microfinance sector is characterized by a wide range of models, from community-based village banking to formalized credit unions. These models cater to different segments of the population, particularly rural and low-income groups.

2. **Outreach and Impact**:
   - While microfinance has reached a large portion of Sri Lanka's rural population, its impact on poverty reduction remains difficult to quantify. The focus on small loans and savings has helped enhance financial inclusion, but challenges remain in ensuring that the sector supports long-term poverty alleviation and development.

3. **Need for Regulatory Reforms**:
   - The report highlights the need for a more robust regulatory framework to ensure the sustainability and transparency of the sector. Regulation is particularly important for protecting clients from over-indebtedness and ensuring that MFIs operate efficiently and responsibly.

4. **Balancing Sustainability and Social Mission**:
   - MFIs in Sri Lanka face a delicate balance between financial sustainability and their social mission. The high costs of serving rural populations, combined with weak portfolio quality, have made it difficult for many MFIs to achieve sustainability. At the same time, there is a risk that commercialization could undermine the sector's focus on poverty reduction.

5. **Challenges of Public Sector Involvement**:
   - The dominance of government programs like Samurdhi in the microfinance sector has created challenges for private sector MFIs. The public sector's involvement, while increasing outreach, often distorts the market by offering subsidized loans and competing directly with private MFIs.

Conclusion:

The study concludes that while Sri Lanka's microfinance sector has made significant strides in expanding financial services to rural and low-income populations, it faces several challenges that must be addressed to ensure its sustainability and effectiveness. Regulatory reforms, improved portfolio management, and greater coordination between public and private actors are critical to the future growth of the sector.

Publication: Institute of Microfinance

Location: Institute of Microfinance in Sri Lanka

Author: Ganga Tilakaratna & David Hulme

Title: Microfinance and Multiple Borrowing in Sri Lanka: Another Microcredit Bubble in South Asia?

Source: South Asia Economic Journal, Vol 16 (1)

Year: 2015

Pages: 46-63

Research Questions:

The study by **Ganga Tilakaratna** and **David Hulme** investigates the growing phenomenon of multiple borrowing in Sri Lanka's microfinance sector. The key research questions include:

1. **What is the extent of multiple borrowing among microfinance borrowers in Sri Lanka?**
2. **What are the contributing factors to multiple borrowing and the risk of over-indebtedness?**
3. **Is Sri Lanka at risk of experiencing a microcredit crisis similar to those seen in countries like India and Nicaragua?**

Methodology:

The study employs a **panel household survey** conducted over two periods (2006-2007 and 2009-2010), covering 450 households across three districts: **Hambantota, Kurunegala, and Ratnapura**. In addition to household data, the researchers conducted in-depth qualitative interviews with borrowers, microfinance institution (MFI) officials, and policymakers. The analysis also draws on secondary data from sources like the **Microfinance Information Exchange (MIX)** and other relevant studies.

Sample:

The sample includes 450 households representing both **single borrowers** (households borrowing from one financial institution) and **multiple borrowers** (households borrowing from more than one institution). The study also includes a divisional-level survey across 47 Grama Niladari (GN) divisions, examining financial institutions' presence in these areas.

Key Findings:

1. **Rising Multiple Borrowing**:
    - Multiple borrowing has become increasingly common in Sri Lanka's microfinance sector, with 74% of households borrowing from multiple financial institutions in 2009-2010, compared to 29% in 2006-2007.
    - Borrowers frequently access loans from both microfinance institutions (MFIs) and commercial financial institutions (CFIs), including **pawning** facilities, which offer loans against jewelry.
2. **Factors Contributing to Multiple Borrowing**:
    - **Increased Density of Financial Institutions**: The number of financial institutions per GN division increased significantly between 1990 and 2009, making it easier for households

to borrow from multiple sources. By 2009, there was an average of 4.2 financial institutions per GN division, with a particularly high density in **Hambantota**.

- **Overlapping Financial Products**: Borrowers often accessed both MFIs and CFIs for credit, leading to a high level of loan overlap. Many borrowers used pawning as an additional credit source due to its flexible repayment terms.

3. **High Turnover and Poor Portfolio Quality**:
   - Many MFIs experienced high turnover rates, with 35-45% of borrowers leaving between 2006-2007 and 2009-2010. At the same time, key MFIs, including **SEEDS** and **SANASA Development Bank**, reported deteriorating portfolio quality, with non-performing loans (PAR 30 days) exceeding 20%.
   - This increase in multiple borrowing and high turnover rates contributed to declining **financial efficiency** and increasing operational costs for MFIs.

4. **Debt Levels Among Borrowers**:
   - The average debt per borrower increased significantly between the two survey periods. For multiple borrowers, the debt-to-income ratio rose from 13% in 2006-2007 to 15.3% in 2009-2010.
   - Despite this rise, the majority of households maintained debt at manageable levels. Around 80% of multiple borrowers spent less than 25% of their income on loan repayments in 2009-2010, with only a small percentage showing signs of severe over-indebtedness (debt-to-income ratio > 50%).

5. **Mitigating Factors Against a Credit Bubble**:
   - While the study acknowledges the risk of over-indebtedness and potential default crises, several mitigating factors reduce the likelihood of a full-blown microcredit bubble in Sri Lanka:
     - **Savings as Collateral**: Most MFIs in Sri Lanka require compulsory savings, which act as partial collateral and reduce the risk of default.
     - **Use of Low-Risk Products**: Pawning, a common financial product in Sri Lanka, poses lower risks to both lenders and borrowers due to its collateral-based nature and flexibility in repayment.
     - **Diversity of MFIs**: Sri Lanka's microfinance sector is more diverse than that of other countries like India. This diversity in institutional models and financial products reduces the risk of systemic collapse.
     - **Declining Donor Funding**: A reduction in donor funding, particularly after Sri Lanka's transition to lower middle-income status in 2008, has slowed the growth of the sector, reducing the likelihood of an over-lending crisis.

Key Analytical Messages:

1. **Multiple Borrowing and Financial Risk**:
   - The increase in multiple borrowing presents challenges for borrowers and MFIs alike. Borrowers face the risk of over-indebtedness, while MFIs face higher loan defaults and increased operational costs. However, these risks remain manageable for most borrowers.
2. **Operational Challenges for MFIs**:
   - The declining financial performance of MFIs, particularly in terms of portfolio quality and borrower turnover, threatens the long-term sustainability of some institutions. Improved credit information sharing and borrower monitoring systems are needed to address these challenges.
3. **Microcredit Bubble Unlikely**:
   - Despite concerns over multiple borrowing and poor portfolio performance, the study concludes that Sri Lanka is unlikely to experience a microcredit bubble in the near future. Savings mobilization, the widespread use of pawning, and the diversity of MFIs help mitigate the risks of a systemic financial crisis.
4. **Policy Recommendations**:
   - The study recommends the introduction of a formal **credit information system** for MFIs to monitor borrower activity and prevent over-indebtedness.
   - A **regulatory framework** that standardizes practices across different types of MFIs is also essential to improve portfolio quality and protect clients from aggressive lending practices.

Conclusion:

The study highlights the growing prevalence of multiple borrowing in Sri Lanka's microfinance sector and the associated risks. However, it concludes that the country is not on the verge of a microcredit bubble, thanks to a combination of mitigating factors. Moving forward, regulatory reforms and improved monitoring of borrower behavior are necessary to ensure the sector's long-term sustainability.

Publication: South Asia Economic Journal

Location: Sage Journal

Author: Chathurika Edirisinghe

Title: Factors Associated with People's Reliance towards Informal Financing Methods in Rural Community of Sri Lanka

Source: Global Journal of Management and Business Research: C Finance Volume 15 Issue 11 Version 1.0

Year: 2015

Pages: 8

Research Questions

The study investigates the factors influencing people's reliance on informal financing methods in rural communities in Sri Lanka, particularly in the Rathnapura District. The research focuses on understanding why individuals in rural areas opt for informal financing, such as borrowing from family or friends, rather than formal financial institutions like banks. The key research questions are:

1. What factors drive reliance on informal finance in rural communities?
2. How do demographic variables (education, income, occupation) and financial behaviors impact the tendency to use informal financial sources?
3. What are the most preferred informal financial methods?

Methodology

The study employs a quantitative approach through a survey distributed to 250 respondents from Rathnapura District. The sample was drawn using convenience sampling due to the lack of a formal or informal sampling frame. The questionnaire included 53 questions designed to measure variables such as financial literacy, financial behavior, personal financial attitudes, trust in financial institutions, and demographic factors (income, education, occupation, gender).

A Chi-square test was used to analyze the data and test the hypotheses. The key dependent variables were the reliance on informal financial methods, particularly focusing on reliance on borrowing from family/friends, the "cheetu" system (a rotating credit association), and borrowing from local credit groups.

Sample

- Population: 52,170 people living in Rathnapura District.
- Respondents: 250 (48% male, 52% female).
- Education: Most respondents (35%) had completed education up to the GCE Advanced Level.
- Income: The largest group (31%) earned between Rs. 15,000 and Rs. 24,999 per month.
- Employment: 46% were employed in the private sector, followed by self-employed individuals (25%).

Findings

1. **Preference for Informal Finance**: The study revealed a high dependency on informal financial sources, with over 54.6% of respondents relying on such methods. The most preferred financing source was loans from family and friends, followed by pawning (both formal and informal), and personal borrowing.

2. **Factors Associated with Informal Finance**: The Chi-square analysis revealed significant associations between reliance on informal finance and several factors:
    - **Income level**: Higher dependency on informal finance was observed among individuals with lower income levels.
    - **Educational level**: A lower educational level correlated with higher reliance on informal finance.
    - **Occupation**: Informally employed individuals showed greater reliance on informal financial methods.
    - **Financial Behavior and Literacy**: Individuals with limited financial literacy and poor financial behavior were more likely to use informal finance.
    - **Trust and Reliability**: A lack of trust in formal financial institutions led to greater reliance on informal sources.
3. **Gender and Marital Status**: While gender was associated with a preference for informal finance, marital status did not show a significant impact.
4. **Key Analytical Messages**:
    - **Education and financial literacy**: The study highlights the importance of financial literacy and education in reducing reliance on informal financial sources. It suggests that people with better education and financial knowledge are more likely to use formal financial services.
    - **Trust in financial institutions**: Trust and reliability in formal financial systems are critical in encouraging rural communities to transition from informal to formal financial systems.
    - **Financial behavior**: People with sound financial behavior, including saving habits and future financial planning, are less likely to rely on informal finance.

Conclusion

The research concludes that reliance on informal financial methods is heavily influenced by income, education, and trust in formal financial institutions. It recommends that enhancing financial literacy and improving the accessibility and trustworthiness of formal financial institutions could encourage rural populations to adopt formal financing methods.

Publication: Global Journal inc. (USA)

Location: Sabaragamuwa University Sri Lanka

Author: Hansanie Wickramasinghe

Title: Study on Factors Influencing on Microfinance Loan Repayment (Special Reference to Samurdhi Banks in Elpitiya Divisional Secretariat)

Source: International Research Journal of Advanced Engineering and Science

Year: 2020

Pages: 5

Research Questions

The study explores the factors influencing loan repayment among borrowers in microfinance institutions, with a focus on Samurdhi Banks in Elpitiya Divisional Secretariat. The key research questions include:

1. What is the level of influence of borrower characteristics, business characteristics, and loan characteristics on microfinance loan repayment?
2. What is the relationship between these factors and loan repayment?
3. What impact do these factors have on the likelihood of loan repayment?

Methodology

The study adopts a quantitative research methodology, utilizing a structured questionnaire distributed to microfinance loan defaulters from Samurdhi Banks. The sample consists of 40 small and medium enterprises selected through stratified random sampling. Data collection was carried out through questionnaires targeting default borrowers and interviews with bank managers and staff. The data was processed using the Statistical Package for Social Sciences (SPSS) and analyzed through descriptive statistics, correlation analysis, and univariate analysis.

Sample

The sample consisted of 40 small and medium enterprises (SMEs) who had defaulted on their microcredit loans from Samurdhi Banks. These SMEs were involved in various business activities, including trading and agriculture, and were selected using a stratified random sampling method. The survey focused on borrowers' characteristics (e.g., age, gender, education), business characteristics (e.g., type of business, business experience), and loan characteristics (e.g., loan size, repayment terms).

Findings

1. **Borrower Characteristics**: The study found that borrower characteristics such as age, gender, and education level significantly affect loan repayment. Specifically:
    - **Age**: Borrowers aged 36-45 had a higher default rate.
    - **Gender**: Female borrowers were more likely to default than males.
    - **Education**: Lower education levels (e.g., up to O/L) were associated with higher default rates, consistent with past research (Bhatt & Tang, 2002).
2. **Business Characteristics**: The nature of the borrower's business also impacted loan repayment:

- **Business Type**: Businesses engaged in agriculture and trading faced more challenges in repaying loans due to income volatility.
- **Experience**: Businesses with less than three years of experience had higher default rates, indicating that less-experienced business owners struggle more with loan repayment.

3. **Loan Characteristics**: Loan characteristics such as loan size and repayment schedules played a role in defaults:
    - Larger loans correlated with higher repayment success, as borrowers with sufficient funds could finance their business operations more effectively, leading to better financial outcomes.
4. **Correlation Analysis**: The statistical analysis showed significant positive correlations between borrower characteristics, business characteristics, loan characteristics, and loan repayment. The correlation coefficients indicated that these factors have a substantial influence on loan repayment behavior.
5. **Hypothesis Testing**: The study tested three hypotheses:
    - There is no significant relationship between borrower characteristics and loan repayment.
    - There is no significant relationship between business characteristics and loan repayment.
    - There is no significant relationship between loan characteristics and loan repayment.

All three null hypotheses were rejected, indicating that these variables significantly influence loan repayment.

Key Analytical Messages

- **Education and Financial Knowledge**: Borrowers with lower educational attainment struggle more with loan repayment, largely due to their inability to manage business finances effectively.
- **Business Type and Experience**: Loan repayment issues are prevalent among borrowers involved in agriculture, due to income instability caused by factors beyond their control, such as weather conditions.
- **Loan Utilization**: A significant proportion of defaulters misused their loans, using them for non-business purposes like family obligations, which adversely affected their ability to repay.
- **Gender Dynamics**: Female borrowers were found to default more frequently, which may be attributed to additional familial responsibilities and income constraints.

Conclusion

The study concludes that borrower, business, and loan characteristics significantly influence microfinance loan repayment in the Elpitiya Divisional Secretariat. It recommends enhanced loan monitoring, borrower education, and innovative recovery strategies (e.g., loan rebates for timely payments) to improve repayment rates. It also calls for stronger regulation in Sri Lanka's microfinance sector to address issues like informal money lending, which exacerbates default problems.

Recommendations

- **Loan Monitoring**: Microfinance institutions should adopt a group lending approach to improve loan monitoring and ensure proper loan utilization.
- **Training and Capacity Building**: Borrowers, especially those starting new businesses, should receive training in financial management to enhance their business acumen and loan repayment capabilities.
- **Policy and Regulation**: A national policy for microfinance is essential to regulate the sector and mitigate issues arising from informal lending practices.

Publication: Eastern University

Location: Eastern University Sri Lanka

Author: Rauno Zaunder

Title: Barriers to Credit Access in Rural Sri Lanka

Source: Financial Landscapes Reconstructed: The Fine Art Of Mapping Development, a book by F.J.A. Bouman

Year: 1994

Pages: chapter 12

Research Questions:

The study aims to understand the dynamics of credit access in rural Sri Lanka, with a specific focus on identifying the barriers that prevent rural borrowers from accessing formal and informal credit. It seeks to answer the following key questions:

1. What are the components that influence borrowers' choice between formal and informal lenders?
2. What are the primary barriers that restrict access to credit in rural areas?
3. How do factors like guarantor arrangements, collateral requirements, and loan sizes impact the borrowing experience?

Methodology:

The study used a mixed-method approach that involved two separate surveys conducted in two rural areas—Mabodale (a semi-urban village near the capital) and Makkaduwawe (a remote rural village). The surveys included:

1. A sample of 263 adults from 97 households in Mobodale and 103 adults from 40 households in Makkaduwawe. The survey aimed to identify financial intermediaries and assess credit access.
2. A second survey focused on the borrower-lender relationship, involving 158 individuals from Mobodale and 76 from Makkaduwawe. This survey covered both men and women and explored various dimensions of credit access.

The surveys collected both quantitative data (e.g., average loan amounts, interest rates, etc.) and qualitative insights through flexible interviews with different types of lenders, including bank managers, cooperative officers, and informal lenders such as moneylenders and shop owners.

Sample:

The two study sites represent different economic and geographic contexts:

- **Mabodale:** A semi-urban village located 50 km north of Colombo, characterized by part-time farming and proximity to the Katunayake Free Trading Zone. It has a relatively dynamic economic environment.
- **Makkaduwawe:** A remote agricultural village in Northern Kurunegala District, with fewer economic opportunities and more dependence on agriculture.

Findings:

The study identified nine key components that affect a borrower’s decision to seek credit from formal or informal sources. These include:

1. **Average Distance to Lenders:** Proximity to lenders did not significantly affect borrowers' choice of credit sources.
2. **Sanctions for Late or Non-Repayment:** Formal lenders were less aggressive in pursuing defaulters, while informal lenders often used social or reputational pressure.
3. **Collateral Requirements and Guarantor Arrangements:** These were identified as the most significant barriers to accessing credit from formal institutions. Many rural borrowers lacked the necessary collateral or struggled to find guarantors.
4. **Interest Rates:** While formal lenders offered lower interest rates, the total transaction costs (including application processes and time) were often higher compared to informal lenders.
5. **Loan Amounts:** Formal institutions offered larger loans compared to informal sources, giving them a competitive advantage. However, the restrictive collateral and guarantor requirements limited access.
6. **Timeliness of Loan Disbursements:** Delays in disbursal from formal institutions often led borrowers to choose informal lenders, who offered faster access to funds.

7. **Repayment Periods:** Formal lenders generally offered more flexible repayment terms, which were favorable for borrowers who could meet the eligibility requirements.

8. **Securities Required:** Collateral and the complexity of security arrangements posed significant hurdles for borrowers.

Key Analytical Messages:

- **Guarantor Arrangements as a Critical Barrier:** In both study villages, the lack of access to guarantors was the most significant hurdle in securing formal credit. This finding challenges traditional transaction cost analyses, which tend to focus on interest rates and fees as primary obstacles.

- **NGOs and Informal Lending Systems:** NGOs like the Sanasa credit cooperatives offered loans without the strict collateral and guarantor requirements of formal institutions, making them more accessible to rural borrowers. However, their relatively high interest rates and limited loan sizes reduce their attractiveness.

- **Informal Lending Dominance:** Due to fewer barriers and the speed of transactions, informal lenders such as moneylenders and shop owners remained dominant, despite charging higher interest rates. Their ability to offer loans without stringent collateral requirements made them the preferred choice for many borrowers.

Conclusion:

The study concludes that while formal financial institutions have the potential to offer larger and more affordable loans, their stringent requirements—especially related to collateral and guarantors—exclude many rural borrowers. Informal lenders fill this gap, offering quicker and more accessible loans, albeit at a higher cost. The study suggests that future research should explore alternatives to these barriers, such as modifying the role of guarantors and collateral in rural credit markets.

Publication: Boulder; Westview Press

Location: Research Gate

Author: A.M.P. Adikari

Title: Informal Financial System in Sri Lanka: Special Reference to Rural Areas

Source: Proceedings of Jaffna University – International Research Conference (JUICE – 2012), PP 22- 25

Year: 2012

Pages: 4

Research Questions:

The study focuses on understanding the role of informal financial services in rural areas of Sri Lanka. The specific research questions include:

1. What is the structure of informal financial services in Sri Lanka's rural areas?
2. What are the different sources of informal finance in rural Sri Lanka?
3. Why do rural households prefer informal financial services over formal options?

Methodology:

The study employs both primary and secondary data collection methods.

- **Primary Data**: A questionnaire survey was conducted with a sample of 100 households selected randomly from three villages—Deyyanwela, Arama, and Aranayake—within the Aranayake Divisional Secretariat area.
- **Secondary Data**: Documentary sources were used to provide context and background for the analysis. The sample was stratified across the three villages, with 40 households from Deyyanwela and 30 each from Arama and Aranayake. The data were analyzed using descriptive statistics to interpret respondents' financial behavior, specifically their engagement in formal and informal financial services.

Sample:

The study surveyed 100 households, comprising a mix of those who utilized formal, informal, or both types of financial services. The breakdown is as follows:

- 33% of respondents engaged solely with formal financial services.
- 23% engaged exclusively with informal financial services.
- 44% used both formal and informal financial services.

Findings:

1. **Types of Informal Financial Services**: Informal financial services identified in the study include pawning, trade credit, crop mortgages, single-purpose credit services, and direct lending. Among these, direct lending was the most utilized service (26 respondents), followed by pawning (13 respondents), single-purpose credit services (10 respondents), and crop mortgages (6 respondents).
2. **Reasons for Preferring Informal Financial Services**:
    - **Closeness and Personal Relationship**: The majority of respondents (36.51%) preferred informal services due to personal relationships and proximity to lenders.
    - **Ease of Access**: 25.4% cited easy access to borrowing as a key reason.
    - **Family Ties**: 17.46% of respondents mentioned family connections as a driving factor.
    - **Simplified Operations**: 20.63% found informal financial services easier to navigate compared to formal alternatives.

Interestingly, none of the respondents indicated a lack of formal services as a reason for preferring informal options, which suggests that informal financial services continue to thrive despite the presence of formal alternatives in rural areas.

Key Analytical Messages:

1. **Duality in Financial Systems**: The research underscores the persistence of financial dualism in Sri Lanka, where both formal and informal systems coexist. Even with the expansion of formal financial institutions, rural households still heavily rely on informal services, particularly for their accessibility and personalized nature.
2. **Direct Lending Dominance**: Direct lending emerged as the most prevalent form of informal credit, favored for its immediate availability and lack of bureaucratic hurdles. Borrowers often use this service for consumption purposes, further reinforcing its importance in rural financial ecosystems.
3. **Informal Networks' Role in Credit Access**: The study highlights the significant role that personal relationships and social networks play in shaping financial behaviors in rural Sri Lanka. Informal credit is deeply embedded in the social fabric, making it an attractive option for households that might otherwise face barriers to formal credit access, such as collateral requirements and lengthy application processes.
4. **Integration of Formal and Informal Sectors**: The study concludes by advocating for a more integrated approach between formal and informal financial sectors. Enhancing collaboration between the two could increase financial inclusion and help bridge the gap between the underserved rural population and formal financial services.

Conclusion:

The informal financial system remains an essential component of rural Sri Lanka's economy, providing critical credit services to those excluded from or dissatisfied with the formal financial sector. The study suggests that integrating informal services with formal financial structures could boost confidence in the system and encourage broader participation in the formal financial market.

Publication: Rajarata University in Sri Lanka

Location: Department of Social Sciences

Author: K.P.N.S. Karunagoda

Title: Informal markets for financial services in Sri Lanka

Source: Report done for the Association of Professional Bankers – 19th anniversary convention

Year: 2007

Pages: 24

Research Questions:

The study seeks to explore the nature of informal financial markets in Sri Lanka. It aims to answer several key questions:

1. What is the structure and role of informal financial markets in Sri Lanka?
2. How do these informal markets operate in various sectors (rural, urban, estate)?
3. What factors influence the use of informal financial services, and how do they differ from formal financial systems?
4. What are the costs and benefits of formalizing informal financial markets in Sri Lanka?

Methodology:

The study uses secondary data collected from various sources such as the Central Bank of Sri Lanka, Consumer Finance Surveys, and relevant literature. These data sources provide insights into informal financial market dynamics and historical developments. The research also draws on theoretical frameworks and empirical studies to contextualize Sri Lanka's informal financial market within the broader global context.

Sample:

The data used in the study comes from large national surveys, such as the Central Bank's Consumer Finance Surveys, covering a broad spectrum of Sri Lankan households from different regions and sectors. The study does not focus on a specific, independently collected sample but rather uses existing national data to analyze informal financial behavior in rural, urban, and estate sectors.

Findings:

1. **Structure of Informal Financial Markets**: Informal financial transactions in Sri Lanka are categorized into three main types:
   - **Direct Money Lending**: Involving moneylenders, friends, relatives, and pawnbrokers.
   - **Indirect Money Lending**: Through intermediaries like traders, crop mortgages, and commission agents.
   - **Voluntary Credit Groups**: Including Rotating Savings and Credit Associations (ROSCAs) and Accumulating Savings and Credit Associations (ASCAs).
2. **Sectoral Insights**:
   - **Rural Sector**: Informal financial markets play a dominant role due to the lack of access to formal financial services. Popular methods include pawning, trade credit, crop mortgages, and direct lending. Farmers and landless individuals heavily rely on these informal services, often due to irregular incomes and difficulty meeting formal lending criteria.
   - **Urban Sector**: Urban informal markets are less prominent but still significant, particularly for small businesses that face difficulty obtaining formal credit. Informal

lenders assess creditworthiness based on relationships and trust, leading to more flexible and accessible loans.

   - **Estate Sector**: Estate workers often engage in informal financial transactions, driven by low wages, citizenship issues, and limited access to formal financial institutions.

3. **Factors Driving Informal Financial Services**:

   - **Accessibility and Flexibility**: Informal lenders are often more accessible and flexible compared to formal institutions. They require little to no documentation or collateral, offer quick credit, and provide repayment flexibility.

   - **Cultural and Social Ties**: Borrowers often turn to informal lenders due to personal relationships, trust, and the proximity of these lenders to their communities.

   - **Cost and Risk**: Although informal loans are accessible, they often come at a high cost, with interest rates exceeding 100% per annum in some cases. Despite these high costs, the informal sector remains popular due to its ability to provide urgent, flexible credit.

4. **Impact of Informal Financial Markets**:

   - **Economic Development**: Informal markets are crucial in less-developed economies like Sri Lanka, where they meet the financial needs of segments excluded from formal financial systems. However, their dominance in rural and estate sectors highlights the underdevelopment of formal financial institutions in these areas.

   - **Potential for Formalization**: The study emphasizes that informal financial markets coexist with formal ones and that formalization could help improve financial inclusion. However, the process needs to be gradual and sensitive to the needs of local communities, as rapid formalization may disrupt existing systems.

Key Analytical Messages:

1. **Importance of Informal Financial Markets**: Informal financial markets play a critical role in meeting the financial needs of rural, urban, and estate communities in Sri Lanka. They provide essential services to populations that are excluded from formal financial institutions due to barriers like documentation requirements, collateral demands, and irregular income patterns.

2. **Challenges in Formalizing Informal Markets**: While formalization offers benefits like reduced interest rates and legal protection, it comes with challenges. Formalizing informal financial systems would require addressing legal, regulatory, and social barriers. Furthermore, formal institutions must adapt to the needs of rural and low-income populations by offering more flexible and accessible services.

3. **Policy Implications**: The study suggests that policy interventions aimed at expanding formal financial services in underserved regions should prioritize improving infrastructure, reducing procedural complexities, and increasing awareness of formal financial options. Formalizing informal markets should be done incrementally, with the goal of creating a semi-formal financial environment that blends the benefits of both systems.

4. **Risks and Costs of Informal Lending**: Despite its accessibility, informal lending is risky for borrowers due to high interest rates and the potential for exploitation. The lack of legal recourse and formal contracts makes informal lending less secure, particularly for those with limited bargaining power, such as small farmers and estate workers.

Conclusion:

Informal financial markets continue to play a significant role in Sri Lanka, particularly in rural and estate sectors. While formal financial institutions have expanded, they still fail to reach all segments of the population, leaving informal systems as the primary source of credit for many. The study highlights the need for a careful and inclusive approach to formalizing these markets to ensure that the financial needs of all Sri Lankans are met without disrupting existing, informal systems that serve vital roles in their communities.

Publisher: Central Bank

Location: Association of Professional Bankers

Author: Lutz Grasof

Title: Reaching the poor clients in Sri Lanka: People's Bank Pawning and Savings Centers

Source: Report

Year: 2002

Pages: 11

Research Questions:

The key research questions explored in this study include:

1. How do People's Bank Pawning and Savings Centers serve poor and rural clients in Sri Lanka?
2. What role does pawning play in meeting the financial needs of poor clients?
3. How does People's Bank compete with other financial institutions and informal lenders in rural areas?
4. What are the operational structures, performance, and profitability of PB's Pawning and Savings Centers?

Methodology:

The study primarily uses qualitative and quantitative data gathered through interviews with 23 Pawning and Savings Centers (PSCs) across Sri Lanka, divided into rural and urban locations. These interviews, supported by data provided by PB's headquarters, offer insights into customer demographics, preferences, and behavior, as well as the operational performance of the PSCs.

Sample:

The sample includes 23 randomly selected PSCs, with 8 in urban areas and 15 in rural areas. Although not statistically representative, the interviews provide valuable insights into customer preferences and operational trends. The study also uses historical data from PB to illustrate the growth of the pawning business and its significance within the bank's portfolio.

Findings:

1. **Growth and Outreach of People's Bank**: PB is the largest bank in Sri Lanka in terms of customer base, with 40% of its clientele comprising small industrialists and farmers. The bank's focus on micro-savings and pawning has helped it reach rural and low-income segments. PB's pawning business saw significant growth, particularly after 1995, when the bank shifted its focus from corporate lending to microloans.

2. **Pawning Operations**:

    - **Pawning Process**: Customers pawn gold jewelry to secure small loans. The value of the pawn loan is typically less than the market value of the gold, ensuring that borrowers have an incentive to repay the loan. The processing time for a pawn loan is under five minutes, making it highly efficient.

    - **Customer Profile**: Pawning is more common in urban areas, while saving is more popular in rural areas. Women are more frequent users of both pawning and savings services, with 60% of pawning customers being female. In rural areas, farmers and housewives are the primary customers, while urban users are mostly small business owners.

    - **Purpose of Loans**: The primary reasons for taking out pawn loans in urban areas are for business purposes, while rural customers primarily use pawning for consumption and emergencies. Rural customers also use pawn loans for agricultural purposes, with repayment typically occurring after harvests.

3. **Savings and Customer Behavior**:

    - Savings accounts are more common in rural PSCs than in urban ones. Customers in rural areas tend to save for emergencies and consumption needs, while urban savers also focus on business and house construction.

    - PSCs generally offer micro-savings products with low minimum balances and no restrictions on transaction frequency, which are popular among poor clients.

4. **Performance and Profitability**:

    - PSCs handle a significant portion of PB's pawning portfolio, despite having a much smaller workforce than PB branches. PSCs account for 33% of PB's pawn loans but employ only 6% of the staff.

    - Pawn loans are a highly profitable product for PB, with low default rates due to the collateral (gold) that backs the loans. The average pawn loan is Rs. 4,680, and the defaulted loans are auctioned twice a year.

- Savings mobilized by PSCs is lower than expected, indicating potential for growth in savings products in rural areas. However, pawn loans are in high demand, making PSCs an efficient tool for reaching poor clients.

5. **Competition and Market Dynamics**:
   - Despite increased competition from other banks after the 1998 amendment to the Banking Act, PB remains the market leader in pawning due to strong customer relationships and trust. Other banks may offer lower interest rates, but PB's customers prefer the reliability and accessibility of its services.
   - Informal financial services, such as Rotating Savings and Credit Associations (RoSCAs) and loans from friends, relatives, and moneylenders, still play a significant role in rural areas. However, PB has managed to capture a large share of the savings market through its extensive rural outreach.

Key Analytical Messages:

1. **Pawning as a Financial Inclusion Tool**: Pawning provides an important means for poor clients, particularly in rural areas, to access short-term credit. The process is fast, simple, and involves minimal risk for both the bank and the borrower due to the collateral provided. This service has been vital in extending credit to segments traditionally underserved by formal banking systems.
2. **Operational Efficiency of PSCs**: The streamlined operations of PSCs make them highly efficient in serving large numbers of poor clients. By focusing on a limited range of products and maintaining low overhead costs, PSCs can cater to the micro-loan and micro-savings needs of rural populations.
3. **Challenges in Savings Mobilization**: While pawning is highly successful, savings mobilization at PSCs lags behind. This highlights a potential area for improvement, as rural and poor clients still hold a significant portion of their wealth in non-cash assets such as gold.
4. **Sustainability and Profitability**: PSCs have proven to be profitable, primarily due to the demand for pawn loans. However, their long-term sustainability will depend on their ability to mobilize more savings and expand their product offerings to meet the broader financial needs of rural clients.

Conclusion:

People's Bank Pawning and Savings Centers have successfully reached poor and rural clients by offering a limited but highly demanded range of financial products. Pawning, in particular, has proven to be an effective tool for financial inclusion, providing quick and easy access to credit for those who lack the documentation or collateral required by formal lending institutions. The PSC model demonstrates that by simplifying procedures and reducing transaction costs, formal financial institutions can effectively compete with informal lenders in rural areas.

Publisher: People's Bank

Location: People's Bank