Journal of Management Matters Volume 4 Number 2 December 2017: 37-45

Journal of Management Matters

Journal homepage: www.rjt.ac.lk/mgt

Faculty of Management Studies, Rajarata University of Sri Lanka

Microfinance services and growth of micro & small scale industries in Sri Lanka

T.D.S.H. Dissanayake
Department of Accountancy and Finance, Faculty of Management Studies,
Rajarata University of Sri Lanka, Mihintale, Sri Lanka.
sulochanad@mgt.ac.lk

Abstract
This study investigates the impact of microfinance services and growth of micro and small scaled enterprises in Mathugama area in Kaluthara District. A sample of 120 firms was selected for the study using stratified random sampling method. Data were collected using a structured questionnaire which was tested for validity and reliability. Correlation and regression analysis were used as main methods of data analysis. The study found that micro credit facilities such as loan size, repayment period, installment mode, follow up procedures, and interest rates and training provided by micro finance institutions have significant influence on the growth of micro and small scale enterprises. This study suggests that the micro finance services and training provided by micro finance institutions are important factors to determining growth of micro and small scaled enterprises. Furthermore, this provides insights to micro finance institutions, potential investors and other stakeholders make their decision better.

Key words: *Micro credit, Microfinance, Micro and small scaled enterprises*

1. Introduction

Micro finance is an effective mechanism to empower people who are excluded from the traditional banking system (Gamage, 2003). According to evolution of micro finance, it comes from 1976 with the development of the Grameen Bank concept introduced by Prof. Yunus in Bangladesh (Lutzenkirchen & Weistroffer, 2012). On the other hand someone has argued that it traced back to 1906 in Latin America since, there was evidence for Social banking, Group based lending, and Self-help group concepts (Gamage, 2003). Even though it is believed that origin of microfinance is in Bangladesh and all concepts are arranged to obtain small loans and advisory services to develop small scaled business who are excluded from traditional banking system (Christoper, 2011).

It is evident that; micro finance activities contribute more on enhance Micro and Small scaled Enterprises (MSEs). Recently Sri Lankan government has introduced varieties of loan facilities through Enterprise Sri Lanka concept to support the small scaled businesses. Businesses can be categorized as micro, small, medium and large scale enterprises (Gamage, 2003) and this sector comprises of agriculture, plantation, construction, manufacturing, trade and other service (Jayasekara & Thilakarathna, 2013). However, Gamage (2003) argues that there is no clear definition for MSEs in Sri Lanka. Based on the above background information it is essential to identify how these activities involve growth of MSEs in Sri Lanka as a developing country. Accordingly, this study is investigating the impact of microfinance service on the growth of MSEs in Mathugama area in Kaluthara District.

The MSE sector has become a high-powered segment and key section of private sector in developing countries like Sri Lanka (Jayasekara & Thilakarathna, 2013). At present, main job creation segment is MSEs' in Sri Lanka. Therefore, it is very important to accelerate the developing of MSEs for economic growth. On other hand, microfinance institutions is very important to development of MSEs since most of the MSEs are used microfinance services provided by microfinance institutions (Franca, 2013). Mainly they provide micro credit to MSEs. In addition to these financial services, they provide non-financial services like business training, financial and business management to improve the capacity of MSEs.

However, there is dearth of studies regarding Microfinance and MSEs in Sri Lanka and many researches have been conducted by eastern and western countries. Thus, it is important to conduct a study in this area and this can contribute to fulfill the existing awareness gap. Because in Sri Lanka lack of researches have been conducted in this area and for the current study researcher has selected Mathugama area in Kaluthara district since it is a recent developing city in Kaluthara district. Many MSEs in Mathugama are engage with micro finance services (Regional Development Bank project report, 2017). Thus most of them are excluded from traditional banking sector.

The general objective of the study is to investigate the impact of micro finance services on the growth of micro and small entrepreneurs in Mathugama area in Kaluthara District. The study specifically attempts to achieve the following specific objectives;

- To identify the impact of micro credit on growth of micro and small scale enterprise
- To identify the impact of training provided by micro finance institutions on growth of micro and small scale enterprise.

2. Review of literature

Microfinance as an economic development method that involves providing many financial services to low-income clients, who are the people excluded by the traditional banking system, that services include credit saving and insurance services provided by the Microfinance Institutions (Wanambisi, 2013). Further, many microfinance institutions provide social intermediation services such as, organizational support, training and education, health and skills according to their development objectives. On the other hand Pillai and Nadarajan (2010) refers microfinance as small savings, credit and insurance services extended to socially and economically poor segments of society. It is defined as provision of thrift, credit and other financial services and products of very small amounts distributed to the poor in rural and semi urban or urban areas, for enabling them to raise their income levels and improve living standards. The accessing credit is considered to be an important factor in increasing the development of micro & and small scale enterprises. It is thought that credit accretes income levels, competitiveness increase sales volume, and business development and there by more profits. It is believed that access to credit enables MSEs to overcome their liquidity constraints and undertake investment. The main objective of microfinance according to is to improve the welfare of the low income earners in rural area (Ngehnevu & Nembo, 2010).

Furthermore, Babajide (2012) found that micro-financing practiced in Nigeria microfinance banks do not enhance growth and expansion capacity of micro and small enterprise in Nigeria which implies that micro finance does not enhance the expansion capacity of small business in Nigeria. Further findings indicate that although the MFIs have performed below a set standard on average due to some industry wide challenges, they have had a significant impact in linking SMEs and the poor to sources of credit and contributed to their growth in terms of growth of business capital and stock accumulation. It is recommended that there is need for an institutionalized public-private partnership for creating favorable conditions for the operations of these enterprises (Khan, Naseem & Kasi, 2012)

On other hand, Ngehnevu and Nembo (2010) found that microfinance is only a portion of what is needed to boost an enterprise activity in the rural areas and who are incapable of getting the loan necessary assistance from a commercial bank. It develops new markets, increases income, creates and accumulates assets and promotes a culture of entrepreneurship. The Cameroon Corporative Credit Union League (CamCCUL) has a positive impact in the development of the members' businesses. CamCCUL provides its members with financial and social intermediation services to improve their businesses. Further, Wanambisi and Bwisa (2013) identified the amount of loan significantly positively related with performance of MSEs in Kitale Municipality and study indicated a strong positive significant relationship between the amount of loan and performance of MSE increase in income/sales. Babajide (2012) had used of characteristics of microfinance institution such as, asset loan size received from microfinance bank, asset loan duration, asset loan repayment, loan interest of his study and results of suggest size of assets loan on expansion capacity of the micro & small enterprise show that unit increase in size of assets loan will increase sales growth Nigeria. But the size of the loan is too small for any meaningful impact on small firms. Duration of assets loan shows a positive relation with sales growth for the entire sample, but not statistically significant for total sample and small firms, meaning that the duration of the asset loan is too short for any meaningful impact on micro & small enterprises growth. Further, repayment of asset loan, the results show a negative correlation with sales growth, which is in support of economic theory but negates micro finance theory because of the frequency of repayment. As well as it is not statically significant with sales growth of the Babajide

(2012) study. The result revealed that a unit increase in repayment period will cause annual sales growth to decrease. Further, the result for total sample and small firms sample are not statistically significant.

Koech (2011) conducted a study to find out the financial constraints that hinder growth of SMEs in Kenya. The researcher adapted the case study approach and targeted SMEs in Kamukunji District. The study used structured questionnaires as the main tool for data collection. Data was analyzed by exploratory factor analysis and descriptive analysis with the help of SPSS to obtain percentages and frequency distribution tables. The factors hindering growth of SMEs were identified as capital access, cost, capital market collateral requirements information access, capital management and cost of registration. The study recommended that business financiers through loans consider reducing collateral requirements to facilitate SMEs easy access to loans.

Accordingly, it summarized micro finance organizations provide more financial services to their clients such as savings and credit services to enhance the MSEs'. They provide access to capital on smaller scale and enable poor people to engage in productive economic activities and thus contribute to the development in low income population. Micro finance organizations also provide social intermediation services such as formation of groups, development of self-confidence and the training of members in that group on financial literacy and management. They also provide micro insurance services to SMEs to enable them manage their business risks.

3. Methodology

Research approach is vital part of the study since it allows researcher to understand the problems to be examined in their research choose the appropriate research method. Further, the positivism paradigm is the approach that investigates studies with complex sets of facts and associations between those facts (Smith, 1998 as cited in Cooper and & Schindler 2003). This paradigm is frequently associated with quantitative methods of analysis that examine the relationships between measurable variables (Bryman, 2008 as cited in Wanambisi & Bwisa 2013). The aim of such research is to reveal patterns within quantitative data that can be used to produce general laws and to predict future pattern of behavior (Ayuub, 2013). Accordingly current study attempts to identify the association between microfinance services on growth of MSE. Thus, it is more appropriate to use positivism research approach with quantitative research method. Further, Wanambisi and Bwisa (2013) use this approach to identify association.

The current study selects firms in agriculture, plantation, construction, manufacturing, trade and & other service according to (Gamage, 2003) and the population of the study consists of micro and small size enterprise in 24 Gramaniladari divisions in Mathugama area in Kaluthara District. The study used the definition for MSEs, which is an enterprise with less than 10 people and turnover below Rs.5 million per annum. A total number of 120 sample units were selected from stratified random sampling method and this study employed a structured questionnaire as a sole means of data collection from respondents and the questionnaire was adopted from Helms (2006) as cited George (2012) to elaborate the growth of MSEs' and Micro finance services. All questions of micro credits, training provided by MFIs and growth of MSEs' was rated on five point Likert scale and questionnaire was divided into three sections. First section contained demographic questions and second on the microfinance services and next section was on growth of MSEs. Microfinance services divide into two as micro credit and training provided by MFIs. Further micro credit measures through loan size, repayment period, installment mode, follow up procedures, and interest rates.

The conceptual model that was used in this study was in the form of an econometric expression. It was in the form;

$Y = \alpha + \beta X1 + \beta X2 + \infty$

Where;
Y = Growth of MSE
α = Constant/the intercept point of the regression line and the y-axis
β = The slope/gradient of the regression line
X1 = Microcredit
X2 = Training provided by MFIs
∞ = Error Term

It is necessary to build up hypothesis to test the relationship between dependent variable and independent variables to see the validity of the assumptions.

H1: There is a significant impact of micro credits on growth of MSEs'

H2: There is a significant impact of Training provided by MFIs on growth of MSEs'

4. Result and discussion

This section involves the result and discussion in relation to achieve the objectives.

Table 1
Demographic information of the sample

Gender	%	Age	%	Education	%	Business Experience	%	Sales in "000"	%
Male	39.2	<18-25	12.5	Primary	21.7	<1 year	27.5	5-10	18.3
Female	60.8	<26-35	22.5	Secondary	55.8	<2 year	21.7	10-20	24.2
		<36-45	25.8	Diploma	19.2	<3 year	14.2	20-50	31.7
		<46-55	23.3	Graduate	1.7	<4 year	22.5	50-100	21.7
		>56	15.8	Other	1.7	>4 year	14.2	>100	4.2

Loan in "000"	%	Sector	%	Installment Period	%
5-20	8.3	Manufacturing	22.5	1 week	45
20-50	15.8	Service	29.2	2 week	45
50-100	31.7	Whole Sale & Retail	48.3	3 week	6.7
>100	44.2			1 year	2.5
				Above 1 year	0.8

According to above descriptive statistics the majority of females are engaged with the micro finance activities which is 60.8 percent and most of them are in between 26 to 45 years. Most of them have completed their secondary education 55.8 percent and their business experience is less than 2 years and some of them have 4 years' experience. The sales given in thousand rupees and commonly they earn Rs.20000 – Rs.50000 sales margin which is 31.7 percent compared to other sales breakup. The MFIs mostly given loans category in between more than Rs.100000 and it is 44.2 percent as well as using this loan most of them are involved with whole sale and retail business. Further as usually, MFIs grants loans for 1 week and 2 weeks.

Table 2
Test of validity and reliability

Variables	Convergence validity			Reliability
	KMO Statistics	Bartlett's test stat. (P value)	AVE to be > 0.5	Cronbach's Alpha
Micro credit	0.742	175.748 (<0.001)	0.5623	0.766
Training provided by MFIs	0.798	541.936 (<0.001)	0.5231	0.828
MSEG	0.823	589.519 (<0.001)	0.5842	0.903

According to the Table 2, KMO statics represented that this sample adequate. In fact, all the cases of this value is higher than 0.5 among all variable and it concluded the sample adequacy of each variables. Next Bartlett's test value tested P value of the survey data for measure the validity of sample. Same as KMO here in all the cases it ensure the validity of sample. Then again to measure the validity of questionnaire has been used AVE value and this value should be more than 0.50. Micro credit facilities show 0.5623 and training provided by MFIs indicates 0.5231 and growth of MSE shows 0.5842. The generally accepted minimum standard for internal consistency is 0.7. In this study Cronbach Alpha value was presented above 0.7 of all variables. Thus it is satisfied the internal consistency of the constructs.

Table 3
Descriptive statistics

	MSEG	Micro credit	Training provided by MFIs
Mean	2.6458	2.9194	3.2861
Median	2.7500	2.8333	3.3333
Std. Deviation	.97020	.58181	.49773
Variance	.941	.339	.248

According to the data presented in Table 3, all the values are at a moderate level thus sample MSEs, have moderate perception on loan size, repayment period, installment mode, follow up procedures, interest rates and training provided by MFIs.

Table 4
Correlation analysis

	MSEG	Micro credit	Training provided by MFIs
MSEG	1		
Micro Credit	.788**	1	
Training provided by MFIs	.685**	0.721*	1

According to Table 4, correlation analysis every variables are significant and positively correlated with growth of MSEs and less than 80 percent and it conclude there is no multi-collinearity.

Table 5
Regression analysis

	MSEG	Micro credit	Training provided by MFIs
R – Square	0.685		
F – Value	46.824**		
Unstandardized Coefficient		0.658 (<0.001)	0.255 (<0.05)
Standardized Coefficient		0.636	0.111

According to Table 5, R – square represents the explanatory power of the study model and it has recorded as 68.5 percent. Thus, Micro credits and training provided by MFIs are 68.5 percent explained by growth of MSEs. As well as overall model significant at 1 percent level. On other hand, coefficient values of micro credit and training provided by MFIs are significant at 1 percent and 5 percent level respectively and all the hypotheses were accepted. Accordingly, there is a significant impact on growth of MSEs by micro credits as well as there is a significant impact on growth of MSEs by training provided by MFIs.

5. Conclusion

The present study investigated the impact of microfinance services and growth of MSEs in Mathugama area in Kaluthara District. This study adopted positivism research approach with quantitative research method to identify the association between microfinance activities on growth of MSEs in Mathugama area and research showed that financial credit services such as loan size, repayment period, installment mode, follow up procedures, interest rates and training provided by MFIs have positive significant impact on growth of MSEs in Mathugama area. The loan size is important factor to initiate or expand the business of MSEs' since most of the cases they face problems when financing capital to the organization. The next significant factor is repayment period and follow-up procedures. These are important in both parties such as MFIs and MSEs' since the main problem face by MFIs is increasing non-performing loan rate. So MFIs need to provide considerable period to repay the loan while reducing non-performing loan rate in the organization. Next interest rate of micro credit and this should be fair in two perspective since as per the MFIs, they grant loans to poor people who are excluded from traditional banking system so they need to consider default and market risk when deciding interest rate for micro credit facilities. Further, it provides insights for policy makers and other stakeholders of above significant variables when providing micro finance services as a means of growth of MSEs.

References

Abdul, A. (2000). Impact of Microfinance Institutions on Growth of Micro and Small Enterprises and Owners in Tanzania. *Journal of Finance and Management*, *2*.

Abdul, A., & Chijoriga, M. (2000). The Performance and Sustainability of Micro Finance Institution in Tanzania, *Working Paper.*

Ayuub, S. (2013). Impact of Microfinance on Poverty Alleviation: A case Study of NRSP in Bahawalpur of Pakistan. *International Journal of Academic Research in Accounting and Management Sciences, 3*(1), 119-135.

Babajide, A. (2012). Effects of Microfinance on Micro and Small Enterprises (MSEs) Growth in Nigeria. *Asian Economic and Financial Review, 2*(3), 463-477.

Christopher, I. F. (2011). Impact of Microfinance on Small and Medium-Sized Enterprises in ESBA, Micro and Small Business in the EU: European Small Business Alliance.

Cooper D. R., & Schindler P. S. (2003). Business Research Methods, (8 Ed) Tata McGraw-Hill Inlc, New York

Franca, N.C. (2013). The Impact of Micro Credit Institutions on the Development of Small and Medium Enterprises in Anambra State, *IOSR Journal of Business and Management*, *14*(5), 75-81.

Gamage, A. S. (2003). Small and Medium Enterprise Development in Sri Lanka, *M.Sc. Research Paper, University of Sri Jayawardenapura, Colombo.*

George, K. A. (2012). Effects of microfinance institutions on small and medium scale enterprises in rural Ghana, *MBA project*

Jayasekara, J.P.D.R. & Thilakarathna A. (2013). Government Policy and Strategy for SME Development, *Sri Lanka,* the Fourth IMF-Japan High-Level Tax Conference for Asian Countries in Tokyo April 2–4.

Khan, S., Naseem, A., & Kasi, S. (2012). Microfinance and Small Enterprises Development: Client Perspective Study of Baluchistan, Pakistan. *International Journal of Arts and Commerce, 1*(5), 279-292.

Koech, C. B. (2011). A survey of the financial constraints hindering growth of SMEs in Kenya: The case of Kamukuji District in Nairobi County. *MBA Project.*

Lutzenkirchen, C., & Weistroffer, C. (2012). Microfinance in evolution: An industry between crisis and advancement. Current issues, Deutsche Bank, DB Research.

Ngehnevu, C. B., & Nembo, F. Z. (2010). The Impact of Micro Finance Institutions (MFIs) in the Development of Small and Medium Size Businesses (SMEs) in Cameroon. *Uppsala.*

Pillai, N., & Nadarajan, S. (2010). Impact of Microfinance - An Emperical Study on the Attitude of SHG Leaders in Kanyakumari District - Tamilnadu. *International Journal of Enterprise and Innovation Management Studies. 1*(3), 89-95.

Shaheid, N. (2014). Creating an Enabling Environment for SME's in Sri Lanka - The Role of the Public Sector Sri Lanka: National Enterprise Development.

Wanambisi, A. N., & Bwisa, H. M, (2013). Effects of Microfinance Lending on Business Performance: A Survey of Micro and Small Enterprises in Kitale Municipality, Kenya. *International Journal of Academic Research in Business and Social Sciences*, *3*(7), 56-67.

Wilfred, N. K., Max, A., Michael, O., Moses, N., & Norman, T. (2013). The Impact of Microfinance Service Delivery on the Growth of SMEs in Uganda. Kampala: Investment Climate and Business Environment Research Fund, *ICBE-RF Research Report N0. 69/13.*