

## **Analytical Study on Factors Affecting Sustainable Growth of Microfinance Companies in Trincomalee District**

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### **ABSTRACT**

This study investigates the factors affecting the sustainable growth of Microfinance companies in Trincomalee District. Microfinance has become an important tool for poverty reduction in Sri Lanka especially in Trincomalee District. Sustainability of MFIs is the key expectations of the investors and other stakeholders in the industry and government and regulatory bodies also concern the sustainability element. So that this paper assesses the factors affecting the sustainable growth of Microfinance companies in Trincomalee District by using sustainable growth as the dependent variable while profitability, interest rate, liquidity and loan default are the independent variables. The researcher used primary and secondary data for conducting the study. Hence, primary data for the study was collected through survey (Quantitative study) through distributing questionnaires among the managers/executives and credit field officers from respective two leading MFIs in Trincomalee District. Univariate, bivariate and multivariate statistics were used to analyze data. Under Univariate statistics, mean, median, mode, standard deviation are used. Under Bivariate statistics, correlation analysis is performed to measure the causal relationship between the variables. Multiple regression analysis is performed under multivariate analysis. Reliability and sample adequacy of study was run to ensure the reliability of the study and sample adequacy. According to the study, it found there is a high relationship between profitability and sustainable growth of MFIs. And also the findings expressed that there is a moderate level of relationship between liquidity and sustainable growth of MFIs. Besides it indicates that other factors such as loan default rate and interest rate are the key forces influences on the sustainable growth of MFIs. It is recommended that the management has to formulate the business strategies for increasing the business profitability to ensure the business viability.

### **Key Words**

Micro finance, Sustainability Growth, Business profitability

## **Introduction**

Financial sector has been developed in Sri Lanka in past few decades and microfinance sector has become so popular among the people. According to Otero (1999), Macro finance is “the provision of financial services to improve access to small deposits and small loans for poor households neglected by banks (Schreiner, 1999). According to this definition microfinance is the financial method and source in which financial providers aim to deliver the finance to economically poor people in the society and self – employed persons in the society to empower the economic capability. Microfinance includes the provision of financial services such as savings, loans and insurance to poor people or public who live in both urban and rural areas that are unable to acquire such services from the formal financial sector (Otero, 1999).

## **Literature Review**

Attanayake (1997), has classified microfinance institutions in to three groups in Sri Lanka. First type is formal credit institutions which includes commercial banks (state and private) and regional development banks (RDB). Second category is Co – operatives which was introduced in 1990s. Third type is semi-formal financial institutions which includes Sarvodaya Economic Enterprise Development Services (SEEDS). With the analysis of the current situation and development in relation to macro finance sector behavior, Microfinance has become the core product which contributes to organizational profitability at the considerable level.

The sustainability has become key strategic direction of the firms. The organizational sustainability consists of many aspects including institutional sustainability, mission sustainability, program sustainability, Human resource sustainability, financial sustainability, market sustainability, legal and policy environment sustainability etc.

With the analysis of available literature, it is shown that microfinance is the financial solution for the people who need the finance for different situations. It shown that microfinance has several objectives such as empowering economically poor people and community, improving household economic welfare, empowering women by supporting women’s economic participation promoting gender equity, poverty reduction by generating capital for poor people in the society, development of the human capital, entrepreneurship development, social capital development, organizational development, empowerment of the social units, eradicating extreme poverty and hunger, to achieve universal primary education, to promote gender equality and empower women, to reduce child mortality, to improve maternal health, to ensure

environmental sustainability, to combat diseases and social and economic equity etc. In addition to above, it summarized that microfinance is the solution for improving financial inclusion. It is summarized that sustainable growth is the part of the business sustainability and it is influenced by many factors such as profitability, loan default, interest rate and liquidity of the firms.

Patric (2014), stated that the firm profitability is one of factor affecting to the sustainability of MFIs. According to Higgins (2000), profitability refers the ability to obtain profit from all the business activities of an organization. It is a management effort to efficient and effective utilization of organizational resources in order to achieve the desire profit. Further, sound management has the ability to make value addition to profit maximization. According to Donnahoe (1999), the word profitability can be divided in to two, as profit and ability. The word refers to ability is the power of business entity to earn the profit. Therefore, profitability can be defined as ability to gain the profit by given investment. Most of the “MFIs are having problem to attain the required profitable level of business operations in Africa” (Mosley, 1998).

Aseiduk (2010), pointed out that competition and gender composition (Female) are also having positive relationship on sustainability in microfinance. As per the study of Sumith (2011), the competition may play a major role in sustainability of the sector and further, it said that increasing the competition for profit would decrease the efficiency as well as sustainability. In the study of profit would decrease the efficiency as well as sustainability. In the study of Attanayake (1997), revealed that growing of MFIs is highly dependable on the profitability of the institution and it can be measured by analyzing operations and financial return on assets and return on equity ratios.

Armendariz (1999) in his study stated that, to achieve the sustainability.MFIs should utilize donors, investment, reduce loan losses and to ensure Co-operate social responsibility (CSR).According to Angaine (2013), technology, market strategy, market intelligence and competition would be affected to the profitability. Mutua (2017), highlighted that the level of firm liquidity is the key factor affecting to the sustainability of MFIs. According to Higgind (2000), the liquidity can be defined as the ability to increase the funds in assets in order to meet the obligation when an institution requires without having any losses. The liquidity risk has to

be managed in such a way to fulfill the cash demand either internal or external of the institution. Therefore, managing the liquidity in an institution may cause to the system or wide bad repercussion.(Basel Committee on Banking Supervision,2008).

According to Buckley (1997), found that financial institutions have a problem with liquidity and it may face difficulties in fulfilling the cash demands of depositors. Thus, the risk of liquidity may be overcome by maintaining adequate cash reserves, raising deposits and narrowing the liquidity gap.(Donnahpoe,1999).Illustrated that the financial performance of MFIs are greatly dependent on liquidity level of the institutions. Therefore, have to have some mechanism in order to increase the liquidity. Further, MFIs have to offer more loans and it would increase the liquidity while facilitating the asset growth. According to Aseiduk K (2010), the liquidity can be defined as the ability of the financial institutions to cover its liabilities without having any losses.

### **Statement of Problem**

Microfinance has become the solution for “provision of financial services to low income people” to meet their financial needs and wants. The microfinance aims to enhance the income generation, living status and capabilities of households by taking an active role to the Sri Lankan economy. The microfinance sector in Sri Lanka has been evolved and developed through the wide range of products, services, institutions to meet the need of financial inclusion. According to (CBSL, 2016), Microfinance solutions are delivered by licensed banks, licensed finance companies, co-operative rural banks, thrift and credit cooperatives societies, divineguma banks and other community based organizations, microfinance companies, non-governmental organizations that engage in microfinance business.

The poor and low income people lend money from MFIs with high interest rate while other financial institutions provide the loan with low interest rate when compared to the MFIs. most of the poor and the people who are living in rural areas are low educated and therefore, they seek the financial assistance from MFIs due to low documentation and less guarantees and they do not realize that they will have to pay high interest rate for the loan. The main reason for having such a number of MFIs in the Trincomalee district and other districts in Sri Lanka, the majority of farmers and households are moderately literate people. Most of them do not have

fixed assets to pledge as collateral to obtain loan facilities for the agricultural activities from the commercial banks. Therefore, MFIs are more popular in the district due to these reasons.

According to (Centre for Financial Inclusion, 2008), the sustainability of financial firms has become a key requirement for the long run development of the financial operations. Especially, Central Bank of Sri Lanka has focused on the sustainability of microfinance institutions and other operators in the industry. The internal and external factors affecting the sustainability of microfinance to sustain the microfinance companies and socio economic factors, financial aspects in organizational factors effects on sustainability of MFIs, Sri Lanka.

Specially, the sustainability of MFIs is the key expectations of the investors and other stakeholders in the industry and government and regulatory bodies also concern the sustainability element. Therefore, the research objective of this study is what are the factors affecting sustainability of microfinance institutions in Trincomalee district.

### **Research Questions**

1. What are the factors affecting the sustainable growth of microfinance companies in Trincomalee District?
2. What effect of these factors to increase the sustainable growth of Microfinance companies in Trincomalee District?
- 3.

### **Research Objectives**

#### Primary Objectives

The main objective of the study is to assess factors affecting the sustainable growth of Microfinance companies in Trincomalee District.

#### Secondary Objectives

The secondary objectives of the study are as follows:

1. To explore factors affecting the sustainable growth of microfinance companies in Trincomalee District.
2. To identify what effect of these factors to increase the sustainable growth of microfinance in Trincomalee District.

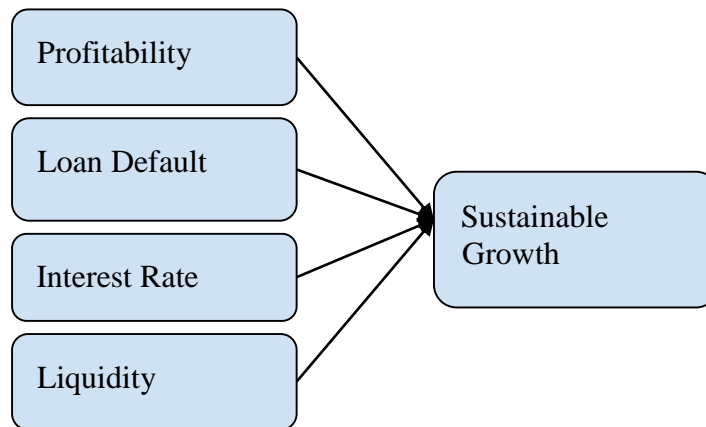


Figure 01: Conceptual Framework

Table 01: Operationalization of Variables

<b>Variables</b>	<b>Attributes</b>	<b>Measures</b>
Sustainability	<ul style="list-style-type: none"> <li>○ Customer satisfaction</li> <li>○ Client background and demand</li> <li>○ Loan terms and requirement attract new client</li> <li>○ Effective awareness program for customer</li> <li>○ Innovative financial planning</li> <li>○ Employees motivation and satisfaction</li> </ul>	Ordinal data: 5 points Likert scale
Profitability	<ul style="list-style-type: none"> <li>○ Customer focus</li> <li>○ Scale of loan</li> <li>○ Low promotion cost</li> <li>○ Less loan security</li> </ul>	Ordinal data: 5 points Likert scale
Loan Default	<ul style="list-style-type: none"> <li>○ Willful negligence</li> <li>○ Improper loan appraisal</li> <li>○ Productive loan collection</li> <li>○ Easy collection method</li> <li>○ Progressive lending</li> <li>○ Team lending</li> </ul>	Ordinal data: 5 points Likert scale

Interest rate	<ul style="list-style-type: none"> <li>○ Willingly payment</li> <li>○ Bearable rate</li> <li>○ Loan default risk</li> <li>○ High monitoring cost</li> </ul>	Ordinal data: 5 points Likert scale
Liquidity	<ul style="list-style-type: none"> <li>○ High risk</li> <li>○ Loan recovery period</li> <li>○ Continues lending</li> <li>○ Number of clients</li> <li>○ Development of institute</li> </ul>	Ordinal data: 5 points Likert scale

### Hypotheses

In order to meet the objectives, this study adopts the following hypotheses:

Ho: There is no relationship between dependent variable and independent variable

**H1:** There is a positive relationship between profitability and sustainable growth

**H2:** There is a positive relationship between loan default and sustainable growth

**H3:** There is a positive relationship between interest and sustainable growth

**H4:** There is a positive relationship between liquidity and sustainable growth.

### Sampling Design

The study focuses on sustainable growth of MFIs in Trincomalee district, therefore population, sampling framework, final sample size was defined in relation to the study.

Table 02: Sampling design

Strategy	Population	Sampling Framework	Final sample size	Sampling method
Survey with Officers:	Total number of executives/ Managers in MFI-1	A list of executives/ Managers in MFI-1	50 of executives/ Managers in MFI -1	Simple Random sampling- Probability sampling
Survey with officers:	Total number of executives/ Managers in MFI-2	A list of executives/ Managers in MFI-2	50 of executives/ Managers in MFI-2	Simple Random sampling- Probability sampling

Survey with customers	Total number of customers in both MFIs	A list of executives/Managers in MFIs 1&2	100 of customers of MFIs 1&2	Simple Random sampling-Probability sampling
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### Methods of Data Collection

The researcher aims to use primary and secondary for conducting the study. The primary data was considered to be the key input for the analytical process of the study. Hence, primary data for the study was collected through survey (Quantitative study) through distributing questionnaires among the managers/executives and credit field officers from respective two leading MFIs in Trincomalee District.

### Data analysis method

Univariate, bivariate and multivariate statistics were used to analyze data. Under Univariate statistics, mean, median, mode, standard deviation are used. Under Bivariate statistics, correlation analysis is performed to measure the causal relationship between the variables. Multiple regression analysis is performed under multivariate analysis. Reliability and sample adequacy of study was run to ensure the reliability of the study and sample adequacy.

### Analysis

Table 03: Summary of Bivariate Analysis and Hypothesis Testing: Profitability

Sample type	Officers		Customers	
	HNB	Kanrich	HNB	Kanrich
Correlation Value	0.866	0.875	0.864	0.466
Hypothesis testing results	Positive relationship between profitability and sustainable growth of MFI	Positive relationship between profitability and sustainable growth of MFI	Positive relationship between profitability and sustainable growth of MFI.	Positive relationship between profitability and sustainable growth of MFI.

Source: (Survey findings, 2019)

Table 04: Summary of Bivariate Analysis and Hypothesis Testing: Loan default

Sample type	Officers	Customers
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	HNB	Kanrich	HNB	Kanrich
Correlation Value	0.866	0.875	0.864	0.388
Hypothesis testing results	Positive relationship between loan default and sustainable growth of MFI	Positive relationship between loan default and sustainable growth of MFI	Positive relationship between loan default and sustainable growth of MFI.	Low positive relationship between loan default and sustainable growth of MFI.

Source: (Survey findings, 2019)

Table 05: Summary of Bivariate Analysis and Hypothesis Testing: Interest Rate

Sample type	Officers		Customers	
	HNB	Kanrich	HNB	Kanrich
Correlation Value	0.991	0.783	0.879	0.294
Hypothesis testing results	Positive relationship between loan interest and sustainable growth of MFI	Positive relationship between loan interest and sustainable growth of MFI	Positive relationship between loan interest and sustainable growth of MFI.	Low positive relationship between loan interest and sustainable growth of MFI.

Source: (Survey findings, 2019)

Table 06: Summary of Bivariate Analysis and Hypothesis Testing: Liquidity

Sample type	Officers		Customers	
	HNB	Kanrich	HNB	Kanrich
Correlation Value	0.631	0.808	0.536	0.466
Hypothesis testing results	Positive relationship between liquidity and sustainable	Positive relationship between liquidity and sustainable	Positive relationship between liquidity and sustainable	Low positive relationship between liquidity and sustainable

	growth of MFI	growth of MFI	growth of MFI.	growth of MFI.
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Source: (Survey findings, 2019)

## Results and Discussion

According to the study, it found there is a high relationship between profitability and sustainable growth of MFIs. Business profitability is the key investor expectation which has to be achieved by the business to delight the investor. When the business increases the business profitability, the investor's satisfy with the investment decision. In order to increase the business profitability, MFIs have to reduce the operational cost and increase sales and revenue.

The primary survey found that there is a high effect of loan default on sustainable growth of MFIs. Because, loan default rate can directly influences to non – performing loans (NPLs) by reducing the profitability, growth of income, sales and market share. Then, it is evident that loan default rate of microfinance can reduce ability of sustainable growth. Generally, loan value per customer is low and number of the customers of microfinance is high compared to the general loan behavior. Specially, group based financing systems and micro credit system has become the most popular strategy for reducing the loan defaults.

With the analysis of correlation value between the variables of interest rate and sustainable growth, it found that the interest rates have positive relationship with sustainable growth of MFIs. It revealed that the interest rates are also a significant factor affecting to sustainable growth of MFIs. Because interest rate is the key factor which gives the income to the organization. Therefore, MFIs will have to pay significant attention to decide the interest rate when offering the loans. Even though, high interest rate generates more profit, customer may move to another financial solution due to high interest rate. MFIs should have strategic interest rate while keeping customers and earning the desire profit of the business. The hypothesis testing results also show that there is a positive relationship between loan interest and sustainable growth of MFI.

The literature survey found that liquidity if the firm is the main financial concern and it effects on day to day operations of the firm. In this sense, managing favorable liquidity ratio is the key requirements for running the day business operations. The managing the firm liquidity is a

strategic decision and it leads to the financial risk of the firm. The financial institutions is having a problem with liquidity may face difficulties in fulfilling the cash demands of borrowers and depositors. Therefore, the risk of liquidity may be overcome by maintaining adequate cash reserves, raising deposits and narrowing the liquidity gap. Central bank of Sri Lanka has taken initiatives to ensure the liquidity ratio to the respective MFIs to sustain the industry. The primary study found that there is a moderate level of relationship between liquidity and sustainable growth of MFIs. It indicates that other factors such as profitability, loan default rate and interest rate are the key forces influences on the sustainable growth of MFIs.

### **Conclusion and Recommendations**

Based on study findings, it is concluded that profitability is a key performance indicator of the business and it shows the operational efficacy of the business operations and resource utilization. Secondly, it is concluded that sustainable growth also is a key achievement and key performance in the business and it is concluded that level of loan defaults of MFIs effect on the sustainable growth of MFIs. The level of loan defaults in MFIs effects on the business sustainability because, the default rate of micro loan can decide on investment profitability and finance risk. In addition to above, default rate of micro loan can effect on the achievement of micro finance goals and objectives through sustainable micro financing and it demotivates the investors to allocate or re-invest for the business expansion or growth. It is concluded that interest rate is also the significant factor affecting on the sustainable growth of MFIs. Then, MFIs have to consider consumer expectations, industry interest rate and regulatory requirement in managing interest rate as the main product feature of micro credit. In addition to above, it is concluded that effective interest leads to achieve the significant profit for ensuring institutional sustainability.

It is recommended for the management of MFIs to manage the micro loan default ratio to ensure the business sustainability. Then, MFIs have to formulate effective and efficient recovery, collection policies and legislation for reducing the micro loan default for reducing non-payment ratio of the MFIs and it is recommended for MFIs to maintain a sustainable liquidity level to ensure the sustainable growth of MFIs through the effective liquidity ratio by minimizing the risk of the business besides it is recommended that the management has to formulate the business strategies for increasing the business profitability to ensure the business viability.

For the future studies, it is suggested to develop the existing model by adding other variables affecting on sustainable growth of microfinance companies and to increase the sample from another companies and also the time horizon of the study is cross sectional in nature. In addition to above, moderating and controlling variables are ignored from the study. Then, it is suggested to consider moderating and controlling variables for the study.

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