MANCHESTER 1824
The University of Manchester
Brooks World Poverty Institute

CREATING KNOWLEDGE TO END POVERTY

Issue 19
September 2013

MULTIPLE BORROWING IN THE SRI LANKAN MICROFINANCE SECTOR

Ganga Tilakaratna

Sri Lanka has seen a growth of microfinance institutions (MFIs) in recent decades. There is now a wide range of MFIs: co-operatives, development banks, NGOs and government programmes. Formal financial institutions, such as commercial banks, have also expanded their outreach to rural areas. Today, multiple financial institutions are operating in most parts of the country.

In this context, this brief discusses the extent of multiple borrowing in the microfinance sector in Sri Lanka, and its implications. It is based on a panel household survey carried out in 2006-07 and 2009-10. Detailed interviews with multiple borrowers and key informant interviews were also conducted.

Our research reveals increasingly high levels of multiple borrowing in the Sri Lankan microfinance sector. The share of multiple borrowers has increased to almost three-quarters of MFI borrowers in recent years. Multiple borrowing was high across all districts surveyed.

Most multiple borrowers access a mix of MFIs and formal financial institutions, like commercial banks (see Figure 1). A key reason for MFI clients' widespread use of commercial banks is to access pawning facilities (gold-pledged loans). These are commonly used by low-income households for financial emergencies.

The study finds that MFI clients borrow from multiple institutions for a number of reasons:

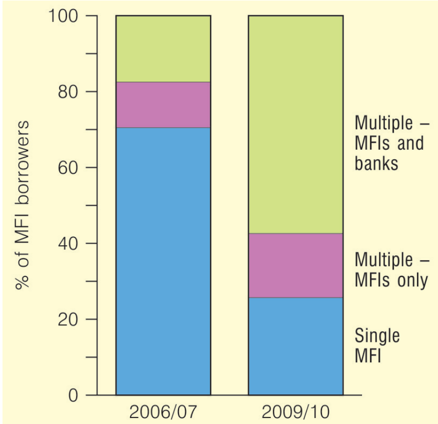
- to build up a lump sum;
- to have access to credit more regularly;
- to access a range of financial products to meet diverse needs; and
- to cross-finance.

Micro-credit bubble?

While the high level of access to financial services should be lauded, some conditions in the microfinance sector in Sri Lanka raise concern about a micro-credit bubble. Debt levels among MFI clients, particularly multiple borrowers, have increased notably in recent years. A number of MFIs, including some key players, have experienced deteriorating portfolio quality, weakening financial performance and high levels of borrower turnover in recent years. There is also a lack of mechanisms to monitor multiple borrowing, and weaknesses in the current regulatory framework for MFIs.

However, mitigating factors indicate that a systematic collapse in the Sri Lankan microfinance sector is unlikely in the near future. Debt levels for most MFI borrowers remain at moderate levels. Moreover, the majority of MFIs mobilise compulsory or voluntary savings from their borrowers, which act as partial collateral for their loans. Other factors that reduce risk are: widespread use of low-risk loan products, such as pawning; the diversity of MFIs and products available; and the decline in donor funds to the sector.

Figure 1: Extent of multiple borrowing in the microfinance sector.



Source: Based on the panel household survey (2006-07 and 2009-10).

Key policy points

- MFI clients borrow both from (multiple) MFIs and from formal financial institutions. Loans from all sources need to be taken into account when monitoring multiple borrowing.
- Mechanisms such as credit information bureaus are needed to monitor multiple borrowing in the microfinance sector and to share credit information among MFIs.
- Diversification and quality improvement of services and products to cater to clients' needs is important to minimise the risk of client drop-outs as competition in the microfinance sector increases.
- Strengthening MFI performance and effective regulation of the microfinance sector are key to sustainable provision of quality financial services to low-income households.

Ganga Tilakaratna is Research Fellow at the Institute of Policy Studies of Sri Lanka and External Associate of the Brooks World Poverty Institute.

Email: ganga@ips.lk

Further reading

Tilakaratna, G. and Hulme, D. (2013). 'Microfinance and multiple borrowing in Sri Lanka: another micro-credit bubble in South Asia?' Paper presented at the Third European Research Conference on Microfinance, Kristiansand, Norway, 10-12 June 2013.

worldpoverty@manchester is produced by the Brooks World Poverty Institute (BWPI). BWPI's mission is to create and share knowledge to end poverty, in both North and South, and to shape policies that deliver real gains for people in poverty.
BWPI website: http://www.bwpi.manchester.ac.uk/