ABSTRACT

Throughout the world, the long-lasting problem with microfinance institutions is how to attain financial sustainability while achieving poverty reduction mission. Several studies have been conducted in various countries focused on outreach, sustainability and mission drift scenarios of microfinance institutions. Some studies illustrated these sustainability factors and their level of significance with outreach is different from one economy to another. However, only a few studies have been conducted in the Sri Lankan context. Also, the empirical evidence of the trade-off between outreach and sustainability of MFIs, and their ability to reach the poor and the poorest segment of the population through outreach remain unclear and dearth in microfinance literature in Sri Lanka.

Therefore, this study is a passage to fill this knowledge gap focusing on microfinance institution in Sri Lanka. The prime objective of this research is to examine; can microfinance organizations in Sri Lanka achieve financial sustainability while achieving the outreach to the poor which is the prime mission of those institutions. It was followed by the descriptive and quantitative research approach using panel data regression and correlation as the main data analysis techniques. Estimation was done by specifying the models using linear equations and calculating the coefficient using the computer software program STATA. The secondary and primarily data was collected from 43 microfinance institutions out of the 67 institutions all around Sri Lanka. The researcher selected the sample considering MFIs with five or more years of existence, and that kept validate data on outreach and sustainability activities. Thereby, the researcher increased the heterogeneity in the sample; hence, increased external validity concerning the target population.

The Study determines the relationship between outreach and sustainability using Welfare and Institutionalist theories. Outreach was analyzed using six aspects of the framework that was proposed by Schreiner (2002). The sustainability was measured through the Financial Self Sufficiency. It was found that breadth, cost, length, and worth of outreach have a positive statistically significant relationship with sustainability. Further, the study concluded that age of MFIs and profit margin was positive and statistically strongly significant and have a strong relationship with financial sustainability of MFIs in Sri Lanka and when these two variables increase, it causes a substantial improvement of the financial sustainability. Also, number of active borrowers, yield on gross loan portfolio, and interest rates are positive and significantly increase the financial sustainability of MFIs in Sri Lanka. The major factor

that negatively affected is operating expenses ratio and it can be concluded that when operating expenses increase it is strongly affected to decrease the financial sustainability of MFIs in Sri Lanka.

The specific objective focused on determining the factors affecting the sustainability of MFIs based on twenty variables including ten outreach and ten other firm-level variables. It was found that loan officer productivity, MFIs age, organization type, the yield on the gross loan portfolio, and the profit margin positively and very strongly affect to determine the financial sustainability whereas, interest rate and the number of active borrowers are positively significant at 5%. Further, operating expenses ratio, and capital structure strongly affected to decrease the financial sustainability of MFIs in Sri Lanka.

The study concluded that the microfinance institution in Sri Lanka should be aware of their initial mission on poverty alleviation; it was found that these organizations are growing together with the average loan size of their outstanding loan portfolio, implying less depth of outreach and drifting away from their prime mission. Further, the study emphasizes that the MFIs need to pay more attention to financial cost management systems by adopting effective cost reduction methodologies on their operations to improve sustainability. The government needs to provide an appropriate enabling environment for these organizations by implementing the Microfinance Act and other policies and directions for the betterment of the institutions (Supply Side) and the clients of these organizations (Demand Side) to do their business creatively and attractively.