



The impact of microfinance services on the growth of the micro enterprises in Sri Lanka (with special references to Homagama Region)

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Abstract

The provision of microfinance service is used as development tool mostly in developing economies where microenterprises do not have access to other sources of financial assistance. The main objective of the study is to establish impact of micro finance services on the growth of microenterprises. The micro enterprises in Sri Lanka is the target population and 60 of them which have obtained the micro loans were drawn as sample based on the judgmental sampling method. The primary data were collected on face to face interview through structured questionnaire and the secondary data were collected literature survey. The paired sample t-test, multiple regression, chi-square test, gamma and Kendal tau-b tests were used as quantitative techniques and b descriptive statistics to achieve the expected objective. The findings of the study indicated that micro finance services have created positive impact on the income and productive growth of the micro enterprises. Majority agreed that the micro loan, insurance and advisory and training facilities were fair enough for the expected tasks, they were satisfied with financial assistance received and success of their business. So, the study concluded that the micro finance services created positive impact on the growth of the microenterprises in Sri Lanka.

Keywords: impact, growth, microenterprises, micro finance

1. Introduction

Today, the microfinance has become an important source of capital flow into the development process of micro enterprises across the world. Robinson (1998) [18] defines it as a financing tool which provides many financial services like micro loans, savings, leasing, insurance and money transfer etc. The term microfinance could also be defined as the provision of financial services to low income entrepreneurs from Micro Financial Institutions. The financial services provided by MFIs generally include savings, credit, insurance, payment services. And also many MFIs provide social intermediation services like group formation, development of self-confidence, financial literacy and management among the members of a group. Thus the definition of microfinance often includes both financial and social intermediation (Ledgerwood, 1999) [12]. Hence, Microfinance is not simply banking; it is a development tool in deed (Ngehnevu 2010) [16]. According to the Burkett (2003), micro enterprises require diversification of financial instruments in building assets, stabilizing consumption, minimizing risks and increasing income level.

According to the Economic census report (Non-agricultural economic activities in Sri Lanka, 2013-2014) defines a business entity employing up to 5 people as a microenterprises and up to 25 people as a small enterprise. Microfinance services are delivered in Sri Lanka in two main methods as formal and informal (Atapattu, 2009) [2]. The Microfinance industry is playing a critical role in Sri Lanka. The Cooperative Credit Society (SANASA) and Rural Development Bank (RDB) are the main microfinance institutions while commercial banks, finance companies and

non-government organizations operate in small scale. All provide both financial and non-financial services including loans, savings, micro insurance and money transfers. Non-financial services include financial education, training and advisory services.

Although the survey studies have been conducted covering the whole Sri Lanka in this regard, but no proper study of impact of micro loans on the income and productivity growth of the microenterprises had been conducted. Thus, this study is geared towards establishing impacts of microfinance services on the income and productivity growth of the microenterprises operating in Sri Lanka. The information from the present study would act as a feed back to the microfinance institutions that are providing different financial services in the process. The study findings would also help the institutions concerned to formulate the policies and strategies. The microfinance institutions can then design and refine their range of products to meet the level of needs of the micro enterprises. The study findings would act as an awareness program for micro entrepreneurs about the services and products.

1.1 Theoretical background

The world's poorest people account about 19.3 million and 74% of them are women according to the Cheston and Kuhn (2002) [5] and now they are being helped by the MFIs. Most of these women operate their own business with access to micro loans facilities. Whatever the hardships they face, they maintain repayments without defaults (Mbithe, 2013) [13]. He pointed out three (3) paradigms. The first is the provision of financially self-sustainable microfinance services to large numbers of micro and small entrepreneurs. The objective is to

avoid microfinance from other interventions and setting interest rates to cover costs so as to capture economies of scale.

The second is the poverty alleviation reduction among the poorest and well-being in the community. The MFIs provide services like small savings and loans for consumption and production, group formation, etc. The woman then gets responsible for house-holds well-being, poverty alleviation and women empowerment (Mbithe, 2013) ^[13]. The women's access to microfinance would increase household income which will then translate into improved well-being of the household. The third paradigm women empowerment which concern to drive women to get the status of economic, social and political in the society. So the microfinance is considered as an entry point (Khan, 2008).

The group lending theory among micro finance institutions is also one strategy to finance money to Grameen model of microfinance where loans are made to individual groups (Mbithe, 2013) ^[13]. The Grameen model have access to subsequent loans and the system is more dependable as the repayment is done by all group members. This method is effective in deterring defaults as evidenced by loan repayment rates. The mutual trust enhances the social network and thus, creates social benefit (Ledgewood, 1999). However, these group based mechanisms tend to be vulnerable to free riding and collusion (Gruber, 2005). The group lending theory of micro finance binds each other on group liability (Mbithe, 2013) ^[13]. According to the Guinnane (1999) ^[9] group liability could improve repayment rates.

1.2 Empirical survey

Many studies revealed that the income of the micro entrepreneurs have increased after the provision of micro loans. The technological training, advisory services and business counselling also proved the increase in income and productivity growth (Nahmya. *et al.* 2013) ^[15]. The studies provide a strong evidence of positive relation between the technological related training and the productivity (Mwangi, 2013) ^[14]. Therefore, the micro enterprises could be able to manage their business and raise the income through better productivity on the provision of both microfinance financial loans and non-financial services.

Small and Medium Enterprises see unfair interest as a challenge today. According to the Kyale (2013) ^[11] the provision of MFIs loan products along with fair interest rates can minimize the cost of borrowing and provide them an opportunity to grow and expand their business. The poor financial management is another obstacle for their growth and majority of SMEs lack skills to document the activities for over-viewing their business. So, the study revealed that SMEs can manage their finance through the provision of skills by MFIs. However, the services provided by the MFIs are not up to the satisfactory level the most SMEs expect.

Olu (2009) ^[17] conducted a study on the impact of microfinance on entrepreneurial development of micro and small scale enterprises that are craving for growth and development in a stiffened economy of Nigeria. It is evident that the microfinance institutions are capable to help the entrepreneurship for their growth and they play better role

towards the development of the economy. Christopher (2002) ^[6] found in his study that majority of the SMEs accepted that there was positive contribution from MFIs loans towards promoting the market share, product innovation, achieving excellence and competitive advantage. Other than tax incentives and financial supports, it is recommended that the government should provide sufficient infrastructural facilities like electricity, water, road network and training institutions to support SMEs.

Copstake *et al.* (2000) ^[8] carried out a study to ascertain the impact of micro loans on micro business in Zambia. It was designed to find out the status of the poorest business operators but 30% of the entrepreneurs were below the national poverty line. They had achieved higher growth in their profits and household income at the second loan than at the first one in which much experience was gained in diversification of their business activities more rapidly. Alarape (2007) ^[1] conducted a study to examine the impact of entrepreneurship programs conducted by MFIs on operational efficiency and growth of micro businesses in Nigeria. The findings were true that the entrepreneurs who had participated in work shop programs received higher growth in their micro businesses than those who had not participated. According to the study conducted by Babajide (2012) ^[3] microfinance institutions do only micro financing no other programs launched to enhance growth and expansion capacity of micro and small enterprise. It was also revealed that the technology related training received by the entrepreneur, business location, and business age, education and size of the loan would impact significantly on micro firm growth.

2. Methods and procedures

The study was focused to base on a survey design and is mainly quantitative in nature. It used some aspect of qualitative data to gather information about weaknesses in the provision of the micro loans and then how to guide through one platform to facilitate and improve the micro economies.

The micro enterprises in the Sri Lanka area are the target population of the study. The study was aimed to collect data on sample size of 60 micro enterprises which had obtained micro loans from various microfinance institutions and it was arranged on the judgmental sampling method. The primary data required for the study was collected through a survey conducted at the Homagama administrative division in Sri Lanka. The survey was conducted in interviews with the owners of the selected micro enterprises which had obtained micro finance services from MFIs by using a structured questionnaire. The questionnaire was consisted of both multiple choice and open ended questions. The secondary data was mainly collected through the research journals, books and statistical reports issued by the Census and Statistics department and the Divisional Secretariat Office.

Quantitative and qualitative techniques were used to analyze the data respectively based on the descriptive statistics, parameter estimations and open ended questions. In this study, paired sample test was conducted to detect whether there are any significance differences between the mean income and productivity before and after the provision of microfinance services.

The Paired sample t-tests to measure the impact of micro loan upon the income and productivity of micro enterprises

- H0;** There is no significance difference between the mean of income before and after the provision of micro loan
 - H1;** There is a significance difference between the mean of income before and after the provision of micro loan
 - H0;** There is no significance difference between the mean of productivity before and after the provision of micro loan
 - H1;** There is a significance difference between the mean of productivity before and after the provision of micro loan
- The Paired sample t-tests to measure the impact of both micro loan, advisory and training services upon the income and productivity of micro enterprises.
- H0;** There is no significance difference between the mean of income before and after the provision of both micro loan, advisory and training services
 - H1;** There is a significance difference between the mean of income before and after the provision of both micro loan, advisory and training services

The P value depicts the sig level in the paired sample t-test, If the P value is lower than 0.05 (95% confidence level) the null hypothesis will be rejected. The Eta squared was adopted to measure the magnitude of microfinance intervention’s effect. The Eta squared is derived by calculating an effect size statistic in the following equation.

$$\frac{t^2}{t^2 + N - 1} \tag{1}$$

t= t value, N = sample size

In interpreting the eta squared values the following guidelines can be used, 0.01=small effect, 0.06=moderate effect, 0.14=large effect (Cohen, 1988)

Two multiple regressions were conducted to measure the factors (under the micro finance services) which affect the income and productivity growth separately. Both multiple regression models were conducted through univariate analysis under the general linear model. Two expected models are given below.

$$1. IG = \alpha + \beta1(AL) + \beta4(AT) + \beta2(FR) + \beta3(IL)$$

$$1. PG = \alpha + \beta1(AL) + \beta4(AT) + \beta2(FR) + \beta3(IL)$$

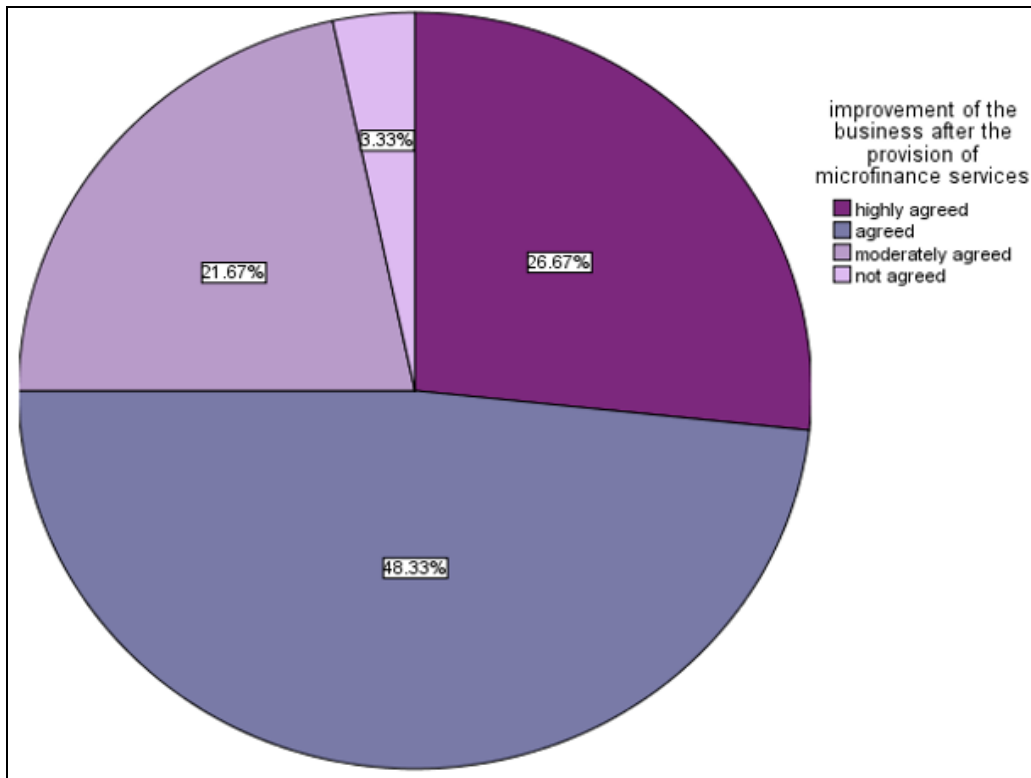
- IG = Income growth
- PG = Productivity growth
- AL = Amount of the loan borrowed from the MFIs
- AT = Advisory and training services obtained from the MFIs
- FR = Facilities gained in acquiring the raw materials after the provision of micro loan
- IL = investment of the total amount of micro loan obtained from the MFIs

In the regression model, Beta value of two models indicates separately the impact of microfinance services upon the income growth and productivity growth of micro enterprises. If the sig value is less than 0.05, that particular factor significantly contributes to the impact growth and productivity growth of micro enterprises. The partial effect size indicates the magnitude of each factor upon the income growth and productivity growth. (Cohen, 1988)

In this study, the Gamma tests were conducted respectively to evaluate the relationship between the adequacy of micro loan and satisfaction of the service and the improvement of the business after the provision of micro loan. In the Gamam test, (Approx sig) value indicates the significance level. If this value is less than 0.05, there is relationship between those two ordinal variables. An obtained value of +1 for gamma indicates the presence of a perfect correlation between the two ordinal variables. In contrast, an obtained value of -1 indicates the presence of a perfect negative correlation. Two separate Kendall’s tau-b tests were conducted accordingly to evaluate the same relationship. In common with other measures of correlation Kendall’s tau-b will take values between -1 and +1, with a positive correlation indicating that the ranks of both variables increase together whilst a negative correlation indicates that as the rank of one variable increases and the other one decreases. The chi-square test was conducted to evaluate the relationship between the investment of the total amount of the loan into the business and the facilities obtained in acquiring the raw materials. In the Chi-square test, if the sig value is (this is presented in the column labelled Asymp. Sig. 2-sided) is less than 0.05, the null hypothesis will be rejected. If the null hypothesis is accepted there would be no relationship between two nominal variables. (Cohen, 1988).

3. Results of the study

As per the descriptive analysis, majority of the loan borrowers have agreed that the income growth of the business was improved after the provision of micro loan. And also they could obtain more quantity of raw materils with good quality.

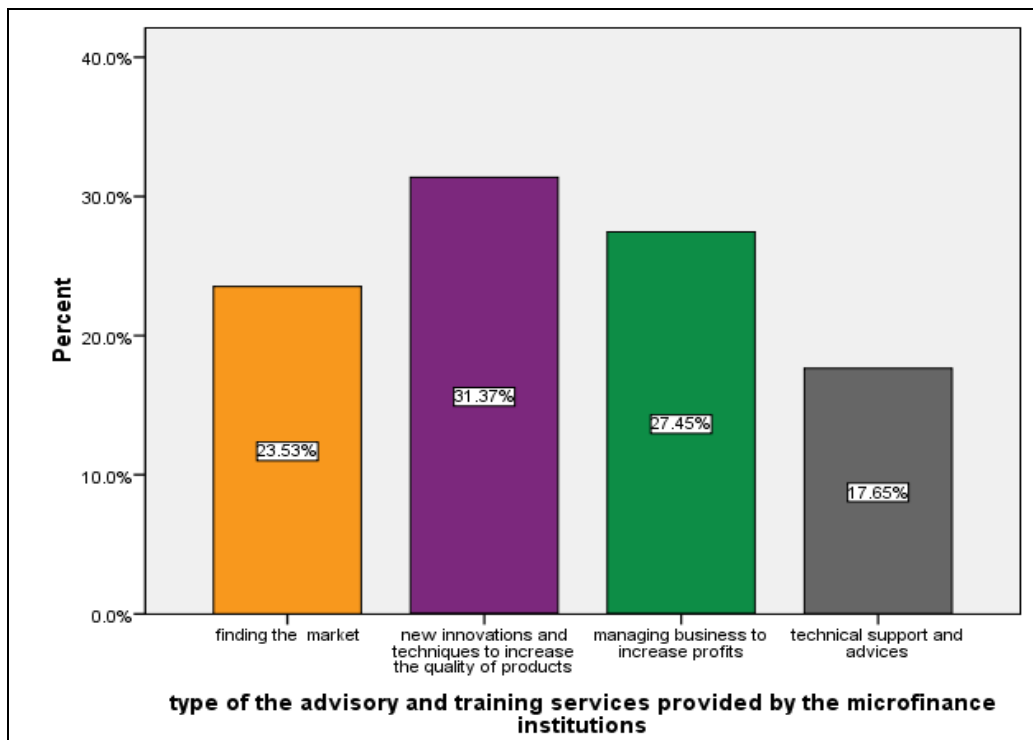


Source: Survey conducted in 2017 in Homagama administrative division

Fig 1: The level of the improvement of the business after the provision of microfinance loan

The 52% of micro entrepreneurs are struggling to find a market place for their products and 12% of them are finding hard to buy quality raw materials from the local market and even without adequate money to import the same. Moreover,

32% of micro entrepreneurs have used the borrowed loans for the purposes of consumption, houses renovation and repaying mortgages loans instead of investing into the business.



Source: Survey conducted in 2017 in Homagama administrative division

Fig 2: Type of the advisory training services provided by the microfinance institution

Considering the value added services provided by MFIs, 31% of the micro entrepreneurs received the advisory and training services regarding new innovations and techniques to improve the quality of their products and 27% of them received the same regarding managing the business. According to the

Findings, it is observed that these types of workshops and seminars conducted by MFIs would assist micro entrepreneurs how to manage funds and output process in making better profits and also MFIs will help micro entrepreneurs to find markets for their products.

Table 1: Impact of both Microfinance services on microenterprises

	Type of Impact	Mean Difference	t value	Sig; level	Effect size – Eta squared $\frac{t^2}{t^2 + N + 1}$
Impact of micro loan facility	Impact on income	8.317	3.843	.000	0.20
	Impact on productivity	5.434	2.309	.025	0.09
Impact of both micro loan and advisory and training facility	Impact on income	10.255	5.509	.000	0.387
	Impact on productivity	10.133	2.869	.006	0.157

Source: SPSS result output, survey conducted in 2017 in Homagama administrative division

The statistics showed that there is significant difference (sig value; $0.00001 < 0.05$) in income and productivity before and after the provision of micro loans. The mean difference value is 8.317 to the income and 5.434 to the productivity. The mean difference value after provision of both micro loan and advisory and training services have increased. Since, the mean difference value to the income is 10.255, there is a considerable increase of income. The Eta squared value is

0.387, which is a large effect with the substantial differences in income before and after the provision of micro loans. Since, the mean difference value to the productivity is 10.133; there is a considerable increase of income. The Eta squared value is 0.157, which is a large effect with the substantial differences in income before and after the provision of micro loans. Thus, the impact of both services is higher than loan service only.

Table 2: impact of microfinance services upon the income growth of micro enterprises

Arameter	Beta	Sig.	Partial Eta Squared
Intercept	4.723	.000	.037
AMT_LOAN	2.124	.000	3.89
[ADV_SER=0] [ADV_SER=1]	- 3.1210 ^a	.002	1.03
[INV_BUS=0] [INV_BUS=1]	-4.4760 ^a	.391	1.4
[FC_RAW=0][FC_RAW=1]	-2.0530 ^a	.980	.110
[INV_BUS=0] * [ADV_SER=0]	-9.560	.408	.013
[INV_BUS=0] * [ADV_SER=1]	0 ^a	.	.
[INV_BUS=1] * [ADV_SER=0]	0 ^a	.	.
[INV_BUS=1] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=0] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=1] * [ADV_SER=0]	0 ^a	.	.
[FC_RAW=1] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=0] * [INV_BUS=0]	-5.079	.782	.001
[FC_RAW=0] * [INV_BUS=1]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=0]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=1]	0 ^a	.	.
[FC_RAW=0] * [INV_BUS=0] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=0] * [INV_BUS=1] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=0] * [ADV_SER=0]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=0] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=1] * [ADV_SER=0]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=1] * [ADV_SER=1]	0 ^a	.	.

Source: SPSS result output, survey conducted in 2017 in Homagama administrative division

As per the regression analysis the amount of loan significantly contribute to estimate the income growth of micro enterprises (sig value; $0.0005 < 0.05$). But, the investment of the total loan amount into business and the facilities gained do not

significantly contribute to estimate the income growth. The partial effect of loan amount is 3.89 which is a considerable amount.

Table 3: impact of microfinance services upon the productivity growth of micro enterprises

Parameter	B	Sig.	Partial Eta Squared
Intercept	5.567	.117	.052
AMT_LOAN	5.182	.020	2.12
[ADV_SER=0] [ADV_SER=1]	-5.0430 ^a	.039.	1.91.
[INV_BUS=0][INV_BUS=1]	-4.3930 ^a	.396.	1.06.

[FC_RAW=0] [FC_RAW=1]	-2.6620 ^a	.767.	1.2.
[FC_RAW=0] * [INV_BUS=0]	-1.657	.926	.006
[FC_RAW=0] * [INV_BUS=1]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=0]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=1]	0 ^a	.	.
[FC_RAW=0] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=1] * [ADV_SER=0]	0 ^a	.	.
[FC_RAW=1] * [ADV_SER=1]	0 ^a	.	.
[INV_BUS=0] * [ADV_SER=0]	-8.145	.517	.009
[INV_BUS=0] * [ADV_SER=1]	0 ^a	.	.
[INV_BUS=1] * [ADV_SER=0]	0 ^a	.	.
[INV_BUS=1] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=0] * [INV_BUS=0] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=0] * [INV_BUS=1] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=0] * [ADV_SER=0]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=0] * [ADV_SER=1]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=1] * [ADV_SER=0]	0 ^a	.	.
[FC_RAW=1] * [INV_BUS=1] * [ADV_SER=1]	0 ^a	.	.

Source: SPSS result output, survey conducted in 2017 in Homagama administrative division

The multiple regression was conducted to evaluate the contribution and impact of each factor upon the productivity growth of the micro enterprises. According to the statistics revealed in table amount of loan and advisory services are significantly contribute to estimate the productivity growth of micro enterprises because the sig level of amount loan (Sig value; 0.02) and advisory services (Sig value; 0.039) are lower

than the ($p < 0.05$). But, the investment of the total amount of loan into business and facilities gained after the provision of micro loan do not significantly contribute to estimate the productivity growth and when other factors are held constant, the increase in one unit of amount of loan leads to increase the productivity of micro enterprises 5.182 units. The partial effect of loan amount is 2.112 which is a considerable amount.

Table 4: Symmetric measures of Gamma and Kendall’s tau-b test for relationship between the adequacy of the loan and the improvement of the business

		Value	Asymp. Std. Error ^a	Approx. T ^b	Approx. Sig.	Correlation-Kendall's tau_b
Ordinal by Ordinal	Kendall's tau-b	.718	.064	9.549	.000	0.781
	Gamma	.931	.050	9.549	.000	

Source: SPSS result output, survey conducted in 2017 in Homagama administrative division

Kendall’s tau-b correlation depicts that there is a strong positive relationship (78%) between the adequacy of the micro loan and the improvement of the business. The value of Kendall tau-b is 0.718 and gamma is 0.931, which indicate that there is a moderate and strong positive relationship between the adequacy of the loan and the improvement of the business respectively. Kendall’s tau-b correlation depicts that

there is a strong positive relationship (69%) between the adequacy of the micro loan and the satisfaction of the services provided by the microfinance institutions. The value of Kendall tau-b is 0.69 and gamma is 0.935, which indicate that there is a moderate and strong positive relationship between the adequacy of the loan and the satisfaction about the services respectively.

Table 5: chi-square statistics

	Value	df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	44.211 ^a	1	.000		
Continuity Correction	29.831	1	.000		
Likelihood Ratio	19.323	1	.000		
Fisher's Exact Test				.000	.000
Linear-by-Linear Association	43.474	1	.000		

a. 3 cells (75.0%) have expected count less than 5. The minimum expected count is .20.

Source: SPSS result output, survey conducted in 2017 in Homagama administrative division

As per the chi-square statistics, this value is 29.831 with the associated sig level 0.000 (0.0005). This implies that there is relationship between the investment of the total amount of loan into business and the facilities received in obtaining the raw materials required for the business

4. Discussions

According to these findings majority of the microenterprises

are engaged in the readymade garment business since long period. The most important nature of the business is that the majority of them operate their business as a sole proprietorship while very few do so as group business. Mostly they acquired the funds through personal savings to start their business. The study in one aspect too was focused as to know how many micro entrepreneurs obtained loans in initiating the micro enterprises. In this respect a positive result was revealed

in the analysis that the considerable numbers of micro enterprises had received micro loans to start their business and also, the provision of the microfinance loan is the best option to start up a micro enterprise.

All micro loan companies mainly offer two types of services. Those are lending money and maintaining savings accounts. They provide customers the value added services like training programs, projects evaluation and advices so that to minimizing risks in the business activities. The micro enterprises which had undergone the study obtained only the micro loan and advisory services because the provision of micro insurance, micro leasing and micro remittance is not available at Samurdhi Programme, Sanasa Bank, Rural Development Bank (Popular MFIs in Sri Lanka)

According to the findings of the study, majority of micro entrepreneurs have invested the total loan amounts into their business. Therefore, it is possible to state that the micro entrepreneurs use the microfinance loans mainly for purchasing of raw materials, machineries and equipments rather than expending for capital requirements.

The study also found that the majority of the micro enterprises have obtained the advisory and training services from the MFIs for new innovations and techniques to improve the quality of products and to well manage the business for profit maximizing. Even though it is not adequate to achieve the expected business goals, majority of them are satisfied with the services provided by the MFIs. Moreover, most of the micro entrepreneurs are highly agreed that their business is improved after the provision of micro finance services, especially the micro loan.

Even though, micro entrepreneurs are facilitated by micro finance services, they have also faced many constraints and limitations in obtaining the micro loans due to the unacceptable conditions and insufficient value added services being practiced in those institutions. Those limitations are; lack of adequate number of micro financing institutions, poor flow of information about the micro loans and benefits, bureaucracy of the officers in the institutions, stringent terms and conditions in loan criteria, higher interest rates and insufficient loan credits, poor diversification of products and weak regulatory authority for micro financing.

The study found, that there is a significant difference in micro enterprises' income, capital accumulation and productivity before and after the provision of both microfinance loans and advisory services. But, there is no any significant difference in micro enterprises' employment level before and after the provision of both micro loans and advisory services. Thus, the micro credits along with other value added services would impact on the expected goals of the micro entrepreneurs.

The multiple regressions were conducted to evaluate the impact of selected factors (loan amount, advisory and training service, other facilities and the loan investment) upon the income growth of the micro enterprises. The amount of the loan and advisory and training services provided by MFIs have positively contributed to the income growth of the micro enterprises. A separate multiple regression was conducted to evaluate the impact of the above mentioned factors upon the productivity growth of the micro enterprises. In that case, the study found that the amount of the loan, advisory and training services have significantly contributed to the productivity

growth of the micro enterprises. Furthermore, the study found that the income and productivity growth of the micro enterprises have decreased by a considerable amount for those who have not obtained the advisory services, not invested the total loan amount and not gained the facilities in acquiring the raw materials.

The statistical tests used in the study revealed that there is a relationship between the investment of the total loan amount into the business and the facilities received in obtaining the raw materials required for the business. Higher the investment of the loan amount, higher will be the facilities in obtaining raw material. Moreover the study found that higher the amount of the loan borrowed from the MFIs and if it is adequate, higher will be the improvement of the business and the satisfaction about the services provided by the MFIs.

5. Conclusion and recommendation

Having gone through the study, it was concluded that the micro loan, advisory and training services provided by the MFIs positively contribute to the income growth and as well as the productivity growth of the micro enterprises. Thus, the study concluded that the microfinance services have positive impact on the growth of the micro enterprises in the Homagama administrative division. As recommendations new proposals need to be mentioned here. A reasonable and affordable interest rate is more appropriate as most micro enterprises operated by the marginalized community facing a vulnerable nature of the business. MFIs organizational structure should consist of the officers with subject knowledge and experience and restructure the low income groups through strategies. MFIs should introduce insurance covers at affordable premiums for the micro enterprises to minimize the risk on the business. And also government attention is always more important to intervene the supply of cash deficit requirements of MFIs at lower rate than the micro loan.

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