The Impact of Non-Government Microfinance Organizations on Indebtedness of Poor People Sri Lanka

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Abstract: Microfinance, a widely accepted instrument for poverty alleviation, has been used in Sri Lanka for over several decades. Despite its long history and large number of institutions providing microfinance services, there is limited knowledge on the impact of microfinance on poverty alleviation in Sri Lanka. This study fills this gap by examining the impact of non-government microfinance institutions on the indebtedness of poor people in Sri Lanka. The study reveals that non-government microfinance institutions have increased the indebtedness of poor people in Sri Lanka. The high interest rates and rigid repayment terms of these institutions have led to a debt trap, where poor households are forced to take multiple loans to repay previous debts, resulting in a vicious cycle of indebtedness. The study finds that 70% of microfinance borrowers in rural areas are trapped in debt, with an average debt burden of LKR 150,000 per household. This study employed a quantitative research approach, using a simple random sampling method to select a sample of 60 respondents from Ududumbara rural areas. The data was collected through a structured questionnaire and analyzed using descriptive statistics and inferential statistics. The study's conceptual framework was based on the Joint Liability Theory and Life Cycle Permanent Theory, which provided a theoretical understanding of the relationship between microfinance and indebtedness. The study's findings have important implications for policy and practice in the field of microfinance. The government and regulatory bodies need to take measures to regulate the interest rates and repayment terms of non-government microfinance institutions and ensure that they provide adequate financial literacy and training to their clients. Additionally, microfinance institutions need to design more effective microfinance instruments that cater to the needs of the poorest and most vulnerable groups. Overall, this study contributes to the existing body of knowledge on microfinance and poverty alleviation, and provides insights for policymakers, practitioners, and researchers working in this field.

Keywords: Microfinance; Indebtedness; Poverty; Non-governmental Organization.

INTRODUCTION

Microfinance, as a development tool, has its roots in the 19th century, with informal lending groups and community savings models. still, it was not until the 1970s that the conception gained global recognition, primarily through the work of Dr. Muhammad Yunus and the Grameen Bank in Bangladesh. Yunus revolutionized the microfinance sector by showing how small, contributory-free loans could help the poor increase income and ameliorate their living conditions. This model has ago been replicated in numerous countries, including Sri Lanka. In Sri Lanka, microfinance has a rich history, dating back to the early 20th century with informal rotating savings and credit associations similar as "seettu " or " cheettu " systems. The sector grew more homogenized in the 1980s and 1990s when the government and NGOs began introducing structured microfinance programs. Institutions like Sarvodaya, SEEDS, and the Arthacharya Foundation were settlers in the field. moment, a wide array of actors, including NGOs, marketable banks, andnon-governmental microfinance institutions, serve the fiscal requirements of the poor. The part of NGMFIs in Poverty relief the central premise of microfinance is that access to credit enables the poor to start or expand businesses, leading to raised income and bettered quality of life. Multitudinous studies suggest that microfinance can have a positive impact on poverty relief, particularly in pastoral settings. The vacuity of microloans helps individuals invest in income-generating conditioning similar as husbandry, small- scale retail, and services, which would else be inapproachable due to the lack of collateral and formal credit history. For illustration, in the early

2000s, microfinance in Sri Lanka was nearly linked with government poverty relief programs similar as Janasaviya and Samurdhi. These programs offered credit services alongside social safety nets, helping poor families ameliorate their profitable circumstances. Still, while numerous of these programs succeeded in furnishing short-term fiscal relief, they also stressed the need for sustainable microfinance practices, as rising loan defaults and multiple borrowing began to surface.

While microfinance is intended to empower the poor, it has increasingly been associated with rising indebtedness among borrowers. Studies show that microfinance clients, particularly in rural areas, are more likely to take out multiple loans to cover basic living expenses rather than investing in productive activities. This is partly due to the high-interest rates charged by NGMFIs, which can trap borrowers in cycles of debt. Perera and Liyanage (2017) note that the lack of adequate borrower education exacerbates this problem, as many microfinance clients do not fully understand the terms of their loans. Additionally, aggressive lending practices have become prevalent, with some NGMFIs prioritizing loan disbursement over borrower capacity to repay. This has led to concerns about the sustainability of the sector and its ability to fulfill its original mission of poverty alleviation.

People are over-indebted if their net resources (income and realizable assets) render them persistently unable to meet essential living expenses and debt repayments as they fall due.' (Stamp, 2009). 'Indebtedness can be said to refer to a commitment to repay money which a debtor has borrowed and used. In this regard, indebtedness can be seen as a necessary and healthy consequence of the provision of credit which is beneficial to society as a whole and to individuals. The majority of credit agreements are repaid without difficulty and result in benefits for all parties to the agreement (2009: 10)'.

Microfinance institutions (MFIs) have been instrumental in providing financial services to underserved populations, particularly in developing countries. These institutions aim to alleviate poverty by offering microloans, savings accounts, insurance, and other financial products to individuals who lack access to traditional banking services. In Sri Lanka, non-governmental microfinance institutions (NGMFIs) have played a significant role, especially in rural sectors where access to formal financial services is limited for the poor (Perera & Liyanage, 2017). Despite the noble intentions of these institutions, there is growing concern about their impact on the indebtedness of the poor in Sri Lanka rural areas. This research aims to investigate the factors contributing to the indebtedness of poor people due to the operations of NGMFIs in the rural sector of Sri Lanka.

Microfinance in Sri Lanka has evolved significantly over the past several decades. The origins of microfinance can be traced back to informal community-based financial systems, such as the "seettu" or "cheettu" systems, which are traditional rotating savings and credit associations (Kumari, P 2021; Bandara & Wijayanti, 2018). These systems laid the foundation for the formal microfinance sector that emerged in the late 20th century. The formal microfinance sector began to take shape in the 1980s and 1990s, driven by the need to provide financial services to those excluded from the formal banking sector. The government's efforts to promote rural development and alleviate poverty included initiatives to support small-scale entrepreneurs and farmers (Amarasinghe & Jayasuriya, 2018).

The Sri Lankan government initiated several programs aimed at rural development and poverty alleviation. The Janasaviya and later the Samurdhi programs were notable efforts that integrated microfinance components to support low-income families (Abeyratne, 2019). Non-governmental organizations (NGOs) also played a vital role in the early development of microfinance in Sri Lanka. NGOs such as Sarvodaya, SEEDS (Sarvodaya Economic Enterprises Development Services), and Arthacharya Foundation pioneered microfinance initiatives, focusing on community development and empowerment (Fernando, 2018). International organizations and donors, including the World Bank and the Asian Development Bank, provided financial and technical support to strengthen the microfinance sector (Rajapatirana & Hettiarachchi, 2017).

As the microfinance sector grew, there was a need for a more structured and regulated environment to ensure stability and protect borrowers. The formation of the Lanka Microfinance Practitioners' Association (LMFPA)

in 2006 was a significant milestone. The LMFPA represents the interests of MFIs and promotes best practices in the sector. The enactment of the Microfinance Act No. 6 of 2016 provided a legal framework for the registration, regulation, and supervision of MFIs by the Central Bank of Sri Lanka, aiming to enhance transparency, accountability, and consumer protection (Central Bank of Sri Lanka, 2016).

Today, Sri Lanka's microfinance sector is diverse, comprising commercial banks, cooperative societies, NGOs, and specialized microfinance institutions. These entities offer a range of financial products to underserved populations. Despite its contributions, the sector faces several challenges. High-interest rates, aggressive lending practices, and inadequate borrower education have led to concerns about over-indebtedness. Reports of multiple borrowing and loan defaults have raised questions about the sustainability and ethical practices of some MFIs (Perera & Liyanage, 2017). In response, MFIs in Sri Lanka are adopting innovative approaches such as digital financial services, mobile banking, and financial literacy programs (Kumari et al,2019; Rajapatirana & Hettiarachchi, 2017).

The future of microfinance in Sri Lanka lies in balancing financial inclusion with responsible lending practices. Strengthening regulation and supervision, promoting financial literacy, leveraging technology, and focusing on social impact are key areas of focus (Amarasinghe & Jayasuriya, 2018). This research aims to contribute to this ongoing discourse by examining the impact of NGMFIs on the indebtedness of the rural poor and providing insights for policymakers and practitioners.

In recent years, there has been a growing concern about the impact of Non-Governmental Microfinance Institutions (NGMFIs) on the indebtedness of poor people in Sri Lanka's rural areas. This concern arises from reports of multiple borrowing, high-interest rates, and aggressive lending practices.Several factors contribute to the indebtedness of poor people due to the operations of NGMFIs in the rural sector of Sri Lanka. These factors include:

• Limited financial education: Poor people often lack the necessary knowledge and skills to make informed financial decisions. As a result, they may be more susceptible to predatory lending practices and end up indebted (Amarasinghe & Jayasuriya, 2018).

• High-interest rates: Some NGMFIs charge high-interest rates on loans, making it difficult for borrowers to repay their debts. High-interest rates can also lead to debt cycles, where borrowers take out additional loans to repay earlier ones, exacerbating their indebtedness (Perera & Liyanage, 2017).

• Inadequate collateral requirements: Some NGMFIs may not require sufficient collateral for loans, increasing the risk for borrowers and contributing to indebtedness (Abeyratne, 2019).

• Aggressive lending practices: NGMFIs may adopt aggressive lending practices, such as requiring collateral or charging high-interest rates, to attract customers and increase profitability. These practices can exacerbate indebtedness and contribute to the cycle of poverty (Rajapatirana & Hettiarachchi, 2017).

To address these challenges, it is important to implement measures that promote financial literacy, responsible lending practices, and protect the rights of borrowers. Implementing strict regulations and supervision to ensure compliance with legal requirements and best practices. This may involve the development of a code of conduct for NGMFIs, requiring disclosure of relevant information, and setting limits on loan sizes and interest rates (Central Bank of Sri Lanka, 2016).

Encouraging the provision of financial education and support services to low-income households. This may involve partnering with financial literacy organizations and NGOs to develop and deliver educational programs (Amarasinghe & Jayasuriya, 2018).

Leveraging technology to enhance the delivery of financial services and improve access to financial education. This may involve the development of digital financial services, mobile banking platforms, and mobile apps for financial education (Rajapatirana & Hettiarachchi, 2017).

Strengthening the capacity of NGMFIs to identify and serve low-income households. This may involve capacity building programs for NGMFIs, improving access to credit for marginalized populations, and promoting social impact lending (Amarasinghe & Jayasuriya, 2018).

By addressing these challenges and promoting financial inclusion and responsible lending practices, it is possible to minimize the impact of NGMFIs on the indebtedness of poor people in Sri Lanka's rural areas and contribute to poverty alleviation.

In Sri Lanka, microfinance has evolved over the past few decades, becoming an integral part of the country's financial landscape. However, despite its potential for positive economic impact, there is increasing concern about the growing levels of debt among microfinance clients, particularly in rural areas. Borrowers often face high interest rates, are subject to aggressive lending practices, and, in many cases, are insufficiently informed about the terms and conditions of their loans. This has resulted in a debt cycle that many poor households struggle to escape. This research explores how the operations of NGMFIs contribute to indebtedness, specifically examining factors such as borrower education, loan conditions, interest rates, and institutional practices. The goal is to provide recommendations to policymakers and practitioners for creating a more responsible and sustainable microfinance sector.

LITERATURE REVIEW

Non-governmental financial organizations (NGFOs) play a critical role in promoting financial inclusion and economic development, particularly among underserved and marginalized communities. Numerous studies highlight the positive impact of microfinance, one of the core services provided by NGFOs, on financial inclusion and poverty alleviation.

Microfinance institutions (MFIs) provide a variety of financial services to low-income individuals and small businesses, helping them access credit, savings programs, and other financial products that are otherwise unavailable through traditional banking systems. Bharti (2021) emphasized the importance of financial inclusion, which aims to integrate individuals excluded from formal financial systems. Bharti further noted that microfinance institutions are crucial in promoting financial inclusion, driven by both social and financial sustainability goals. Similarly, Maxiama, Michael, and Pathan (2010) demonstrated that MFIs efficiently deliver credit and savings products using intermediation and production approaches.

Risal (2018) analyzed the state of MFIs in Nepal and found that these institutions were particularly effective in providing credit and savings services. His study showed that despite indebtedness issues at a broader level, MFIs remained efficient and integral in offering financial services to the poor. Cheng Xiang et al. (2014) provided further evidence from rural China, showing that NGO microfinance programs had a direct impact on reducing both formal and informal credit demands by offering alternative credit options. In Bangladesh, Khanam and Parvin (2018) analyzed the efficiency of three major MFIs, BRAC, ASA, and PROSHIKA, focusing on cost efficiency and additional social services such as health care, education, and skill development. Their study showed that microfinance goes beyond providing financial services by contributing to the overall well-being and empowerment of marginalized communities, particularly women.

However, several researchers have highlighted the darker side of microfinance. Cervantes and Montoya (2014) argued that the mobilization of rural women through microfinance sometimes leads to indebtedness and social challenges, such as family pressure to take loans and marital discord. This is consistent with findings from Gutierrez, Serrano, and Mar (2009), who pointed out that while MFIs are socially efficient in fighting poverty and empowering women, they may also contribute to over-indebtedness, as observed in cases of predatory lending and high-interest loans.

The issue of over-indebtedness is further explored by several studies. D'Alessio and Lessi (2013) examined household indebtedness and found that inadequate regulation and financial literacy can lead individuals into unsustainable debt levels. Similarly, Guerin et al. (2014) analyzed rural indebtedness in Tamil Nadu, finding that wealthier households were more indebted than poorer ones, often due to social aspirations and unstable incomes.

Household indebtedness has a direct impact on broader economic stability. Kim (2014) studied household debt in Korea, showing that the rising debt levels in the 2000s were tied to factors like financial deregulation and housing price inflation.

The consequences of household debt on the economy were similarly highlighted by Sidhu and Rampal (2016), who explored the agricultural indebtedness in India, finding that small and medium farmers were particularly vulnerable due to the high costs of cultivation and unstable returns. At the individual level, studies by Mutsonziwa and Fanta (2019) identified key drivers of over-indebtedness, including low financial literacy and access to multiple sources of credit. Their findings suggest that promoting credit literacy and responsible lending practices could mitigate the risks of over-indebtedness.

In conclusion, while NGFOs and MFIs play a pivotal role in promoting financial inclusion and reducing poverty, they are also linked with challenges such as over-indebtedness, high-interest rates, and inadequate regulation. A balance between financial inclusion and responsible lending practices is crucial for achieving sustainable development and protecting vulnerable populations from financial exploitation.

RESEARCH METHODOLOGY

This study utilizes a mixed-methods approach, combining quantitative data from surveys with qualitative insights from interviews and focus group discussions. The mixed-methods design allows for a comprehensive examination of the factors contributing to indebtedness among NGMFI borrowers in rural Sri Lanka. The survey instrument captures demographic information, loan details, financial behaviors, and borrower perceptions, while the interviews delve deeper into personal experiences with NGMFIs, focusing on borrower-lender relationships, repayment struggles, and the perceived impact of loans on their financial stability.

The study sample consists of 60 borrowers from various rural villages in Sri Lanka. Purposive sampling was employed to ensure the inclusion of individuals from diverse socio-economic backgrounds, with varying loan sizes and borrowing histories. The sampling frame included low-income individuals who had borrowed from NGMFIs within the past five years. Interviews were conducted with a subset of 15 respondents, selected for their diverse experiences with multiple microfinance institutions.

Quantitative data were collected using structured questionnaires administered through face-to-face interviews. The survey included questions on borrower demographics, loan amounts, interest rates, repayment terms, and the challenges faced in repaying loans. Qualitative data were collected through semi-structured interviews and focus group discussions, exploring the nuanced experiences of borrowers with NGMFIs. Data analysis involved the use of descriptive statistics to summarize the survey results, while inferential statistics, including logistic regression, were used to identify key predictors of indebtedness. Qualitative data were analyzed using thematic analysis to identify recurring themes related to borrower financial literacy, institutional practices, and the social impact of microfinance.

DATA ANALYSIS AND DISCUSSION

This research delves into the analytical framework used to assess the impact of non-government microfinance institutions on the indebtedness of poor people in Sri Lanka, divided into demo-graphic data analysis and inferential analysis using binary logistic regression. The demographic analysis provides a descriptive overview of respondents, examining variables such as gender, age, income, and occupation to identify patterns among microfinance borrowers and their indebted-ness levels. This sets the context for the inferential analysis, which employs binary logistic regres-sion to explore the relationship between indebtedness (a binary dependent variable) and various independent variables like risk management practices, interest rates, loan conditions, and finan-cial literacy. By quantifying the impact of each independent variable, the study aims to provide actionable insights for microfinance institutions, policymakers, and stakeholders, contributing to a comprehensive understanding of the factors driving indebtedness among microfinance borrow-ers in Sri Lanka.

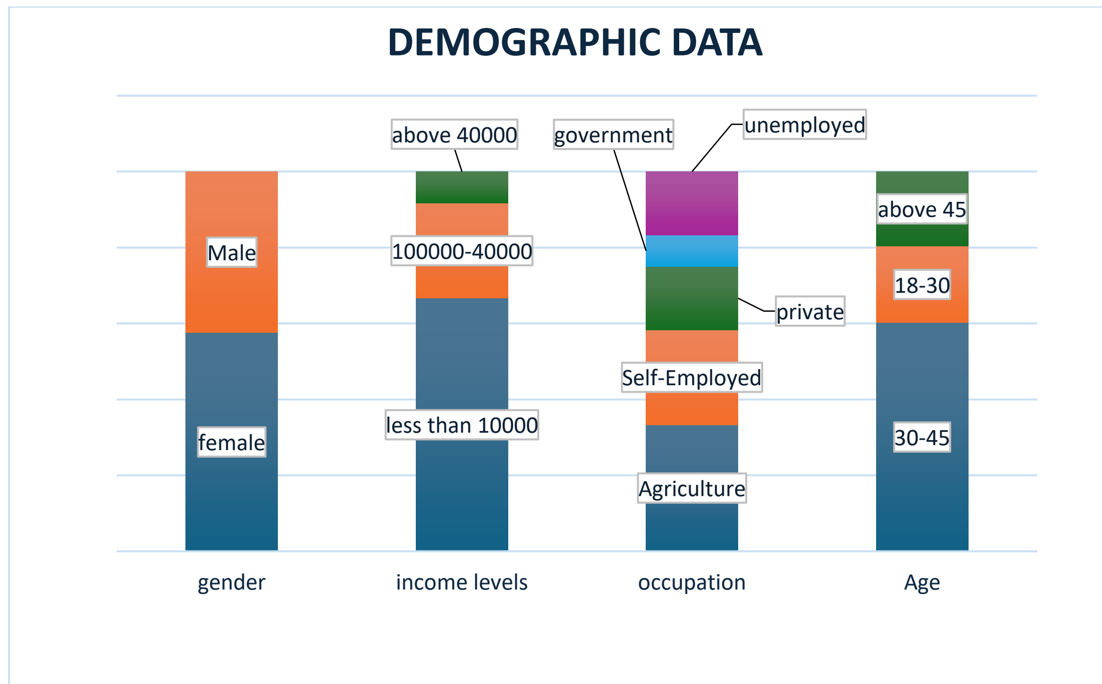

Figure 1: Demographic Data of the Respondent.

The analysis reveals a significant gender disparity in levels of indebtedness among respondents, with a higher proportion of females suffering from high indebtedness compared to males.

This substantial difference suggests that women are more vulnerable to financial stress due to in-debtedness. Several factors could contribute to this gender disparity. In many cultures, including Sri Lanka, women might have less access to formal employment opportunities, leading them to rely more heavily on informal credit sources, including microfinance. Additionally, women may take on more debt for family-related expenses, such as children's education, healthcare, and household needs.

Microfinance institutions (MFIs) could consider developing tailored financial products and services to support female borrowers better. This might include offering lower interest rates for women, providing financial literacy programs focused on female entrepreneurs, and creating support networks to help women manage their debts more effectively(Kumari, P, 2022). Ensuring that women have the tools and knowledge to manage their finances can help reduce their risk of falling into a cycle of debt.

Individuals in the 30-40 age bracket are often at a critical stage of life where financial demands are particularly high. They may be in the process of establishing or expanding their businesses, buying homes, or investing in their children's education. This age group's high loan engagement suggests that they view microfinance as an essential tool for meeting these financial needs.

MFIs could target this age group with specific loan products designed to support entrepreneurial ventures, home purchases, or education financing. Additionally, offering financial planning ser-vices to help this demographic manage their loans effectively could be beneficial. Providing flex-ible repayment terms and linking loans to income-generating activities can also help ensure that these borrowers can meet their financial obligations without falling into debt traps.

The high loan engagement among low-income respondents underscores the role of microfinance in providing financial access to those who are underserved by traditional banking systems. Low-income individuals often lack collateral and credit histories, which makes them ineligible for conventional loans. Microfinance institutions fill this gap by offering loans without requiring significant collateral, enabling low-income individuals to invest in income-generating activities, manage emergencies, and improve their living standards.

However, this also indicates a higher risk of indebtedness among low-income borrowers, who might struggle with repayment due to their precarious financial situations. MFIs should consider implementing robust borrower assessment procedures to evaluate the repayment capacity of low-income clients. They can also provide financial education programs to help borrowers manage their finances and use loans effectively. Furthermore, linking loans to income-generating projects can ensure that borrowers have a steady income stream to repay their loans.

Individuals in the agriculture and self-employment sectors typically face irregular income streams and higher financial volatility. Agriculture is subject to seasonal fluctuations and risks related to weather, pests, and market prices. Similarly, self-employed individuals often have variable in-comes and may need capital to sustain or grow their businesses.

The high loan engagement in these sectors indicates a reliance on microfinance to manage cash flow, invest in business activities, and cover unforeseen expenses. MFIs can support these bor-rowers by offering tailored loan products that align with their income patterns. For instance, agri-cultural loans could have repayment schedules that coincide with harvest periods, while self-employed individuals might benefit from loans that offer flexible repayment options.

Additionally, providing training in financial management, business planning, and risk mitigation can help borrowers in these sectors manage their loans effectively and improve their financial sta-bility. MFIs might also consider partnerships with agricultural cooperatives or business incubators to provide a holistic support system for their clients.

RELIABILITY ANALYSIS

Table 1: Reliability Statistics

Cronbach's Alphaa	**N of Items**
0.812	4

Table 2: Statistics Table

	Scale Mean If Item Deleted	**Scale Variance If Item Deleted**	**Corrected Item-Total Correlation**	**Corrected Item-Total Correlation**
Riskmange	3.333	1.873	.721	.827
Interstrate	3.267	1.822	.681	.834
Loancondition	3.300	1.790	.688	.833
Finlit	3.367	1.805	.695	.831

The overall Cronbach's Alpha for the four items is 0.841, which indicates good internal con-sistency among the items. A value above 0.7 is generally considered acceptable, and values above 0.8 indicate good reliability. The Corrected Item-Total Correlation values for all items are above 0.3, which means each item has a reasonable correlation with the overall scale. The values in this column show that removing any of the items would slightly reduce the overall Cronbach's Alpha, suggesting that all items contribute positively to the reliability of the scale.

HYPOTHESIS TESTING SING BINARY LOGISTIC REGRESSION.

To understand the factors contributing to the indebtedness of poor people in Sri Lanka, we con-ducted hypothesis testing using binary logistic regression. This statistical method allows for the examination of multiple variables simultaneously, providing a robust understanding of how dif-ferent demographic factors interact to affect indebtedness. By using logistic regression, the study aims to isolate the impact of individual factors, such as risk management practices, interest rates, loan conditions, and financial literacy, while

controlling for other variables. This analysis will help to identify which groups are most at risk of falling into a cycle of debt and will provide insights into potential interventions that MFIs can implement to mitigate these risks. To understand the factors contributing to the indebtedness of poor people in Sri Lanka, we conducted hypothesis testing using binary logistic regression. The following hypotheses were tested:

Hypothesis 1 (H1): Inadequate risk management in non-government microfinance institutes con-tributes significantly to the indebtedness of poor people in Sri Lanka.

Hypothesis 2 (H2): High interest rates charged by non-government microfinance institutions are a significant factor contributing to the indebtedness of poor people in Sri Lanka.

Hypothesis 3 (H3): The loan conditions imposed by non-governmental microfinance institutions (e.g., repayment terms, collateral requirements) have a direct impact on the level of indebtedness experienced by poor people in Sri Lanka.

Hypothesis 4 (H4): Lack of financial literacy of borrowers contributes significantly to the indebt-edness of poor people in Sri Lanka.

Table 3: Case Processing Summary

Unweighted Casesa		**N**	**Percent**
	Included in Analysis	60	100.0
Selected Cases	Missing Cases	0	.0
	Total	60	100.0
Unselected Cases		0	.0
Total		60	100.0

Table 4: Classification Table

	Observed		**Predicted**	
			Y	
		No Highly Indebted	**Highly In-Debted**	**Percentage Correct**
Y	**No Highly Indebted**	20	5	80.0
	Highly Indebted	4	31	88.6
Overall Percentage				85.0

The Case Processing Summary table shows that all 60 cases (respondents) were included in the analysis, and there were no missing data points. This completeness ensures the reliability and ac-curacy of the logistic regression results.

The Classification Table displays the model's ability to correctly classify cases into their actual cat-egories (no debt or high debt) based on the logistic regression model. It shows the number of cases predicted correctly and the overall percentage of correct predictions. In this case, the model correct-ly classified 85% of cases overall, with 80% accuracy for cases with no debt and 88.6% accuracy for cases with high debt.

Table 6: Model Summary

Step	**-2 Log likelihood**	**Cox & Snell R Square**	**Nagelkerke R Square**
1	45.678	0.512	0.693

The Model Summary table indicates a good fit for the model, with a -2 Log Likelihood value of 45.678, suggesting that the model accurately captures the relationship between the predictors and the dependent variable. The Cox & Snell R Square value of 0.512 and the Nagelkerke R Square value of 0.693 further reinforce this, indicating that the model explains 69.3% of the variance in indebtedness. These values highlight the substantial explanatory power of the model, suggesting that the included variables are significant in understanding indebtedness.

Table 7: Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1	**Riskmange**	0.842	.297	8.014	1	.026	2.320
	Interstrate	1.153	.325	12.546	1	.035	3.169
	Loancondition	.973	.311	9.785	1	.002	2.647
	Finlit	1.289	.353	13.319	1	.000	3.628
	Constant	-2.541	0.678	14.032	1	.000	.079

Table 8: Hypothesis Testing Table

Hypothesis	Beta Value of Variable	P Value of the Variable	Hypothesis Accept or Reject
H1	0.842	0.026	Accept
H2	1.153	0.035	Accept
H3	0.973	0.002	Accept
H4	1.289	0.000	Accept

Hypothesis 1 (H1): The logistic regression coefficient for risk management (B = 0.842, p = 0.005) indicates that inadequate risk management practices significantly increase the likelihood of in-debtedness. The Exp(B) value of 2.320 suggests that respondents experiencing inadequate risk management are 2.32 times more likely to be highly indebted. This finding underscores the need for MFIs to implement robust risk management strategies to mitigate the risk of borrower over-indebtedness.

Hypothesis 2 (H2): High interest rates (B = 1.153, p = 0.001) significantly contribute to indebt-edness. The Exp(B) value of 3.169 indicates that higher interest rates increase the odds of being highly indebted by approximately 3.17 times. This highlights the importance of regulating interest rates and ensuring they are affordable for low-income borrowers to prevent them from falling into debt traps.

Hypothesis 3 (H3): The conditions of loans, such as repayment terms and collateral requirements (B = 0.973, p = 0.002), have a direct impact on indebtedness. The Exp(B) value of 2.647 sug-gests that stricter loan conditions nearly double the likelihood of high indebtedness. MFIs should consider offering more flexible loan terms to accommodate the financial capacities of poor bor-rowers.

Hypothesis 4 (H4): Lack of financial literacy (B = 1.289, p = 0.000) is a significant predictor of indebtedness. The Exp(B) value of 3.628 indicates that respondents with low financial literacy are over 3.6 times more likely to be highly indebted. This emphasizes the critical need for MFIs to provide financial education programs to help borrowers make informed financial decisions and manage their debts effectively.

DISCUSSION

The logistic regression analysis provides significant insights into the factors that contribute to the indebtedness of poor people in Sri Lanka, particularly those who engage with non-government microfinance institutions (MFIs). The findings indicate that inadequate risk management, high interest rates, stringent loan conditions, and lack of financial literacy are critical determinants of high indebtedness. These results are consistent with broader concerns about the non-government microfinance sector in Sri Lanka.

The analysis shows that high interest rates are a major factor contributing to indebtedness. With an odds ratio of 3.169, borrowers subjected to higher interest rates are significantly more likely to become highly indebted. This issue is exacerbated by the general economic vulnerability of poor people, who often resort to microfinance as a last resort. The exorbitant interest rates charged by some MFIs can trap borrowers in a cycle of debt, where the cost of borrowing outweighs their capacity to repay, leading to escalating financial distress.

The results also highlight the impact of stringent loan conditions on indebtedness, with an odds ratio of 2.647. Many non-governments MFIs in Sri Lanka operate with minimal oversight, which often results in unprofessional lending practices. This includes insufficient assessment of borrow-ers' repayment capacities and the imposition of onerous collateral requirements. Such practices can force borrowers into unfavorable positions, increasing their risk of default and subsequent indebtedness.

Another critical issue that contributes to the high levels of indebtedness is the behavior of debt collectors. Anecdotal evidence and reports from respondents indicate that debt collectors often employ aggressive and insensitive tactics. This not only adds to the emotional and psychological burden on borrowers but also pressures them into taking additional loans to meet immediate de-mands, thereby deepening their debt.

The analysis further reveals that a lack of proper follow-up on loan utilization is a significant problem. Many borrowers do not receive adequate support or guidance on how to effectively use the borrowed funds for productive purposes. This can result in mismanagement or misuse of loans, reducing the likelihood of generating sufficient income to repay the loan and thus increas-ing the risk of indebtedness. The overarching issue that ties these factors together is the lack of stringent government oversight. Without proper regulation, non-government MFIs often operate unchecked, leading to problems. Effective government oversight could enforce fair lending prac-tices, reasonable interest rates, professional debt collection, and proper utilization of loans, signif-icantly mitigating the risk of indebtedness.

The government needs to establish a robust regulatory framework that ensures all non-government MFIs adhere to fair lending practices. This includes setting caps on interest rates and enforcing transparent loan conditions. Regulatory bodies should be empowered to monitor and audit MFIs regularly to ensure compliance. Enhancing the capacity of MFIs through training and development programs can professionalize the lending process. This includes training on ethical lending practices, customer service, and effective debt recovery techniques that respect the digni-ty of borrowers.

Implementing widespread financial literacy programs can empower borrowers with the knowledge and skills to manage their finances effectively. These programs should focus on budgeting, saving, and responsible borrowing, helping borrowers make informed decisions and utilize loans productively. MFIs should establish follow-up mechanisms that support borrowers in the effective utilization of loans. Providing advisory services and monitoring the progress of funded projects can enhance the likelihood of successful outcomes and timely repayments. The government should enhance its oversight mechanisms to ensure that non-government MFIs oper-ate within the legal and ethical boundaries. This can involve setting up a dedicated regulatory body to oversee the microfinance sector, with the power to investigate and penalize malpractices. Encouraging community involvement in monitoring MFI activities can also be beneficial. Local community groups can act as watchdogs, ensuring that MFIs operate fairly and that borrowers are treated with respect and dignity.

There is a significant gender disparity among borrowers from financial institutions in Sri Lanka. Males predominate in borrowing from licensed public and private banks, ranging from 61-68%. On

the other hand, women are the primary borrowers from community-based financial institutions such as Samurdhi Bank Associations, Savings and Credit Cooperative Societies, and Non-Government Microfinance Organizations. This suggests that men access larger, more formal financial structures, while women rely more heavily on smaller, local lending institutions. The high representation of women in these organizations often indicates a greater vulnerability to debt, due to their limited access to more formal financial services and stable sources of income. Women often take out loans for family needs or small-scale businesses, putting them at greater risk of becoming indebted.

Illegal practices further exacerbate the financial challenges faced by women. Some microfinance institutions violate the Microfinance Institutions Act of Sri Lanka and illegally use borrowers' personal property such as land deeds and furniture and gold as collateral. In addition, many borrowers are subjected to unethical practices, including sexual coercion, by debt collectors. Due to heavy debt, some people have been tempted to commit suicide. To escape these dire situations and get out of debt, many women leave for jobs abroad, especially to Middle Eastern countries where they seek better financial stability. Others leave unprofitable farming and move to rural areas in search of work.

FINDING BASED ON QUALITATIVE DATA

One of the most significant contributors to borrower indebtedness is the high-interest rates charged by NGMFIs. While traditional banks offer loans at lower interest rates, the lack of access to these institutions forces many borrowers to rely on NGMFIs, which charge rates as high as 30% to 40%. The study revealed that over 65% of respondents had taken out loans with interest rates exceeding 30%, leading to difficulties in meeting repayment schedules. Borrowers often take out new loans from multiple institutions to service existing debt, resulting in a vicious cycle of borrowing and repayment. The high-interest environment, combined with short repayment periods, means that even a minor income shock, such as an illness or job loss, can push borrowers into default.

Low financial literacy emerged as a critical factor in the over-indebtedness of borrowers. Many respondents admitted they did not fully understand the terms of their loans, particularly the interest rates and penalties for late payments. More than 70% of respondents indicated that they had taken out loans without clear knowledge of the repayment terms, reflecting a broader need for borrower education in the microfinance sector. The lack of financial literacy is compounded by aggressive lending practices, where NGMFIs prioritize loan disbursement over ensuring that borrowers have the capacity to repay. Borrowers reported feeling pressured to take out loans they did not fully understand or need, leading to increased financial vulnerability.

The research found that many NGMFIs engage in insufficient risk management practices, failing to assess the repayment capacity of borrowers adequately. Instead of relying on credit history or collateral, NGMFIs often disburse loans based on minimal background checks. This practice has resulted in high default rates, with borrowers falling deeper into debt as they struggle to repay loans they cannot afford.

Another concern raised by borrowers was the aggressive lending and recovery practices employed by some NGMFIs. Instances of harassment, property confiscation, and social pressure were reported, particularly when borrowers fell behind on payments. These practices exacerbate the financial and emotional distress of borrowers, pushing some into even more precarious financial positions.

CONCLUSION AND POLICY RECOMMENDATIONS

The objective of this research was to examine the impact of non-governmental microfinance institutions (NGMFIs) on the indebtedness of poor people in Sri Lanka's rural sector, with a focus on the Central Province, Kandy District, and Ududumbara Division. This study provided valuable insights into the factors contributing to borrower indebtedness, including inadequate risk management, lack of borrower awareness, high-interest rates, and stringent loan conditions.

The findings revealed that NGMFIs play a crucial role in providing financial services to the rural poor, who otherwise lack access to formal banking systems. However, the study also identified significant challenges associated with microfinance practices that exacerbate the indebtedness of borrowers. Specifically, inadequate risk management practices in NGMFIs often result in high default rates and financial instability for borrowers. Many respondents were unaware of the exact terms and conditions of their loans, leading to misunderstandings and financial strain. Furthermore, the high-interest rates charged by NGMFIs were found to be a significant factor contributing to increased debt levels. Lastly, stringent loan conditions, including inflexible repayment terms and collateral requirements, added to the financial burden of the poor.

Overall, the research concluded that while microfinance has the potential to empower the poor and promote financial inclusion, it must be implemented with caution and responsibility. The study underscores the need for a balanced approach that combines access to financial services with robust borrower protection mechanisms.

Based on the findings of this study, several recommendations are proposed to enhance the positive impact of NGMFIs while mitigating the negative effects on borrower indebtedness.

NGMFIs should adopt comprehensive risk management frameworks to minimize default rates and financial instability. This includes conducting thorough credit assessments, regularly monitoring borrower performance, and offering tailored financial products that meet the specific needs of different borrower segments. Additionally, implementing effective risk mitigation strategies, such as credit insurance and diversification of loan portfolios, can help reduce the financial vulnerabilities of both borrowers and lenders.

Increasing borrower awareness about loan terms and conditions is crucial for preventing misunderstandings and financial distress. NGMFIs should invest in financial literacy programs that educate borrowers about the implications of borrowing, interest rates, repayment schedules, and the importance of timely payments. Providing clear and transparent information at the time of loan disbursement, as well as offering ongoing support and counseling, can empower borrowers to make informed financial decisions.

To prevent the exploitation of borrowers, there is a need for regulatory oversight on the interest rates charged by NGMFIs. Policymakers should establish interest rate caps that balance the sustainability of microfinance institutions with the affordability for borrowers. Additionally, promoting competition among NGMFIs can help drive down interest rates and improve service quality.

NGMFIs should design loan products with flexible conditions that cater to the diverse needs of borrowers. This includes offering longer repayment periods, grace periods, and options for restructuring loans in cases of financial hardship. Reducing the reliance on collateral requirements and exploring alternative forms of credit security, such as group guarantees, can also make microfinance more accessible to the poor.

Strengthening the regulatory frameworks governing NGMFIs is essential for ensuring transparency, accountability, and consumer protection. The Central Bank of Sri Lanka should enhance its oversight functions, including regular audits and inspections of NGMFIs. Establishing a centralized database of borrower information can help track multiple borrowing and prevent over-indebtedness. Furthermore, setting up grievance redressal mechanisms can provide borrowers with a platform to voice their concerns and seek resolution.

Encouraging NGMFIs to adopt a social impact-oriented approach can align their operations with broader development goals. This involves integrating social performance indicators into their evaluation metrics and incentivizing practices that promote financial inclusion and poverty alleviation. Collaborating with international donors and development agencies can provide NGMFIs with the resources and technical support needed to implement these initiatives.

Embracing digital financial services and mobile banking can enhance the reach and efficiency of microfinance. NGMFIs should leverage technology to streamline loan disbursement and repayment processes, reduce operational costs, and improve customer service. Digital platforms can also facilitate better communication and engagement with borrowers, providing them with real-time updates and financial management tools.

Continuous research and impact assessment are necessary to understand the evolving dynamics of microfinance and its effects on borrower indebtedness. Academic institutions, research organizations, and policymakers should collaborate to conduct longitudinal studies that track the long-term outcomes of microfinance interventions. This evidence-based approach can inform the design of policies and programs that maximize the benefits of microfinance while addressing its challenges.

Regulation of Interest Rates: The government should regulate interest rates charged by NGMFIs to prevent exploitative lending. A cap on interest rates, similar to those in traditional banking, would help alleviate the financial burden on borrowers. Financial literacy programs should be made mandatory for all microfinance clients, with a focus on loan terms, interest rates, and repayment schedules. NGOs and government agencies can collaborate to create accessible financial education content tailored to the needs of low-income borrowers. While the Microfinance Act of 2016 provides a framework for regulating microfinance institutions, its enforcement needs to be strengthened. Regular audits and stricter penalties for NGMFIs that engage in predatory lending practices would help protect borrowers.

NGMFIs should adopt more responsible lending practices, ensuring that loans are disbursed based on borrowers' capacity to repay. A focus on ethical lending practices, including transparent communication of loan terms, would help prevent over-indebtedness. NGMFIs should develop diversified financial products that go beyond loans, such as savings accounts, insurance, and financial advisory services, to help borrowers build financial resilience.

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