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## Study on the Impact of Financial Literacy of the Rural Population on Microfinance: In Association with the Middeniya East Grama Niladhari Division, Sri Lanka

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### **Abstract:**

*The research focuses on the poverty-stricken rural communities that use the sector's state and commercialized micro-products:*

- *To empower the people associated with the microfinance sector economically and socially and*
- *To eradicate poverty in the rural community and raise the standard of living and*
- *To find out to what extent personal financial literacy has become a decisive factor*

*The research employed a questionnaire to collect empirical data from 100 households by using random sampling in the Middeniya East Grama Sewa Division, which uses microfinance facilities. Accordingly, personal financial literacy was considered the intrinsic variable, and the efficiency of using financial facilities was used as the extrinsic variable. While reviewing information on personal financial literacy, a lot of data was gathered by presenting questions related to basic financial and advanced basic literacy. Accordingly, a standard multiple regression analysis was carried out to identify the impact of literacy on microfinance affairs. The finding of the multiple regression model was  $M = -27.7129 + 0.410357L + 0.324577AFL$ . The two intrinsic variables, basic financial literacy and advanced financial literacy showed a corresponding connection related to rural people's micro financial dealings. The performance of utilization of microfinance depends on the person's basic and advanced financial literacy. Accordingly, when basic financial literacy and advanced financial literacy increase, the performance of utilization of microfinance increases.*

**Keywords:** *Financial literacy, microfinance, rural population*

### **1. Introduction**

By now, the Governments have implemented various programmes to eradicate poverty in Sri Lanka at the national level. Among these microfinance lineups, we can identify:

- The Janasaviya Programme, which was implemented by the Janashakthi Bank (1989 -1994), and
- The Samurdhi Programme (commenced in 1995), which was launched by the Samurdhi Bank

The Janasaviya Programme was launched, mainly targeting self-employment, generating income for poverty-stricken people. At the same time, the Samurdhi Programme was implemented to identify the inherent capabilities of low-income groups and the ability to develop within the environment they are living in. Also, it was established to empower poor people to help them come out of poverty within a congenial existence for creative, efficient, deprived people, using a method of participation development and improving them (Economic Review, 2005 Aug./Dec. Page 31). Anyhow the Divineguma Programme is being carried out to eradicate national poverty today.

Due to inherent weaknesses of the Janasaviya, Samurdhi, and Divineguma programmes, the names were changed and restructured in a timely manner, but the basic purpose is to eradicate poverty. Accordingly, tasks relevant to micro-financial methods are being conducted through the system of private banks. Anyhow, it can be identified further that there is the potential to promote further the progress of the microfinance method in a productive manner.

In addition to the failure to achieve the intended objectives of the microfinance system (its efficiency and success), it is questionable whether the personal financial literacy of the beneficiaries is also an impact or an obstruction to the shortcomings of this mechanism.

As of today, a large institutional structure has come forward competitively to supply microfinance facilities. It includes not only the Janashakthi Bank and the Grameeya Bank but also government commercial banks, semi-government commercial banks, financial institutions, financial companies, insurance companies, leasing companies, and Community Based Banks, etc. Accordingly, microfinancing has been commercialized today.

Personal financial literacy can be identified as an integration of the awareness, knowledge, capabilities, attitudes, and behaviours required to make productive financial decisions to acquire personal financial welfare (Atkinson & Messy, 2012). What is known as financial welfare is the satisfaction a certain person has regarding that person's financial situation (Williams, 1983). What impacts financial decisions an individual makes is the knowledge he or she possesses, capabilities, attitudes, and modes of behaviour.

At present, the financial market is very extensive and has become quite complex. For example, when a savings account is considered, several different types of accounts have been introduced based on age, income, professional level, whether rural or urban, and gender. At the same time, there are many opportunities where financial resources such as mortgages, fixed deposits, loans, pension plans, insurance, share market, securities market, etc., can be made use of. In addition, financial resources have to be allocated for vehicles, housing, which requires large amounts of resources, and long-term and short-term consumer goods (Chen & Volpe, 1998).

The understanding of financial matters has an impact on the use of financial use of a person. When operating within the share market, loss of finances due to financial crises is the most often seen as a result of inadequate knowledge of finance (Cohen & Nelson, 2011). Explaining further, they say that the majority of loss of financial provisions happens among persons who have little knowledge of finance. Consumers face difficult situations in the current financial environment through weak financial decisions regarding loans, mortgages, and pension plans. Lack of knowledge, especially on financial matters, indicates that basic economic concepts and lack of ability to make financial calculations are conducive to facilitating individuals to make optimal financial decisions (Hastings, Justine, Olivia & Mitchell 2011).

The reason for the importance of personal financial literacy is the responsibility of using personal financial resources due to the complexity of the financial market. Researchers worldwide have focused on personal financial literacy and have been involved in research of various dimensions. It can be identified that in many countries throughout the world, the ability to read and write or literacy has been subjected to studies and services at both national and regional levels. In Sri Lanka, it is the same. However, in Sri Lanka, an index or a quantitative measurement at either the national or regional level regarding personal financial literacy cannot be found. It is equal to nature in several other countries of the world. What is clear from this is that in quite a number of countries, there is a relatively low focus on personal financial literacy. Since personal financial literacy is a factor that impacts people's livelihood level, identifying the financial literacy of citizens of a country is very important by way of macroeconomics.

Accordingly, the research focuses on the poverty-stricken rural communities that use the sector's state and commercialized micro-products:

- To empower the people associated with the microfinance sector economically and socially and
- To eradicate poverty in the rural community and raise the standard of living and
- To find out to what extent personal financial literacy has become a decisive factor

What is intended through this study is to analyze the financial literacy of poverty-stricken people and to learn how such persons' financial literacy affects their use of finances. Also, this identifies the changes in modern socio-economic structure which impact the rural sector's financial literacy. Since the majority in Sri Lanka is the rural population and there is an advanced poverty rate among rural people, this study is important. Moreover, it spreads across a wide range of their standard of living and the economic development process. Therefore, identifying the impact of socio-economic changes in rural poverty-stricken people on their financial literacy is of timely value in geography, education, and nationally.

## 2. Literature Review

This research presents information on pre-studies relevant to personal financial literacy. Attention has been focused on this to learn extensively about the empirical studies conducted in Sri Lanka and other countries concerning financial literacy.

During the past decade, there has been advanced motivation toward academic studies at the international level on the financial literacy concept. It is clear that the effectiveness of using personal financial resources, and their impact on personal financial well-being, have led to the rapid development of the financial sector. An analysis will be done through this study on the financial literacy of the rural community connected to microfinance development access under the concept of financial literacy. In order to prepare the required format and conceptual framework, it is essential to use the literature review.

In a study carried out by Lusardi & Mitchell (2011), it has been identified that the focus of women on financial matters is at a relatively low level in the United States of America (Xu & Zia 2012). However, while studying research on financial literacy worldwide, it is apparent that women have a relatively low level of financial literacy, which is common in developing and developed countries.

Personal professionalism and professional experience have an impact on determining personal financial literacy (Mandell, Lewis & Klein, 2008). Chen & Volpe (1998) stated that less professional experience decreases personal financial literacy levels. Similarly, it has been identified that middle-aged persons with advanced levels of professional experience show advanced personal financial literacy.

Chen & Volpe (1998) studied whether changes exist in personal financial literacy due to ethnicity and nationality. As they highlighted, compared to African and South American countries, people in American and Asian countries have an advanced level of financial literacy. Through pre-studies, changes in financial literacy can be identified in the world within regions and in a country, locally as well. When considering this globally, there is an apparent lesser level of financial literacy in African and South American countries (Xu & Zia, 2012).

### 3. Methodology

The main target of this research is to study the impact of the personal financial literacy of rural people on microfinance performances. The sample used is 100 households in the Middeniya East Grama Sewa Division that use microfinance facilities. In order to select 100 households from the total of 532 households in Middeniya East Grama Sewa Division, the simple random sampling method was used. Here it was considered whether a connection exists between the performance of the rural people in using microfinance facilities and personal financial literacy. Accordingly, personal financial literacy was considered the intrinsic variable, and the efficiency of using financial facilities was used as the extrinsic variable.

Both the primary and secondary data methods were used to collect data. Under these two methods, both quantitative and qualitative data were classified. To obtain data relevant to the two methods, primary and secondary technical methods inherent to that were used for the collection of data. On this occasion, to obtain primary data, the self-counting method, interview method, and direct observance were employed. To mainly gather data, a questionnaire was also used.

This questionnaire was created in three sections:

- In the first section, information regarding the background of the responder was investigated,
- In the second section, information on the responder's use of personal financial use was obtained, and
- In the third section, information in connection with the responder's personal financial literacy and the efficiency of the use of microfinance was reviewed.

While reviewing information on personal financial literacy, a lot of data were gathered by presenting questions about basic financial literacy and advanced basic literacy. Accordingly, a standard multiple regression analysis was carried out to identify the impact of literacy on microfinance affairs. Here, as the intrinsic variable, advanced financial literacy and basic financial literacy were used, and as the extrinsic variable, the performance in using micro financial facilities was used. An index was created based on the answers given to the questions on the use of microfinance by the responders. Also, an index was prepared based on the responders' answers concerning basic financial and advanced financial literacy. Finally, a standard multiple regression analysis was conducted using these indexes as the foundation.

Accordingly, the equation of the standard multiple regression analysis is as follows. The model of the standard multiple regression equation is,

$$y = \beta_0 + \beta_1 + \beta_2 + \varepsilon$$

Consequently, by substituting the above standard multiple regression equation, the following equation can be built up as follows. Therefore, the standard multiple regression model can also be used by applying this formula one. By using the dependent variable, the performance of using microfinance facilities (M), and the independent variables – Basic financial literacy (BFL) and Advanced Financial Literacy (AFL), the model will be

$$M = \beta_0 + \beta_1 BFL + \beta_2 AFL + \varepsilon$$

### 4. Results and Discussion

According to Figure 1 below, 80% of users of microfinance were females, and the remaining 20% were males. Here, it is often women who get directly involved in obtaining microfinance services, and as a result, it is apparent that their representation is high.

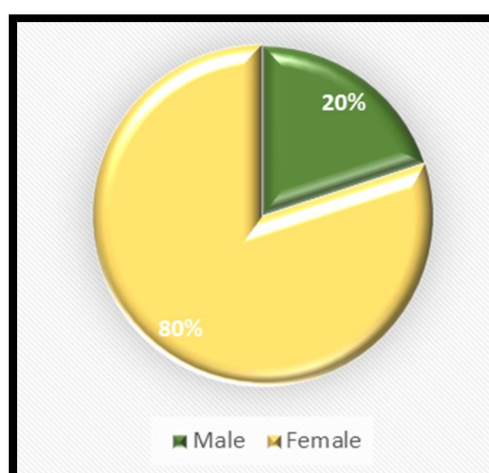


Figure 1: Gender Disparities  
Source: Sample Survey 2020

Based on the level of education, most of the responders were persons who attended school from Year 6 to Year 11. Accordingly, 38% have come forward for their sample. At the same time, it received responses from the group of least

responders, which was 2% who have succeeded at the Advanced Level. The group which has not attended school was as small as 6%. Accordingly, more than half of the samples were persons who have gone to school for more than 6 years. Further information on this is depicted in Figure 2.

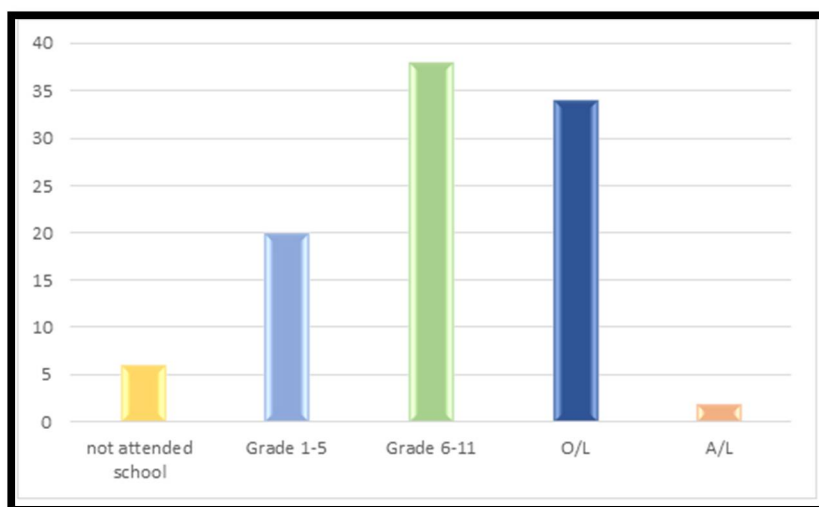


Figure 2: Education Level of Those Using Micro Finance  
Source: Sample Survey, 2020

The following figure provides a detailed explanation of the main factors that influence bank transactions of responders.

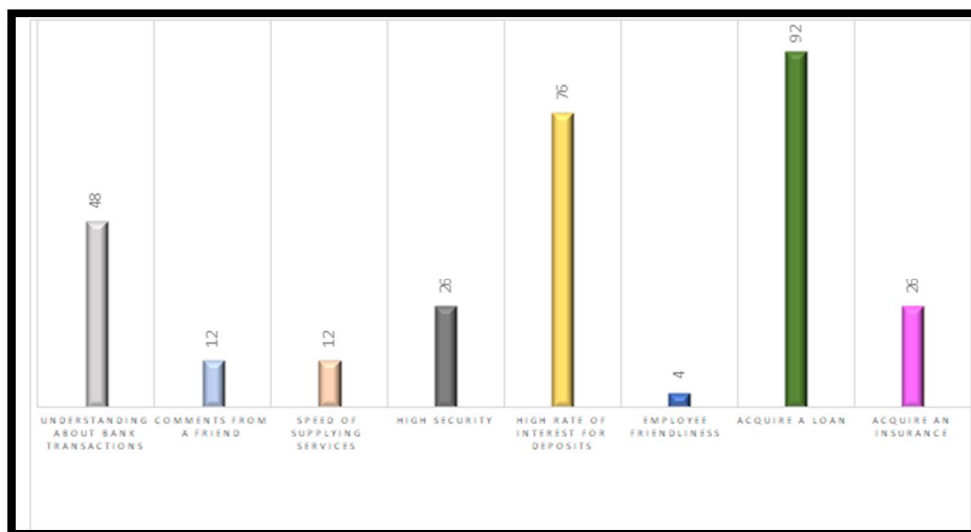


Figure 3: Factors Affecting Transactions with Banks  
Source: Sample Survey, 2020

A percentage such as 92% had dealt with banks to obtain loans. It is possible to identify that another 76% of the total number of responders had dealt with banks with the goal of saving. Anyhow, employee friendliness was very low while highlighting the speed of supplying services based on consumer attraction to responders' decisions.

When many responders got in touch with banks, it is possible to identify that several factors had the same. In line with that, 16% had connected with banks:

- To gain an understanding of bank transactions,
- To obtain a high rate of interest for deposits and
- To acquire a loan or insurance

Another 16% of the responders had come to banks to obtain a high-interest rate for deposits and loans.

The following image depicts data on responders' savings related to microfinance. Accordingly, 32% had two savings accounts each, and 8% had one saving account each. Even though responders had many accounts, only a minority had maintained active savings in them.

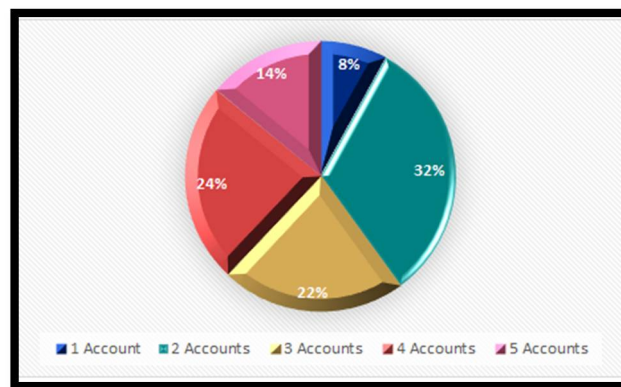


Figure 4: Savings Related to Micro Finance  
Source: Sample Survey, 2020

The relationship between intrinsic and extrinsic variables was analysed using standard multiple regression. Accordingly, the results can be reported as follows.

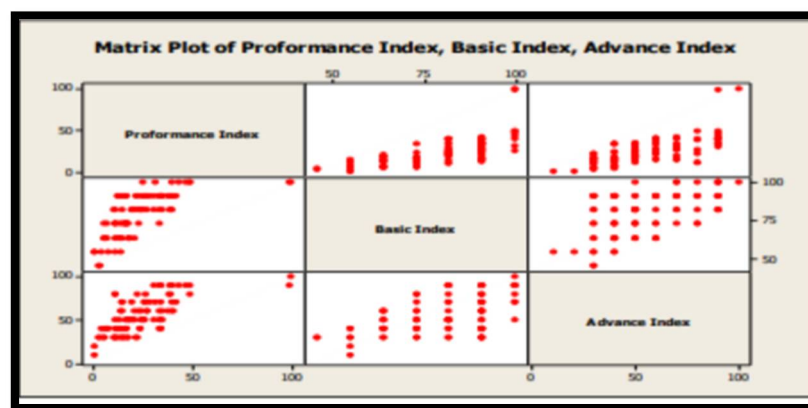


Figure 5: The Nature of Relationships among Variables  
Source: Authors Generated Using SPSS

In order to consider the validity of the prepared model, the Scatterplot graph was used. In compliance with the Scatterplot graph, homoscedasticity exists since the spots are randomly dispersed around 0. Therefore, against the observance order and according to the scatterplot graph, it is clear that homoscedasticity is protected.

At the same time, to identify whether multi-collinearity exists within the model, the Variance Inflation Factor (VIF) value was used. Here in relation to both variables, since the VIF is lesser than 10, it is possible to identify that multi-collinearity does not exist within the model. Also, the Durbin Watson frequency is 1.97677, and based on this value, it can be declared that at a level of 95% confidence interval, there is no autocorrelation in the model.

Source	SS	df	MS	Number of obs = 2	
Regression	7384.3	1	2175.34	R Square = 75.76%	
Residual	2965.3	1	2965.28	Adj. R Square = 75.22%	
Total	10349.6	2	5174.80	Durbin-Watson = 1.97677	
M	Coef	Std.Err.	t	Sig	VIF
_cons	-27.7129	3.73120	-7.42733	0.000	
Basic financial literacy	0.410357	0.05308	7.73101	0.000	1.34284
Advanced financial literacy	0.324577	0.03596	9.02621	0.000	1.34284

Table 1: The Results of Standard Multiple Regression  
Source: Authors Generated Using SPSS

Based on the data in the above table, the impact of financial literacy of rural people on microfinance affairs can be investigated. Accordingly, the regression model is as follows,

$$M = -27.7129 + 0.410357L + 0.324577AFL$$

According to the above regression model, performance without the impact of financial literacy, the independent variable is -27.7129. At the same time, it was possible to identify a corresponding connection between intrinsic and extrinsic variables, basic financial literacy, and advanced financial literacy. The two intrinsic variables, namely basic

financial literacy and advanced financial literacy, showed a corresponding connection related to rural people's micro financial dealings. When people's basic financial literacy changes by one unit, the performance of the use of microfinance changes by 0.410357. Similarly, when the advanced financial literacy changes by one unit, the efficiency of the use of microfinance correspondingly changes by 0.324577.

## 5. Conclusion

The performance of utilisation of microfinance depends on the person's basic financial literacy and advanced financial literacy. Accordingly, when basic financial literacy and advanced financial literacy increase, the performance of utilization of microfinance increases. So, to increase the performance of utilization of microfinance and the personal financial literacy required, necessary arrangements must be made. Overall, to increase the financial literacy of rural people, it is important for the Regional Development Department of the Central Bank of Sri Lanka to conduct programmes to raise awareness among entrepreneurs and about controlling debt and for other commercial banks and financial institutions to implement programmes to impart knowledge to the public on the use of finance, etc.

Similarly, programmes with community participation should be carried out:

- To raise awareness among rural people regarding financial products in the informal sector,
- To raise national-level financial literacy indexes,
- To compile programmes to increase standards of personal financial literacy and introduce special projects,
- To improve financial literacy and allocate required financial provisions for these are of immense importance

While ensuring that personal financial literacy is increased through such processes, it is important to take steps to increase the efficiency of microfinance services. Through these, a group with advanced financial literacy will be encouraged to use microfinance, and the expected results can be achieved successfully.

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