

Informal Financial System in Sri Lanka: Special Reference to Rural Areas

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Abstract: An effective financial system is required to mobilize resource from surplus sector to deficit sector. This service is provided by both formal and informal financial markets in an economy. Informal financial markets provide very important service in meeting financial needs of units who are not deal with the process of formal financial markets. Characteristics of informal financial services in Sri Lanka can be studied under Rural, Urban and Estate sectors. This study examines the informal financial services in Sri Lanka with special reference to rural areas. Primary data and secondary data are used this study. Secondary data are extracted from the documentary sources. Primary data are gathered through questionnaire conducted with a random sample of 100 household drawn from the list of household available with Grama Niladhari. This sample is selected from purposively selected villages namely Deyyanwela, Arama and Aranayake that are located in three different Grama Niladhari divisions of Aranayake Divisional Secretariat area. The data says that Majority of the respondents are engaging in both financial markets, formal as well as informal financial market, while total of 23% respondent engage in informal financial sector. Pawning, trade credit, crop mortgages, single purpose credit services and direct lending are identified as informal credit services in theresearch areas. Direct lending service is the most utilized financial service by the respondents. As evidenced in data, most of the respondents' reason for preferring informal financial services is closeness and personal relationship. The research reveals that informal financial services are still playing in rural areas though there can be seen strong spread of formal financial services. It is concluded that integrating informal financial market with formal financial market will increase thescope of the financial transactions and create people confidence in the system thereby encouraging those in the informal sector to patronize the formal sector.

Keywords: Crop mortgage, Direct lending, Financial market, Informal financial service, Pawning, Trade credit.

I. INTRODUCTION

The financial system in an economy plays a considerable role in stimulating economic growth via the process of directing funds from surplus sector to areas of need. Historically developing countries including Sri Lanka have been experiencing financial dualism, formal and informal sector. An informal (Unorganised) market serves the needs of the informal finance while Currency Board or the Central bank, Commercial banks, savings institutions, co-operatives and the share market serve as the sources of formal (organised) finance. On the other hand it was the money lenders, indigenous bankers, pawn-brokers, traders and merchants, landlords, friends and relatives act as intermediaries in the informal credit market. Also informal financial sector is a key source of credit supply, especially among parties which are limited to access formal financial sector. The opening up of the economy in 1977 paved the way for most of the institutions to the practices of formal markets in advanced countries enable them to have advanced methods with sophistication. The informal sector has moved in far with the formal sector to cater to the groups which could not benefit from

the formal sector institutions. With advantages of unregulated money supply, easy accessibility, easy liquidity, low administrative and procedural costs, little or no collateral/mortgage requirements, flexibility in interest rates and repayments Schedules, informal credit markets are ideally suited to cater to the lower income groups and informal sector's requirement of credit. Informal financial services are heterogeneous with a wide variety of operators, services, including lending and borrowing using wide variety of debt instruments [8]. Characteristics of informal financial services in Sri Lanka mainly can be studied under three different sectors which are,

- a) Rural sector informal financial market,
- b) Urban sector informal financial market, and
- c) Estate sector informal financial market [5].

There are distinctive characteristics in informal financial services across sectors; there are common features as well.

II. PROBLEM OF THE STUDY

Sri Lanka is experiencing financial dualism, as formal and informal sector. The existence of informal financial market is a wide spread global phenomenon according to literature. The degree of their importance is largely associated with the financial development. On the basis of financial operations and characteristics, informal financial services in Sri Lanka can be studied under three different sectors which are rural, urban, and estate sectors. And also informal financial transactions in, Sri Lanka can be studied under three different categories are as direct money lending, indirect money lending, and voluntary credit groups. Through the presence of formal financial transactions in the rural sector has improved in line with the expansion of institutional financial sector, the informal financial transactions also still play a dominant role in rural sector. The research intends to examine the characteristics and operations of informal financial activities in Sri Lanka with special reference to rural sector. In this research informal sector refers to the non-institutional or unorganised financial sources which consists mainly money lender, traders, pawn brokers, friends and relatives and landlords. Pawning, trade credit, crop mortgage, single purpose credit services and direct lending are considered as financial services in informal financial services in rural sector. This research is set out to examine informal financial services in Sri Lanka with special reference to the rural sector.

III. OBJECTIVES

This research was undertaken to examine informal financial services in Sri Lanka with special reference to the rural sector. The specific objectives of the research were to:

- Identify the structure of informal financial services in Sri Lanka.
- Examine different informal financial sources in rural areas of Sri Lanka.
- Identify reason for preferring informal financial services in rural areas.

IV. METHODOLOGY

Primary data and secondary data were used this study. Secondary data were extracted from the documentary sources. Primary data were gathered through questionnaire conducted with a random sample of 100 household drawn from the list of household available with Grama Niladhari. This

sample were selected from a purposively selected villages namely Deyyanwela, Arama and Aranayake that are located in three different Grama Niladhari divisions of Aranayake Divisional Secretariat area. A sample size 100 household as 40 Deyyanwela, 30 Arama, and 30 Aranayake were selected. The questionnaire was analyzed and evaluated by using descriptive statistical method.

V. RESULTS AND DISCUSSION

Respondent involvement of financial market: Majority of the respondents are engaging in both financial markets, formal as well as informal financial market, while total of 23% respondent engage in informal financial sector.

Table 1: Respondent involvement of financial market

Financial market	Frequency	Percentage (%)
Formal	33	33%
Informal	23	23%
Both	44	44%
None	0	0%
Total	100	100%

Source: Field survey 2011

Informal financial services in rural areas: Pawning, trade credit, crop mortgages, single purpose credit services and direct lending are identified as informal credit services in the research areas. Respondents were asked about the credit services nearest to them in terms of proximity because some of respondents expressed that they are engaged in both sectors to obtain financial services. Therefore researchers asked the nearest financial services that they obtain.

Table 2: Informal financial services in rural areas

Financial Service	Frequency
Pawning	13
Trade credit	10
Crop mortgage	6
Single purpose credit service	9
Direct lending	26

Source: Field survey 2011

According to the data, 26 respondents have used direct lending service for their credit requirement. 13 respondents have given pawning as their financial service to obtain credit and 10 were single purpose credit service and 6 were crop mortgage. Direct lending service was the most used financial service by the respondents. The respondent have expressed that this was easy source to obtain credit at their request with comparison to other credit source. And also most of them have used this credit for consumption purposes.

Table 3: Respondents' reasons for preferring informal financial services

Reason	Number of respondents	Percentage (%)
Closeness and personal relationship	23	36.51%
Easy access to borrowing	16	25.40%
Family ties	11	17.46%
Easier to operate	13	20.63%
No formal services facilities in area	0	0%

Source: Field survey 2011

As evidenced in Table 3 most of the respondents reason for preferring informal financial services 36.51% was closeness and personal relationship, 25.4% was easy access to borrowing, 17.46% was family ties and 20.63% was easier to operate as reasons for preferring informal financial services. The special reason hidden this data informal financial facilities are available in this areas. Because none respondent respond their preference as absence of formal financial services in this area.

VI. CONCLUSION

According to literature in advanced economies the formal sector is very significant while of the country, the informal sector dominates in less developed economies. But informal finance markets provide a very important service in supporting financial needs of the groups who have less access to also there are large number of reasons for preference of informal financial services. The sample household data set has confirmed what the literature tells us. However the degree of financial market importance is largely associated with the degree of economic development. Providing facilities for formal financial services could avoid disadvantages of informal financial services. The research reveals that informal financial services are still playing in rural areas. It is concluded that integrating informal financial market with formal financial market will increase the scope of the financial transactions and create people confidence in the system thereby encouraging those in the informal sector to patronize the formal sector.

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