State of Microfinance in Sri Lanka

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By

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Introduction

1.1 Introduction and Objectives

This paper is written as one of the country papers for a study of "State of Microfinance in SAARC Countries". The aim of the study is to enquire into the overall state of microfinance sector in SARRC countries and to see comparative trends. Using time series data for analysis, the study will provide information on microfinance program outreach and deepening and impact assessment of both the demand and supply side. An in depth understanding of micro finance regulatory regime and challenges faced due to regulations or lack of them is also discussed. The report is based on available knowledge and data. Information on 20 of the largest MFIs based on the agreed definition of microfinance is also presented.

The term microfinance is defined in different ways by different actors. The definition used in this paper for Micro Finance Institute is "an agency where over 75% of savings and credit and other financial services are done with no physical collateral being taken for loans". The institutions where over 75% of the lending portfolio fits this description were chosen to provide data of top 20 MFIs in the island. However, development banks, which also have microfinance in sizeable manner microfinance activities of commercial banks and finance companies, are also covered where ever data was available.

1.2 Sri Lanka –Country Context

Sri Lanka is an island state situated off the south-eastern tip of India. It is a relatively small country compared to its Asian neighbors and covers a surface area of just over 65 000 sq.km. The estimated population of Sri Lanka is around 19.8 million (2006), of which 85% is rural. Population density is about 300 per sq.km and population growth is contained to about 0.8% per annum. Sri Lanka is a multi-ethnic, multi-religious society. A majority of Sri Lankans are Sinhalese by ethnicity and Buddhist by religion, with large Tamil (generally Hindu), Muslim and Christian communities. A civil war between the Tamil separatists, the Liberation Tigers of Tamil Eelam (LTTE), and the Sri Lankan government has disrupted the country for the last 25 years.

The country has an irregular, dissected topography. A coastal belt (of less than 100 m elevation), succeeded by rolling plains (of 100-500 m elevation) of varying widths extend to the foothills of the central hills. The climate is equatorial and tropical. Rainfall is uneven and broadly divides the country into two climatic zones, namely, a so-called wet zone in the south-west of the country and a dry zone that covers the remainder of it. Annual precipitation in the wet zone averages 2, 500 mm and 1 200-1 900 mm in the dry zone. In 2004, the tsunami that hit the coast of Sri Lanka killed more than 38,000 people and left many more vulnerable from the loss of livelihood. The following table 1.1 provides key socio economic indicators of Sri Lanka.

Table 1.1 Key economic indicators of Sri Lanka 2005- 2008

Indicator	2005	2006	2007	2008
DEMOGRAPHY				
Midyear population ('000 persons) (b)	19,668	19,886	20,010	20,217
Unemployment Rate (per cent of labour force)	7.2 (a)	6.5 (a)	6.0 (a)	5.2 (a)
OUTPUT (f)				
Per capita GDP at market prices (US$)	1,241	1,421	1,634	2,014
PRICES AND WAGES (percentage change)				
Colombo Consumer's Price Index (2002=100)- Annual Average	11.00	10.00	15.80	22.60
EXCHANGE RATES				
Annual Average (Rs/US$)	100.50	103.96	110.62	108.33
INTEREST RATES (per cent per annum at end year)				
Deposit rates – *Commercial banks' Average Weighted Deposit Rate (AWDR)*	6.24	7.60	10.31	11.63
Lending rates – *Commercial banks' Average Weighted Prime Lending Rate (AWPR)*	12.24	15.19	17.95	18.50
LITARACY RATE	92.5%	92.5%	92.5%	90.8%
POVERTY				
Population below US $ 1 a day	6.6%	5.6%	5.6%	5.6%
Population below US $ 2 a day	45.4%	41.6%	41.6%	41.6%
Human Development Index	0.740	0.755	0.743	0.742

(a)- data excluding North and Eastern provinces
Source: Annual reports of Central bank of Sri Lanka 2008

Mahinda Chinthanaya, a ten year horizon development frame work 2006-2016 developed and published by ministry of planning in Sri Lanka provides high importance for microfinance as a development tool and it suggests many strategies to develop the sector such as development of national policy, establishment of a separate department in Central bank to supervise and regulate MFIs and to set up network of institutions to exchange information and policy dialogues.

1.3 Poverty Status in Sri Lanka

Sri Lanka tends to be known as an anomaly in the SARRC region, due to its high human and social indicators which put it on a par with mid/high middle-income countries, despite its status as a low middle-income country. However, despite good GDP growth in recent years (6.0% in 2005, 7.4% in 2006, 6.8% in 2007 and 6.0% in 2008, (Central Bank of Sri Lanka Annual Reports 2005/8), consumption and expenditure poverty levels remain high. The most recent census data from the Department for Census and Statistics puts 23% of population below the poverty line (**DCS, 2002**). Despite this indicating a decline from the figure of 30% in 1990, the figure translates into more than 4 million people living below the official poverty line. This official poverty line was first introduced in Sri Lanka in June 2004 and the figure is now regularly updated by the Department of Census and Statistics.

However this aggregate figure belies the heterogeneity of poverty levels in Sri Lanka, which differs widely between Provinces and Districts. At the two extremes are Colombo District with 6% of the population living in poverty and Moneragala District which registers 37% of the population living in poverty (**DCS, 2002**). This demonstrates the importance of disaggregating poverty statistics in Sri Lanka in order to get an accurate picture of where the poverty 'pockets' lie. The DCS is now using Poverty Mapping in order to reflect the disaggregated statistics and to highlight trends and clusters.

A sectorally disaggregated view shows the highest levels of poverty occurring in the South (Southern, Uva and Sabaragamuwa Provinces). Overall, rural areas are poorest **-** 90% of the poor live in rural areas, but this statistic must be understood in the context of urban/rural classification in Sri Lanka which classes the vast majority of the population as rural. The worst sector in terms of poverty levels and social indicators is the Estate sector (the population who live and work on tea, coconut and rubber plantations) which registers a 30% head count poverty ratio based on the national poverty line (as compared to Rural: 24.7% and Urban: 7.9%) (**DCS, 2002: 15**). The poverty maps highlight the close correlation between isolation from social and economic infrastructure, cities and markets, and higher levels of poverty incidence. This is borne out in the Estate sector which is particularly isolated from mainstream economic infrastructure. The poverty head count index is not uniform across provinces and districts, and while certain districts that have shown dramatic decreases since 2002, there are others in which poverty reduction has been marginal. According to 2002 data seven (7) out of 25 districts (Badulla, Hambantota, Kegalle, Matale, Moneragala, Puttalam and Ratnapura) had between 30**-**37% of their populations in poverty. Of these only Hambantota and Puttalam have shown huge reductions in poverty during 2006 (nearly 20% less) while others show a marginal reduction in the proportion of poor. In the Nuwara Eliya District the poverty head count index has increased significantly since 2002. The data also does not provide a full picture.

In terms of income inequality, the relative position of the poor has fallen over the past few decades. Statistics from 2002 reveal that the lowest decile earned only 1.7% of total income, whereas the highest decile earned 37.4% (**DCS, HIES: 2002**). Less than 1/3 of the population earned around 2/3 of total income, whereas more than 2/3 earned around a 1/3 of the total income. Therefore, while GDP may be rising in Sri Lanka, this growth is not being converted into poverty reduction as the poor's share of that growth is not large enough, and falling.

HIES 2006/07 estimated the national poverty head count index to be 15.2% which is a drop from a national poverty head count index of 22.7% in 2002. The data also indicates that urban and rural poverty has decreased while poverty on the estates has increased since 2002.

Poverty has further come down from 23% in 2003 to 15% in 2007. (www.statistics.lk) .It is indeed difficult to state to what extent microfinance specially of Samurdhi program which targets the poorest segment of the population has contributed to this. No studies or research exist where this variable has been isolated and which shows microfinance's contribution to national poverty alleviation. But circumstantial evidence gives enough reason to believe that microfinance both of Samurdhi and other agencies has contributed to this decline.

Micro Finance Models Practiced in Sri Lanka

In Sri Lanka, there are many models being practiced by MFIs. Historically credit Co-operatives, Village Societies also called community based organisation (CBOs) and Village Revolving Funds were the most popular till 1990's. Credit co-operatives were introduced in early part of the century but were largely confined to middle class salaried employees till it was taken to rural masses in 1980's. Village society model was adopted by SEEDS in 1986 and majority of NGOs followed suit with this model, whilst government with its Samurdhi banks also followed a modified village society model. In the 1980's and even in 1990's many INGOs such as CARE International commenced village revolving funds and this is still popular in conflict areas where UNHCR is also supporting such autonomous village funds. Based on limitations in those models new organisations such as Lakyaya, Ceylinco Grameen and BMI adopted methods of direct lending to clients and collections done at the village itself in a more structured manner such as on a specific data and time and within a very short period of time like 1 hour for a group. These models are described below. The essential factors considered used in this classification of models is the method through which MFIs keep their contacts with clients for transactions. Some other differences evident in these models are also discussed where ever found relevant.

2.1 Common Microfinance Models:

Village Banking

Village Banking or Community Banking model essentially treats the whole community as one unit, and establishes semi-formal or formal institutions through which microfinance is dispensed. Such institutions are usually formed by extensive help from NGOs and other organizations, who also train the community members in various financial activities of the community bank.

There are different ways of making village banks. In case of Sarvodaya, they mobilize the community members for sharing labour and self-help work and then form a formal village society called Sarvodya society. Janashkathi and Samurdi make informal village societies with 30 -50 members for each traditional village with the main intention of microfinance interventions and village banks are made as a federation of 10 -12 such societies. There are village banking structures that commenced as a result of externally injected revolving funds from the government or donor funded projects, which form the community-based savings and credit associations and provide a revolving fund to this association in order to on lend to their members. They typically consist of 25 to 50 low-income individuals initially who are seeking to improve their lives through self-employment activities.

Village banks usually start with savings. Then move into providing small emergency loans and gradually to larger loans. They run the bank: they choose their members, elect their own officers, establish their own by-laws, distribute loans to individuals, and collect payments and savings. Their loans are backed, not by goods or property, but by moral collateral: the promise that the group stands behind each individual loan.

This is the most favored model in Sri Lanka till end 2000 with most NGO MFIs commencing work using this model. As stated already Sarvodaya Societies come close to this model. In the case of the large government program they operate through these legal statues either under Social Welfare Act or through Societies Ordinance and Samurdhi Act. Most of these societies were not originally formed for micro finance only but for overall social development including education and health. Income generation assistance was part of its objectives right from the beginning and from 1986 microfinance became a serious intervention both through credit from savings of the members as well as credit from SEEDS, the Sarvodaya promoted body to provide bulk loans to such societies. SEEDS provide credit to the societies for an identified list of clients and projects; nevertheless the loan is in bulk to the society. The loans are repaid to the village society which in turn repays SEEDS. Savings are done independently by the societies. Village societies also provide credit to members directly from savings. These loans are mainly for emergencies and consumption whilst SEEDS loans are mainly for income generation activities. This model with modifications is followed by Arthcharya Foundation as well as Sewa Finance lending to societies formed by other projects too.

Janashakthi also called Womens Development Federation (WDF) and Samurdhi follow a different version of this model where members of the societies are linked to Village Banks called Janshkathi Bank and Samrudhi Banks respectively for savings and loans. Such village banks are also owned by society members. The small groups and societies only recommend the borrower. Shares in village bank and savings become the part of the collateral. However, individual village banks are not separate legal entities but has operational autonomy within the general guidelines given by the bank federation for Janashakthi and government authority for Samurdi.

One of the first micro finance projects in Sri Lanka “Isuru or Small Farmers and landless credit project” now called PAMP initially funded by IFAD/CIDA and later by JBIC also has a similar model. But in this case the village banks are linked to Regional Development Banks for savings and credit, which has ensured their continuity.

This approach is adopted by Gemidiriya Foundation too in the recent past. Gemidiriya mobilize the community for multifaceted holistic development and village savings and credit organisation (VSCO) is a functional part of the peoples company, which is the legal entity in the community. This model is also very common in International NGO created programs specially in North East of the country. As agencies such as Oxfam and CARE do not do direct lending they form such village or community organizations, transfer the funds to them and give them training and provide hand holding for about 2 to 3 years whilst that particular donor project lasts. However there is no hard evidence to prove long term sustainability of these models unless they are linked to federation or apex MFI. One of the key challenges in this model is diversity of boards and managements of individual village banks making it difficult to maintain shared vision, line of authority which is essential for MFIs.

Grameen Type Group Collateral Lending

The Grameen model emerged from the poor-focused grassroots institution, Grameen Bank, started by Prof. Mohammed Yunus in Bangladesh. It essentially adopts the following methodology:

A bank unit is set up with a Field Manager and a number of bank workers, covering few 15 to 22 villages. The manager and workers start by visiting villages to familiarize themselves with the local milieu in which they will be operating and identify prospective clientele, as well as explain the purpose, functions, and mode of operation of the bank to the local population. Groups of five prospective borrowers are formed; in the first stage, only two of them are eligible for, and receive, a loan. The group is observed for a month to see if the members are conforming to the rules of the bank. Only if the first two borrowers repay the principal plus interest over a period of fifty weeks do other members of the group become eligible for a loan. Because of these restrictions, there is substantial group pressure to keep individual records clear. In this sense, collective responsibility of the group serves as collateral on the loan.

There are many agencies that follow Grameen modified approaches in Sri Lanka but the agency in Sri Lanka which follows closest to Grameen model is Ceylinco Grameen Credit Co. Ltd a private for profit initiative commenced by Ceylinco Consolidated Group one of the largest private sector groups in the island. Recently the name of this MFI was changed to 'Grameen Credit Company'.

Individual lending using group as a focal point

This is an adaptation from ASA model where individual lending is practiced using a group of 25 to 30 as a point of contact. Here group is not used as a form of collateral but used only for efficiency of loan collection and providing other services. Generally no savings is done by these groups. In most cases two members of the group provide guarantee. All loan collections and new applications are taken at group meetings by the credit officer of the micro finance institute. Meetings are held on a specific day and time either weekly or monthly. Lak Jaya and Berendina Microfinance are two institutions, which follow this model with some modifications. Lak Jaya follows the ASA model very closely with women only and weekly recovery resulting from the technical assistance they receive from ASA.

BRAC Sri Lanka has a different group model similar to BRAC model in Bangladesh. Only women are permitted to borrow and they form small groups as well as larger village organizations though they are not registered legal societies as described in the village banking or village revolving fund models. Another difference from other Sri Lankan models is that group meetings and repayment is held once a week. BRAC model also insist that work is done in a closest geographic area and house to house surveys are done in a 4 sq km range in order to find adequate clients for a branch.

Individual lending

This is a straight forward lending model where micro loans are given directly to the borrower. It does not include the formation of groups, or generating peer pressures to ensure repayment. In Sri Lanka this model is followed mainly by both commercial and regional development banks. Instead of group pressure they either ask for collateral or for letters from guarantors. Original agriculture credit given by commercial banks both state and private from 1960's were of this type and even today it is the most significant way for commercial banks to give small loans. A large portion of small loans of regional development banks are given in this methodology. However, increasingly NGO MFIs like SEEDS also follows this model for larger loans or for specific products such as "Solar" loans and business development (C type) loans.

Self Help Groups (SHG's)

Small groups of 10 to 20 women who save and provide credit to each other. In some cases agencies, which promote such groups provide initial capital as well as training. In Sri Lanka this model is not very popular and exists only in very few areas. Certain MFIs make small groups, mobilize them for group level savings, group is used in lending process to provide collateral but make individual group members directly linked to village bank or MFI. Further unlike in India there is no bank credit provided to SHG's in Sri Lanka which may be the key reason why this model is not popular. However, Kurunegala Womens Society and a SEEDS-PLAN Sri Lanka project in Kurunegala, Kandy and Moneragala districts follow this model with lending through SHG's.

Credit Unions /Cooperatives

A credit union is a unique member-driven, self-help financial institution. It is organized by and comprises of members of a particular group or organization, who agree to save their money together and to make loans to each other at reasonable rates of interest.

The members are people of some common bond: working for the same employer; belonging to the same village, labor union, social fraternity, etc.; or living/working in the same community. A credit union's membership is open to all who belong to the group. The main difference of cooperatives from village banking is that ownership of the cooperative may not only be with the clients and clients can be non members also in addition to the type of legal structure within which they are registered.

A credit union is a democratic, not-for-profit financial cooperative. Each is owned and governed by its members, with members having a vote in the election of directors and committee representatives. They also give dividends to members in years where there is a profit.

This is one of the most popular and oldest forms of microfinance in Sri Lanka with the first credit union formed in 1911 with the enactment of the Co-operative Credit Societies Ordinance No.7 of 1911. The movement went through many phases but expanded hugely from 1989. Thrift and Credit Co-operative Societies (TCCS) or SANASA is a major outcome of credit unions. Currently in SANASA, there are Federations at district level and even few at divisional level and a National Federation of Credit Unions. Some of the individual societies also borrow from District Federation and also from Sanasa Development Bank formed by the TCCS movement.

There is another segment of cooperative banks formed under Multipurpose Co-operative Societies being the most popular in the country. They are called Cooperative Rural Banks (CRB). These are totally member savings based organizations and savings is the more relevant service and credit much less. The extent of credit one can obtain is directly related to the amount of savings. In the case of Co-operative Banks there is no need to form groups or meet regularly for savings and credit transactions.

ROSCA's (Seettu)

Rotating Savings and Credit Associations (ROSCAs) also known as "Seettu" are essentially a group of individuals who come together and make regular cyclical contributions to a common fund, which is then given as a lump sum to one member in each cycle. For example, a group of 12 persons may contribute Rs. 100 per month for 12 months. The Rs. 1,200 collected each month is given to one member. Thus, a member will 'lend' money to other members through his regular monthly contributions. After having received the lump sum amount when it is his turn (i.e. 'borrow' from the group), he then pays back the amount in regular/further monthly contributions. Deciding who receives the lump sum is done by consensus, by lottery, by bidding or other agreed methods.

This is an extremely popular informal way of doing savings and obtaining credit in the both urban and rural Sri Lanka. In majority of the cases it is done informally led by one dynamic individual who forms the group through his or her contacts. These are done in offices and in most organizations where a group of people receive a monthly salary. It is also done in rural areas amongst the self employed and farmers. This is also common among business community with large sums which may not fall within the so called definition of microfinance. This is an informal model and in most cases basic records are maintained.

Table 2.1: Comparison of MF models with key feature

Criteria	Model						
	Village banking	**Grameen type groups**	**Groups for individual landing**	**Individual lending**	**Self help groups**	**Cooperatives**	**ROSCA**
1. Model creates large number of smaller MFIs	Yes	No	No	No	No	Yes	No
2. Product offerings	Savings and credit. H/E savings are found to be illegal except for Samurdi and SSS	Savings and credit. H/E savings are found to be illegal due to the legal structure of MFI	Mainly credit. Savings are done by some MFIs but found to be illegal due to legal structure of MFI	Mainly credit. Savings are done by some MFIs but found to be illegal due to legal structure of MFI	Savings and credit. H/E savings are found to be illegal	Savings and credit	Savings and Concept practiced but for a specific time period
3. Loan disbursement	Village	Branch office at nearest town	Branch office at nearest town	Branch office at nearest town	village	Mostly Village	Village
4. Loan and savings collection	Village – but unstructured	Village – structured	Village - structured	Mostly at branch office.	Village	Village – mostly unstructured	Village – structured
5. Need of legal membership for services	Essential	No	No	No	Essential (but informal)	No	No
6. Linkage of clients to larger MFI	Indirect	direct	direct	Direct	indirect	Indirect	N/A
7. Governance and management and products	Diverse across the country from one VB to another but within a given frame work	Uniform and standard	Uniform and standard	Uniform and standard	Uniform and standard	Diverse across the country from one VB to another but within a given frame work	Diverse across the country

Key: SSS – Sarvodaya Shramadana Society

2.2 Other Key features of MF models

Another perspective on which micro finance models can be viewed is based on “credit” only versus those who have a credit plus approach. Credit plus is mainly business development services (BDS) such as enterprise related skills training, support for marketing and providing business linkages. These two models are also referred to as minimalist and maximalist approaches. Agencies such as Lak Jaya, Ceylinco Grameen and BRAC follow a minimalist “credit” only approach whilst agencies such as SEEDS, Samurdhi and Berendina Microfinance Institute follow a maximalist or credit plus approach. Both SEEDS and Berendina try to cover the costs of “credit plus” services through payments from beneficiaries. Berendina follow a very creative model of issuing all borrowers with “BDS coupons” together with the loan. The value ranges from Rs 500 to Rs 5,000 depending on the loan size. The price of the coupon is embedded in each loan installment. Borrowers can use those coupons for any “credit plus” service on offer by the MFI or alternatively cash it at the end of loan period if the client does not need credit plus services. This gives choice and options to the borrower unlike most agencies, which make these services compulsory.

Another key difference in models is loan collection frequency. Historically it was either monthly repayment or balloon payments at the end of the term of the loan for seasonal agricultural loans. However, there is a recent trend to make weekly collections those who follow ASA and Grameen models from Bangladesh. The models based on Bangladeshi experiences offer loans with one year term maximum and the loans are for income generation only. BRAC, Lakjaya and Ceylinco Grameen are such examples. However, there are hybrids of both approaches where cluster or centre type client meeting points with monthly repayments, credit plus and consumption loans in addition to income generation loans, which are also proved to be successful.

Outreach

3.1 Outreach Status as at December 2008.

There are four different types of microfinance institutes in Sri Lanka providing microfinance services. They are:

1. Local, Regional and National level MFIs.
2. Village Banks
3. Cooperative Rural Banks (CRB)
4. Development Banks.

The involvement of microfinance in these organizations differs from one to another. The institutions in number 1 and 2 categories provide almost 90% to 100% microfinance as per the definition used in this report. The CRBs estimate 60% to 70% credit and savings as per the definition. The lowest percentage for microfinance in the business is in development banks. Each type of organizations is discussed separately in the sections below.

3.1.1 Local, Regional and National MFIs

The last comprehensive survey on local, regional and national MFIs was done in 2002 which has identified 75 local MFIs and 5 regional MFIs and 3 national MFIs. This study was titled as National Microfinance Study in Sri Lanka (2002). The following table 6.1 summarizes the outreach findings of the said survey.

Table 3.1: Summary outreach data of MFIs – 2002

Indicator	Performance
Savings accounts	105,218
Savings amount	Rs 118,327,719
Loan disbursed during year 2000	56,388
Loan Amount year 2000	Rs 209,479,431

Source: National microfinance study in Sri Lanka (2002)

By 2008, there were 60 local, regional and National MFIs registered as members of the Lanka Microfinance Practitioners Association (LMFPA), the network of MFIs in Sri Lanka. The data base at LMFPA provided 32 MFIs and limited outreach data of those MFIs. Based on those data, 11 MFIs were selected for top 20 for further study in this report. The balance 9 MFIs, which were bigger than the rest 22 MFIs in the membership list of LMFPA were selected on researchers own knowledge on MFIs in Sri Lanka. Some of them were already members of LMFPA by the time of selection. However, the Grameen Credit Company (formerly called Ceylinco Grameen Credit Company) was not taken for the top 20 MFI because there was no reliable data from this MFI available for the study. As it is known, in the sector it comes next to Samurdi in terms of scale of operation, an interview was held with the chairman of the Grameen Credit Company and provided as a case study for enlightened readers understanding of the operation of the Grameen Credit Company. Table 3.2 provides a comparison of 11 MFIs to the rest 21 small MFIs for 5 outreach indicators available at the LMFPA data base. Except the number of clients or members the coverage for all the indicators, is over 90%

from the 11 MFIs selected from LMFPA list. Almost 98% of loan outstanding and savings were represented by selected 11 MFIs. This indicates the accuracy of the top 20 MFIs and its representation of the 20 MFs to the sector at large.

Table 3.2 : Representation of sector by selected MFIs

Description	Total in 32 MFIs	Total in 11 MFIs selected for the study	% representation by the study
No of clients	328,941	45,367	86%
No of Outstanding loans	250,259	230,604	92%
Outstanding loan balance (RS)	5,402,561,834	5,278,760,623	98%
No of savings account	1,337,460	1,296,053	97%
Savings amount (RS)	3,923,310,031	3,860,014,272	98%

Brach network of MFIs

Table 3.3: No of branches of MFIs

MFI	2006	2007	2008
1. Agro Micro Finance	7	7	7
2. Arthacharya Foundation	n/a	n/a	n/a
3. BMI	0	4	4
4. BRAC Sri Lanka	7	35	45
5. Child Fund	0	7	7
6. Colombo District Business Development Coop Bank	9	13	13
7. Habaraduwa PDF	1	1	1
8. HELPO	12	18	28
9. Janashakthi Bank	72	84	84
10. Lakjaya	4	20	46
11. Pragathisewa Foundation	1	1	1
12. Samastha Lanka Praja Sanwardana Mandalaya	8	8	8
13. Samurdhi Authority	1,040	1,040	1,042
14. Sareeram	n/a	n/a	n/a
15. SEEDS	29	57	65
16. Sewa Finance	15	15	15
17. Vision Fund Lanka	n/a	9	10
18. Women & Child Development Foundation	1	1	3
19. Women's Bank	175	185	185
20. YMCA Batticaloa	1	1	1
Total	**1 ,382**	**1,417**	**1,465**

Source: MFI survey

The total number of branches of MFIs in the sample has not increased dramatically over the years. The growth rates have been 2.5% and 3.3% in 2007 and 2008 respectively, which is mainly due to the Lak Jaya rapid expansion of 400% and 130% increase in number of branches in 2007 and 2008 respectively. It is, perhaps, if Lakjaya would not have expanded, the total number of branches increased would only be 1.3% in 2007 and 1.5% in 2008. However, 74% of the branches in 2008 belonged to Samurdhi, which has the largest number of branches in the country. It is also interesting to note that regional MFIs (Pragathi Sewa, Habaraduwa, YMCA) operate without any additional branches added over the years, which may be due to the potential in the market in the same area or the possibility of expansion with the existing staff, as most of them are NGO based microfinance providers with excess existing staff. It is also a point that borrower to member ratio is higher in these MFIs, because they maintain larger number of members without having any loans who are potential borrowers and receiving savings or non financial services from the institution. That also can be a reason for not to expand the branches in those MFIs.

Staff in MFIs

Table 3.4: No of staff in MFIs

MFI	2006	2007	2008
1. Agro Micro Finance	62	66	76
2. Arthacharya Foundation	105	130	n/a
3. BMI		25	33
4. BRAC Sri Lanka	176	275	381
5. Child Fund		129	143
6. Colombo District Business Development Coop Bank	33	67	74
7. Habaraduwa PDF	31	32	40
8. HELPO	12	12	12
9. Janashakthi Bank	282	317	320
10. Lakjaya	67	176	292
11. Pragathisewa Foundation	23	30	30
12. Samastha Lanka Praja Sanwardana Mandalaya	39	36	35
13. Samurdhi Authority	14,000	14,000	14,000
14. Sareeram	73	52	n/a
15. SEEDS	833	1,031	1,032
16. Sewa Finance	64	64	65
17. Vision Fund Lanka	62	91	110
18. Women & Child Development Foundation	4	5	15
19. Women's Bank	1,482	1,630	1,639
20. YMCA Batticaloa	11	9	11
Total	**1 7,359**	**1 8,177**	**1 8,308**

Source: MFI survey and www.mixmarket.org

Table shows that there is not much increase in the number of staff members in the MFIs during 2006 to 2008. The total number of staff members has increased 4.7% in 2007 and 0.6% in 2008. When compared to the percentage increased in the number of branches in the same period, number of staff increased is lower. While Lakjaya is the main contributor for the increase in number of staff (Lakjaya 162% in 2007), Samurdhi is the main contributor to total number of staff in MFIs for all the 3 years (77% in 2008).

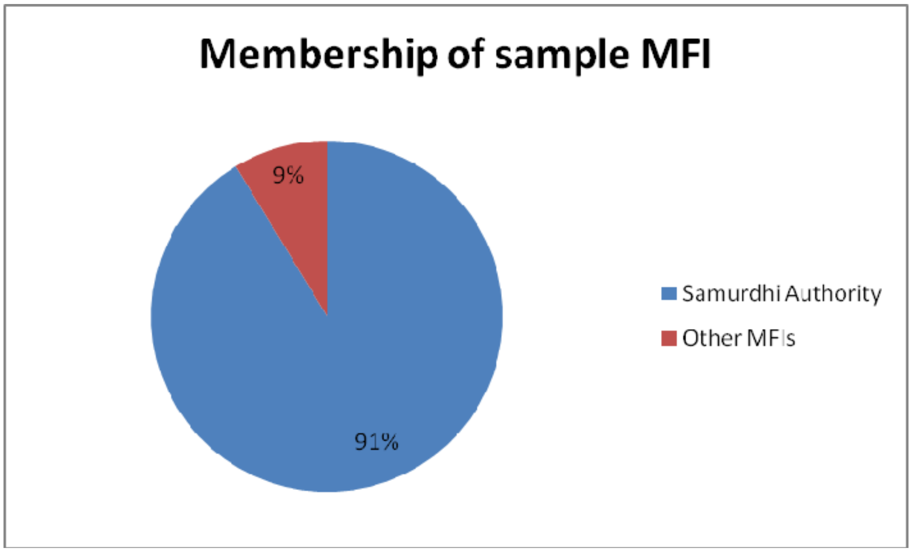
Membership in MFIs

Table 3.5: No of members in MFIs

MFI	2006	2007	2008
1. Agro Micro Finance	4,496	5,886	5,615
2. Arthacharya Foundation	n/a	n/a	n/a
3. BMI	-	6,487	13,769
4. BRAC Sri Lanka	24,421	39,820	72,717
5. Child Fund	-	10,042	9,646
6. Colombo District Business Development Coop Bank	8,084	8,860	11,927
7. Habaraduwa PDF	3,889	5,715	6,796
8. HELPO	4,581	5,088	5,865
9. Janashakthi Bank	32,910	34,290	35,134
10. Lakjaya	7,382	20,696	43,615
11. Pragathisewa Foundation	n/a	4,919	5,207
12. Samastha Lanka Praja Sanwardana Mandalaya	44,658	40,236	45,132
13. Samurdhi Authority	2,370,585	2,464,994	2,484,897
14. Sareeram	n/a	n/a	n/a
15. SEEDS	0	0	0
16. Sewa Finance	12,063	n/a	n/a
17. Vision Fund Lanka	n/a	15,564	n/a
18. Women & Child Development Foundation	1,016	2,012	3,790
19. Women's Bank	22,776	33,165	36,111
20. YMCA Batticaloa	2,712	2,879	3,310
Total	**2,539,573**	**2,700,653**	**2,783,531**

Source: MFI survey

Overall those 20 MFIs provide financial services- either loans or deposit facilities – to nearly 2.8 million clients (often referred to as members). SEEDS does not have membership concept while it is there in SEEDS promoted Sarvodaya societies discussed under village banks. Over 90 % (over 2.4 million) of the members are found in the government intervention, which is Samurdhi Authority as shown in the figure 1.1.



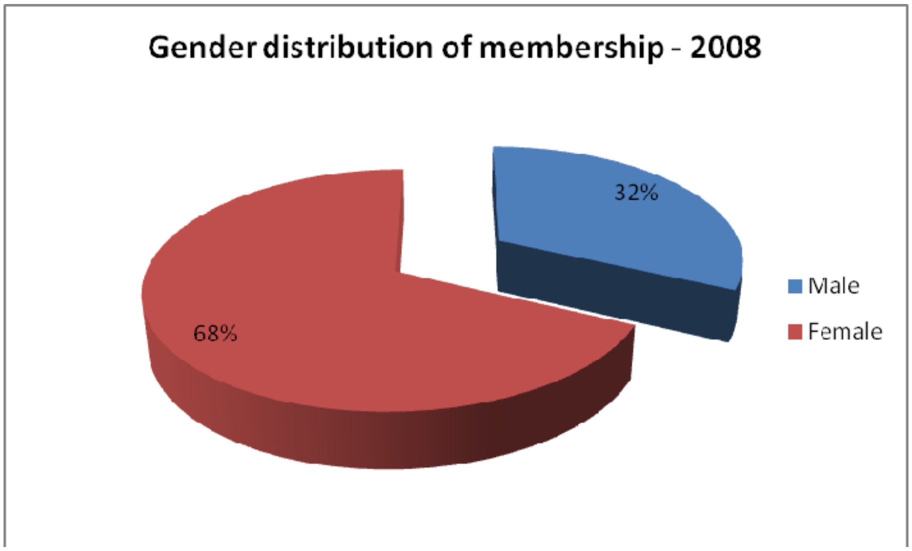
With comparison to 2007, overall growth rate of membership in 2008 is lower. The membership growth declined from 6.3 % in 2007 to 3.6% in 2008. The growth rate in Samurdhi is significantly lower, which dropped from 3.9% in 2007 to 0.8% in 2008. Child Fund and BMI are new MFIs that commenced operations in 2007. The membership growth rate in Lakjaya was 180% in 2007, which declined to 110% in 2008. However, this is a significant growth. BMI also had 112% growth rate in 2008. The other MFIs did not have a significant growth in the 3 years under review.

Table 3.6: Gender Segregation of members

MFI	2006		2007		2008	
	Male	Female	Male	Female	Male	Female
1. Agro Micro Finance	1,799	2,697	2,647	3,239	n/a	n/a
2. Arthacharya Foundation	n/a	n/a	n/a	n/a	n/a	n/a
3. BMI	0	0	2,484	4,003	5,507	8,262
4. BRAC Sri Lanka	0	24,421	0	39,820	0	72,717
5. Child Fund	n/a	n/a	n/a	n/a	n/a	n/a
6. Colombo District Business Development Coop Bank	4,624	3,460	4,700	4,160	6,400	5,527
7. Habaraduwa PDF	72	3,817	112	5,603	117	6,679
8. HELPO	4513	68	4998	90	5820	45
9. Janashakthi Bank	0	32910	0	34290	0	35,134
10. Lakjaya	3,747	3, 635	6,321	14,375	3,390	40,225
11. Pragathisewa Foundation	n/a	n/a	2,115	2,804	1,857	3,350
12. Samastha Lanka Praja Sanwardana Mandalaya	10,897	33,761	9,558	30,678	9,931	35,201
13. Samurdhi Authority	853,604	1,516,981	862,748	1,602,246	850,939	1,633,958
14. Sareeram	n/a	n/a	n/a	n/a	n/a	n/a
15. SEEDS	0	0	0	0	0	0
16. Sewa Finance	2,532	9,531	n/a	n/a	n/a	n/a
17. Vision Fund Lanka	n/a	n/a	4,715	10,849	n/a	n/a
18. Women & Child Development Foundation	68	948	87	1,925	115	3,675
19. Women's Bank	455	22,321	663	32,502	722	35,389
20. YMCA Batticaloa	14	2,698	18	2,861	24	3,286
Total	**882,325**	**1,586,240**	**901,166**	**1,789,445**	**884,822**	**1,883,448**

Source: MFI survey

Though, most of MFIs in Sri Lanka focus on both genders, BRAC and Janashakthi are based on 100% women member strategy. As shown in the following figure, 68% consist of female in gender distribution in the 20 MFIs provided in the above table. Female percentage of overall members has increased over the years; by 1%, from 65% in 2007 to 66% in 2008.



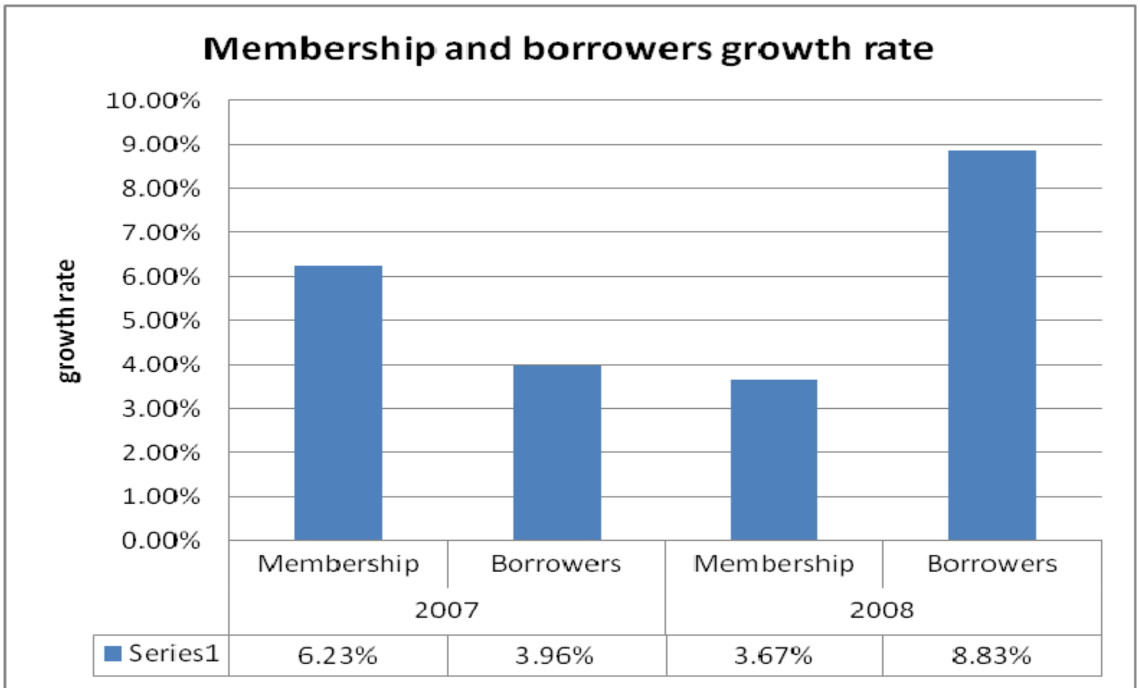
Borrowers in MFIs

Table 3.7: No of borrowers in MFIs

MFI	2006	2007	2008
1. Agro Micro Finance	4,496	5,886	5,615
2. Arthacharya Foundation	8,478	10,364	n/a
3. BMI	0	3,658	11,396
4. BRAC Sri Lanka	20,948	34,537	54,318
5. Child Fund	11,701	8,959	5,599
6. Colombo District Business Development Coop Bank	4,257	6,202	8,929
7. Habaraduwa PDF	1,978	2,182	2,527
8. HELPO	384	819	837
9. Janashakthi Bank	12,482	16,038	15,856
10. Lakjaya	10,245	20,625	28,320
11. Pragathisewa Foundation	n/a	1,805	1,508
12. Samastha Lanka Praja Sanwardana Mandalaya	8,725	7,957	8,896
13. Samurdhi Authority	680,698	666,160	698,417
14. Sareeram	4,010	2,854	n/a
15. SEEDS	170,887	179,366	178,509
16. Sewa Finance	12,063	8,867	n/a
17. Vision Fund Lanka	5,881	11,321	n/a
18. Women & Child Development Foundation	804	1,767	2,778
19. Women's Bank	22,548	32,833	35,749
20. YMCA Batticaloa	1,139	1,875	2,203
Total	**981,724**	**1,021,221**	**1,061,457**

Source: MFI survey and www.mixmarket.org

Overall, 20 MFIs served 1.06 million borrowers in 2008. The borrower growth rate has increased from 3.9% in 2007 to 8.8% in 2008. As shown in the figure below, it is interesting to note that the borrower growth rate in 2008 is significantly higher than membership growth whereas it was a completely opposite scenario in 2007. This can be due to two reasons, the first one, as the MFIs grow they place greater emphasis on increasing portfolio concentration amongst their members as an important measure of increased cost effectiveness enabling better progress towards sustainability. The second one can be, new members recruited immediately avail the loan. This is because recent changes in methodologies of MFIs do not allow a member to remain dormant for over a period of time or the policy changes that all members need to be borrowers concurrently.



However the table 3.8 bellow shows that the borrower – member ratio was not decreased over the years. The effect of Samurdhi, dominant player having 91% of the total membership in 20 MFIs is a factor for this. For Samurdhi the borrower- member ratio in only 28%.

Table 3.8: Active borrowers and member ratio

Year	Borrower-member ratio
2006	30.88%
2007	30.22%
2008	31.72%

Table 3.9: Gender Segregated data of borrowers

MFI	2006		2007		2008	
	Male	Female	Male	Female	Male	Female
1. Agro Micro Finance	1,799	2,697	2,647	3,239	n/a	n/a
2. Arthacharya Foundation	85	893		10364	n/a	n/a 14,710
3. BMI			1,186	4,279	1,972	7,117
4. BRAC Sri Lanka	-	20,948	-	34,537	-	54,318
5. Child Fund			n/a	n/a	n/a	n/a
6. Colombo District Business Development Coop Bank	2,260	1,997	3,242	2,960	5,309	3,620
7. Habaraduwa PDF	62	1,916	38	2,144	76	2,451
8. HELPO						
9. Janashakthi Bank		12,482		16,038		15,856
10. Lakjaya	3,800	6,445	5,600	15,025	3,240	25,080
11. Pragathisewa Foundation			686	1,119	566	942
12. Samastha Lanka Praja Sanwardana Mandalaya	1,884	6,841	1,905	6,052	2,210	6,686
13. Samurdhi Authority	238,244	442,454	233,160	433,000		
14. Sareeram	722	3,288			143	2,711
15. SEEDS	69,736	100,351	73,540	105,826	105,320	73,189
16. Sewa Finance	2,532	9,531	n/a	n/a	n/a	n/a
17. Vision Fund Lanka	471	5,410	1,585	9,736	n/a	n/a
18. Women & Child Development Foundation	0	804	24	1,743	n/a	n/a
19. Women's Bank	450	22,098	663	32,170	722	35,027
20. YMCA Batticaloa	13	1,126	18	1,857	24	2,179
Total	**322,058**	**639,291**	**324,294**	**680,089**	**119,582**	**229,176**

Source: MFI survey and www.mixmarket.org

There is no difference in gender among members or borrowers. It is 67% are female and 33% are male among borrowers. In addition to that, there is no significant growth in female borrower composition over the years. However, the gender segregated data was not available for Samurdi borrowers in 2008.

Loan disbursement

Table 3.10: Loan amount disbursed by MFIs

MFI	2006	2007	2008
1. Agro Micro Finance	190,290,500	271,023,820	n/a
2. Arthacharya Foundation	n/a	n/a	n/a
3. BMI		83,500,000	172,000,000
4. BRAC Sri Lanka	488,255,400	1,067,079,400	1,161,124,500
5. Child Fund		95,332,000	229,702,000
6. Colombo District Business Development Coop Bank	148,986,614	253,990,110	213,073,511
7. Habaraduwa PDF	36,449,000	53,993,600	65,937,500
8. HELPO	7,200,000	10,000,000	14,920,000
9. Janashakthi Bank	217,274,504	349,308,744	413,696,299
10. Lakjaya	12,690,745	351,919,875	552,200,000
11. Pragathisewa Foundation	34,734,095	44,555,150	42,965,260
12. Samastha Lanka Praja Sanwardana Mandalaya	18,162,000	7,860,000	16,435,000
13. Samurdhi Authority	5,419,000,000	6,808,000,000	9,118,000,000
14. Sareeram	n/a	n/a	n/a
15. SEEDS	1,968,003,046	2,588,555,613	2,214,689,350
16. Sewa Finance	187,000,000	197,000,000	n/a
17. Vision Fund Lanka	99,942,606	232,806,848	n/a
18. Women & Child Development Foundation	8,177,000	14,728,211	36,802,000
19. Women's Bank	421,065,342	577,174,388	583,280,734
20. YMCA Batticaloa	20,839,000	28,570,500	31,100,000
Total	**9,257,230,852**	**12,726,327,759**	**14,421,129,855**

Eighteen (18) MFIs out of the top 20 have disbursed Rs 9,257 millions in 2006 and it has increased by 39% in 2007 up to Rs 12,726 million as shown in the above table 6.10. However, the increase in loan disbursement is only 18% in 2008, having total disbursement of Rs 14,421 million during the year. This shows a low growth rate in 2008 compared to 2007. This does not correspond with growth rates in borrowers as described earlier. This is an implication of lower individual loan sizes by MFIs. This could be due to new borrowers in both new MFIs and old MFIs. Decrease in repeat loans, which are usually higher than the previous loans can also be a reason for this situation

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Loan Outstanding

Table 3:11: Loan outstanding by MFIs

MFI	2006	2007	2008
1. Agro Micro Finance	95,106,292	142,838,066	176,174,821
2. Arthacharya Foundation	63,592,537	145,967,305	n/a
3. BMI		73,823,095	158,319,740
4. BRAC Sri Lanka	248,344,847	261,645,151	682,571,892
5. Child Fund		71,905,000	170,971,130
6. Colombo District Business Development Coop Bank	136,285,140	161,676,610	212,733,260
7. Habaraduwa PDF	68,317,362	67,771,829	71,600,855
8. HELPO	5,644,446	10,650,102	16,520,922
9. Janashakthi Bank	186,240,124	279,887,167	372,446,727
10. Lakjaya	57,683,745	247,239,744	488,133,422
11. Pragathisewa Foundation	29,999,577	45,366,853	44,953,500
12. Samastha Lanka Praja Sanwardana Mandalaya	43,988,544	39,789,917	43,648,062
13. Samurdhi Authority	7,635,000,000	8,696,000,000	10,615,000,000
14. Sareeram	98,824,105	91,103,289	n/a
15. SEEDS	3,269,871,305	3,800,363,485	3,875,135,654
16. Sewa Finance	100,000,0000	161,399,575	n/a
17. Vision Fund Lanka	94,683,242	227,359,653	
18. Women & Child Development Foundation	4,556,795	13,537,700	35,194,506
19. Women's Bank	601,464,778	818,461,220	1,026,705,451
20. YMCA Batticaloa	11,615,818	15,970,269	19,063,074
Total	**12,751,218,657**	**15,372,756,030**	**18,009,173,016**

Source: MFI survey and www.mixmarket.org

Except the few MFIs whose outstanding loan balances were not available, the total loan portfolio outstanding was Rs 18,009 million. Samurdhi has 61% in the total MFI portfolio. SEEDS being the second has 21% in the total portfolio. All other MFIs have the balance 18%. Some of them such as Pragathiseva Foundation and Habaraduwa development Federation have insignificant share like 0.2% each in the total loan portfolio.

Savings by MFIs

Table 3.12: Savings held by MFIs

MFI	2006	2007	2008
1. Agro Micro Finance	2,539,550	19,724,162	40,156,644
2. Arthacharya Foundation	n/a	n/a	n/a
3. BMI	-	-	-
4. BRAC Sri Lanka	-	-	-
5. Child Fund	n/a	n/a	7,717,300
6. Colombo District Business Development Coop Bank	119,865,310	142,528,830	160,178,050
7. Habaraduwa PDF	44,553,946	53,605,424	n/a
8. HELPO			
9. Janashakthi Bank	99,281,192	204,398,430	252,753,037
10. Lakjaya	4,689,955	59,442,860	130,139,486
11. Pragathisewa Foundation	24,834,251	31,671,551	36,439,660
12. Samastha Lanka Praja Sanwardana Mandalaya	7,179,547	6,625,792	7,807,076
13. Samurdhi Authority	16,162,000,000	19,187,000,000	21,341,000,000
14. Sareeram			
15. SEEDS	1,958,818,000	2,340,928,000	2,290,266,765
16. Sewa Finance	n/a	n/a	n/a
17. Vision Fund Lanka			
18. Women & Child Development Foundation	1,921,433	3,439,965	75,950,600
19. Women's Bank	262,704,794	401,511,544	489,140,875
20. YMCA Batticaloa	4,700,061	6,038,858	8,146,488
Total	**18,693,088,039**	**22,456,915,416**	**24,839,695,981**

There are few MFIs such as Vision Fund Lanka, BRAC and BMI, which do not mobilize savings deposits from clients. They are only lenders. The other 16 MFIs except the 2 MFIs, which have not given data, have mobilized Rs 24,839 million of deposit at the end of 2008. The savings amount was Rs 22,456 million in 2007. The savings growth rate was 20% for 2007 and it was 10% in 2008. This is a 10% drop in savings growth rate during the year 2008, that possibly resulted due to economic recession in 2008 as well as the breakdown of the trust on financial institutes due to scandals of bankruptcy of leading financial institutes both regulated and unregulated in nature. This situation severely affected MFIs as they are not regulated and supervised by Central bank

3.1.2 Outreach performance of Village Banks

The village banking societies are very important microfinance supplier in Sri Lanka. The operational methodology of these village banking societies is described under the chapter 2 on microfinance models. The salient feature is that each bank is a legally independent body owned and managed and benefited by the community in the village. The market dominates with three types of village banks promoted by 3 organizations. The Sanasa societies are cooperative societies promoted and developed by SANASA movement in Sri Lanka. Sarvodaya Sharamadana Societies (SSS) are promoted by Lanka Jathika Sarvodaya Shramadana movement, which is the largest indigenous NGO in Sri Lanka and those societies are trained and supported by SEEDS for microfinance activities. Gemidiriya is a World Bank funded project implemented by the government, which promotes village banking model called 'Village Savings and Credit Organizations' (VSCO) in a different way with people's company legal framework. The following table 3.13 shows that there are 7,039 such village banks under these 3 major market players. There are other such village banks promoted by various MFIs such as Arthacharya Foundation and Seva Finance and larger number of other local as well as international NGOs. The number can be estimated around 10-15% more from other such small village bank promoters. The major challenge was the collection of data of these village banks. For Sanasa societies there was a national study conducted in 2008 for 2007 data. For SSS, a study done in 2006 was available. However, SEEDS management reports and a sample survey undertaken by SEEDS on 43 SSS made available reasonably reliable data on SSS. Gemidirya project office tracks the information on VSCO's and data was available for 2008.

Table 3.13: Outreach of Village banks

Type of Village Bank (VB)	Year for which data available	Performance							
		No of VB	No of staff	No of members			No of borrowers		
				Male	Female	Total	Male	Female	Total
Sarvodaya Shramadana Societies (SSS)	2006 /2008	2,296	4,592 (a)	n/a	n/a	518,117	75,000 (b)	175,000 (b)	250,0000 (b)
Gemidirya VSCO	2008	1,034	4,869	29,319	117,276	146,595	16,573	75,499	92,072
Sanasa Societies	2007	3,709	13,227	218,937	245,695	464,632	n/a	n/a	55,898
Total		**7,039**	**22,688**			**1,129,344**			**379,970**

Source: Sanasa Statistics book, SEEDS MIS and www.gemidiriya.org
(a) – estimated @ 2 average 2 staff per Society by SEEDS
(b) – estimated based on a survey in 43 societies by SEEDS

There are 1,129,344 members in these village banks. This is over 10% of the total population in the country. Majority of these village banks are located in rural areas and membership is 6% of the rural population. The gender of members is not reasonably traceable in SSS but 60% of the members are females. The borrowers are 379,970. This is equivalent to 35% of the total MFI borrowers derived under this study for the year 2008. The female borrower percentage is 73% for SSS and Gemidiriya.

Table 3.14: Summary savings and credit performance of village banks

Type of Village Bank (VB)	Loan disbursement (Rs)	Outstanding loan balance (Rs)	Savings (Rs)
Sarvodaya Societies	n/a	2,965,974,000	3,416,958,000
Gemidirya	1,417,000,000	574,000,000	210,000,000
Sanasa Societies	690,929,854	522,691,720	521,418,390
Total		**4,062,665,000**	**4,148,376,390**

Source: Sanasa Statistics book, SEEDS MIS and www.gemidiriya.org

The above table indicates that the village banks are net saver, but ratio between savings to credit is almost 1:1 indicating that savings mobilized from the rural people are reinvested in the same areas for same type of clients. However, the lowest ratio (1:0.86) is in SSS and highest (1:2.7) is in Gemidiriya. However, in Gemidiriya all the loans are funded from revolving funds given by Gemidiriya Foundation and savings are deposited in commercial banks. Sanasa, which uses savings mainly for credit has almost 1:1 ratio. However, both SSS and Sanasa societies have borrowed funds from various external sources such as SEEDS and SANASA development bank, which indicates that substantial savings are kept in commercial banks and in various other forms of investments. The annual disbursement figures of Gemidiriya and Sanasa indicate disbursements are 2 times of the outstanding. The loans and savings balances of village banks are equal to 16% and 22% of the total loans and savings balances of the national and regional MFIs in the country. Although village banks have higher percentage of membership, percentages of the loans and savings are not in the same level with regional and national MFIs.

3.1.3 Outreach performance of Cooperative Rural Banks (CRBs).

CRB is another type of grassroots level institute providing microfinance services. CRB is the savings and credit division of Multipurpose Cooperative Society, of which the main business is sales of consumer goods in both rural and urban areas. As per the statistics hand book of CRB’s published by Cooperative ministry in 2007, by 2006 there had been 1,608 CRB branches in the country. Of them 8 CRBs were independent CRB societies and the rest 1,600 have been managed under 302 multipurpose cooperative societies. The number of CRB branches was 1,628 by the end of 2007.

From the savings and credit activities of CRBs' substantial portion represents microfinance as per the definition used in this paper. CRBs provide Gold pawning loans (assets backed loans) too and 2005 and 2006 disbursement figures indicate that 35% of the portfolio is in pawning and others are loans to their members under other products. The remaining 65% can be considered as the microfinance loan portfolio under the definition used in this report.

The CRBs have over 3 million members and approximately 6,700 staff to provide services to them. Majority of these staff are office staff and not field staff. However, the branches are very close to villages as they are widely spread with 1.628 in number even more than the number of Samurdi branches.

Table 3.15: CRB societies, branches, members and staff 2005-2007

Year	No of Cope/CRB societies	No of branches	No of members	No of staff
2005	310	1650	3,361,361	6,809
2006	310	1608	3,188,643	6,872
2007	310	1628	n/a	n/a

Source: CRB statistics hand book 2006 and MIS data from Cooperative ministry

The following table 3.16 shows that CRB is a net saver. Savings to loan ratio is 1: 0.65. The loan products are of different types, which make the microfinance loans with 65% in the portfolio. It comprises 14.5% housing loans, 42.5% consumption and other purpose loans, 3% self employment loans and 5% production loans. While CRBs lend from their own savings, the repayment rate does not sound good where it remains at 85%. CRBs do not measure PAR.

Table 3.16: Deposits and Advances of District Co-operative Rural Banks (2003-2007)

Year	No. of Branches	Deposits			Loans			
		No.	Amount (Rs '000)	Average Rs.	No.	Amount (Rs.000)	Average (Rs.)	Repayment rate
2005	1650	6,459,178	23,569,780	3,649	1,282,244	12,636,100	9,855	85%
2006	1608	6,491,592	25,311,550	3,899	1,527,469	14,620,570	9,572	86%
2007	1628	6,608,318	31,998,400	4,842	1,314,862	21,711,610	16,512	n/a

Source: CRB statistics hand book 2006 and MIS data from Cooperative ministry

3.1.4 Development Banks

There are 7 development banks in Sri Lanka having substantial portfolio in both savings and credit from poor and general microfinance clients such as rural people, people involved in agriculture and micro and small scale enterprises etc. These development banks borrow from poverty alleviation credit programs such as NDTF, on refinance programs of the Central bank such as Isuru, and PAMP too for on lending to their clients. The table 13.17 provides refinance loans from the Central bank, which are delivered through the regional development banks and some commercial banks. In a recent supply side study by GTZ-ProMiS (unpublished so far) different development banks have stated that they have 50% to 100% of their income coming from microfinance business based on their own definition for microfinance. While 100% is found to be an over estimation, 50% would be a reasonable assumption. There is a substantial portfolio in assets backed lending too. One of the very clear asset backed loans product is Gold Pawning. In 2008, the share of gold pawning and staff loans in the loan portfolio accounts were 36%, 46% and 58% in Ruhuna, Rajarata and Sabaragamuwa development banks respectively. Another factor to be considered is that these development banks have branches in main city centers in their regions making 281 in total in the country. These banks have limited field staff and no grassroots level structures like CBOs and clusters where officers can meet clients to have greater outreach to rural areas. Therefore, while it is clearly evident that these development banks provide microfinance services as per the definition used in this report it is extremely difficult to assess quantities from secondary data available.

Table 3.17: Microfinance lending from refinancing programs managed by Central bank of Sri Lanka

KDB	Kandurata Development Bank
RUDB	Ruhuna Development Bank
WDB	Wayamaba Development Bank
SBDB	Sabaragamuwa Development Bank
UDB	Uva Development Bank
RDB	Rajarata Development Bank
SDB	Sanasa Development Bank
PB	Peoples Bank
BOC	Bank of Ceylon
SB	Sampath Bank
HNB	Hatton National Bank
SFLCP	Small Farmers and the Landless Credit Scheme
PAMP	Poverty Alleviation Microfinance Project
PAMP (RF) LC	Poverty Alleviation Microfinance Project

Source: Regional development Division, Central Bank of Sri Lanka

Key:

MF project	Participating Banks		2006		2007		2008	
	Development Banks	Commercial banks	No of loans	Disbursement (Rs million)	No of loans	Disbursement (Rs million)	No of loans	Disbursement (Rs million)
SFLCP	KDB,RUDB, WDB	None	3,919	111.5	3,769	103.6	5,848	147.8
PAMP	KDB,RUDB, WDB, SBDB, UDB	None	15,011	317.2	-	-	-	-
PAMP (RF) LS	KDB,RUDB, WDB, SBDB, UDB	PB, BOC, SB, HNB	-	-	3,788	121.1	15,220	514.4
Total			**18,930**	**428.7**	**7,557**	**224.7**	**21,068**	**662,2**

Table 3.18: No of branches and savings and credit balances of development banks during 2006 - 2008

No	Name	Year	Number of Branches	Loan Outstanding balance (Rs)	Savings balance (Rs)
1	Sabaragamuwa Development Bank	2006	49	4,140,124,041	4,279,582,588
		2007	52	4,592,837,120	4,968,181,713
		2008	55	5,274,363,587	5,652,073,004
2	Rajarata Development Bank	2006	25	1,534,924,943	1,636,417,752
		2007	25	1,968,605,358	1,754,815,366
		2008	25	2,597,205,766	2,380,975,493
3	Kadurata Development Bank	2006	33	2,500,035,677	2,168,488,612
		2007	33	2,957,054,689	2,714,659,173
		2008	33	3,426,162,212	3,174,176,305

4	Wayamba Development Bank	2006	37	5,280,109,411	5,844,684,662
		2007	37	6,105,557,453	6,379,068,728
		2008	37	7,035,282,827	7,640,189,486
5	Ruhuna Development Bank	2006	46	4,102,515,406	3,176,012,527
		2007	45	4,612,612,230	3,742,424,976
		2008	53	5,388,297,360	4,851,253,306
6	Uwa Development Bank	2006	28	1,868,728,992	1,645,570,606
		2007	33	2,187,380,221	2,426,297,168
		2008	33		
7	Sanasa Development Bank	2006	32	3,589,319,645	4,448,492,838
		2007	32	5,386,280,483	6,035,960,342
		2008	45	7,383,042,086	8,232,263,964
	Total	**2006**	**250**	**23,015,758,115**	**23,199,249,585**
		2007	**257**	**27,810,327,554**	**28,021,407,466**
		2008	**281**	**31,104,353,838**	**31,930,931,558**

The above table provides the outstanding and loans and savings balances of the six regional development banks owned by the government and SANASA development bank, which is a privately owned development bank in Sri Lanka. The numbers of branches increased by 2% and 9% respectively in year 2007 and 2008. Both loan outstanding and savings increased by 21% in 2007. However, the savings and loans growth rates were lower in 2008 although number of branches increased more than the rate in 2007. The growth rates of savings and loans are 14% and 12% respectively. The possible reason for this discrepancy would be commencement of these new branches at the end the financial year; in addition the reasons for low savings in 2008 are given under section 3.1.1 on MFIs

3.1.5 Commercial banks and finance Companies

Although the amounts are negligible compared to national microfinance outreach figures some commercial banks and regulated finance companies were also active in the microfinance industry in the recent past. One may argue the commercial bank involvement in microfinance is limited to implementation of government programs such as ISURU, PAMP, the data from NDTF reveal that Peoples Bank is also active in microfinance by refinancing Rs 143 million rupees during the years 2007 and 2008. This amount is higher than the NDTF borrowing by certain development banks during these two years. Another well known private bank in microfinance sector is HNB through its product 'Gemipubuduwa'. From the finance companies the LOLC was active in microfinance by financing solar home systems for electrification for poor households in very remote areas where grid electricity is not available. They also provided loans under group collateral. LOLC has lent 4,821 and 2,690 such loans amounting to Rs 53.6 million and 25.5 million during 2007 and 2008 respectively and managed Rs 102 and 59 million outstanding loans at the end of those two years respectively.

3.2 Outreach findings of Previous Studies

There are number of studies undertaken on outreach of microfinance from time to time providing information of different aspects of the subject. The GTZ – ProMiS demand side study report "Outreach of Financial Services in Sri Lanka "(2008) based on a nation-wide "demand side" survey conducted in 2,945 households in all districts except war torn districts of Killinochi, Mullaittivu and Manner including a minimum of 30 households from each district found that 84.4% of those surveyed did not find any barriers to accessing micro finance though not all of them had necessarily taken credit. This shows a significant presence of microfinance in the country. CGAP study "Building financial services to the poor" (2006) states that the strength in Sri Lankan microfinance industry, is the the diversity of its Institutions and Services (Government, Bank, Co-operatives, Co-operative Banks, NGO, specialized MFI's, private companies). These institutions offer an unusually wide variety of services and provide poor people with more options than found in many countries. The same report reveals that significant savings culture – Unlike many countries where savings is the forgotten half of microfinance, the review team estimated that there are 15 million savings accounts in MFIs.

Role of formal MFIs

The said demand side survey found that outreach of institutionalized credit and savings was very high with 82.5% households of the sample surveyed having either saving or borrowing or both from a financial institution. Saving habit was strong with 75% of the surveyed households having a savings account.

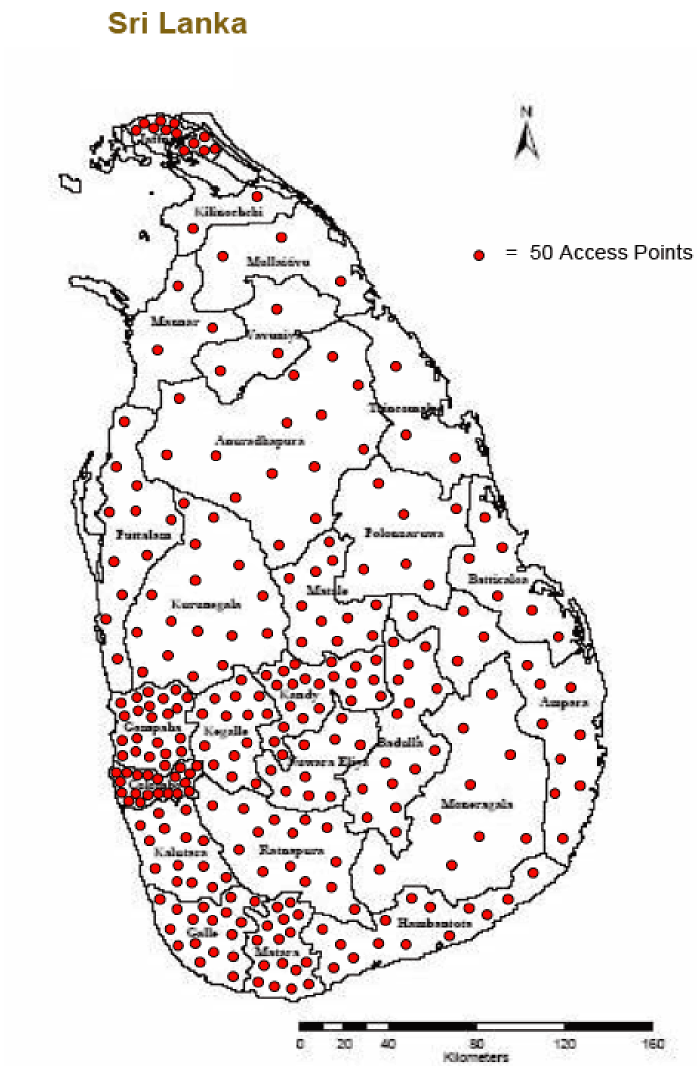


Fig 1: Microfinance access points in Sri Lanka

The above is a map given in the CGAP study "Building financial services to the poor" (2006), which identified 14,000 microfinance access points in the country. These included bank branches, MFI branches, CBOs, MFI collection centers etc. There is one service point for each 1.300 inhabitants. This report also revealed that in 2004, the number of deposit accounts, and savings amounts of MFI clients were 15 million and 48 billion Sri Lankan rupees and number of loans and loans outstanding were 2.2 million and 30 billion Sri Lankan Rupees respectively. However, it should be noted that this data counts not only from the MFIs defined in this report but it counts the data from other organizations such as commercial and development banks too.

A study done by Tilakaratna, G., Wickramasinghe, U., & Kumara, T.in 2005 titled “Microfinance in Sri Lanka: A Household Level Analysis of Outreach and Impact on Poverty” showed that there was a reasonably wide range of geographical outreach of micro finance. The number of MFI’s in each Grama Niladari (GN) division varied from a minimum of 1 to a maximum of 8. GN is the grassroots level administrative division having around 400 to 700 families. 80% of the GN divisions had access to at least 3 MFIs. On the contrary only 6 GN divisions had access to only one MFI, the government Samurdhi program, which was available in every single GN division.

Table 3.19: Spatial outreach of some of the key MFI’s in the surveyed areas.

MFI	Coverage of GS divisions	Spatial Outreach (coverage as a %)
Samurdhi (government poverty alleviation scheme)	50	100
Thrift and Credit Co-op (NASANA)	28	56
Multi-Purpose Co-op* (CRB)	20	40
Regional Dev Banks*	15	30
SEEDS	12	24
Peoples Bank*	11	22
Farmers Organizations	05	10
Bank of Ceylon*	04	08
Fishermen’s Organizations	04	08
Arthacharya Foundation	03	06
Ceylinco Grameen	02	04
Note: The agencies with an * are not strictly micro finance institutes but provide small loans based on personal guarantee or asset collateral		

Source: Microfinance in Sri Lanka: A Household Level Analysis of Outreach and Impact on Poverty

The study also found that loan size varied from a low Rs. 3.000 to over Rs.100, 000 with an average size of Rs.27, 084.

GTZ demand side survey (2008) found that 80% of Sri Lankan households, which has borrowed from institutional sources, have borrowings below Rs.100, 000. In the urban areas 67.9% households, which took loans were borrowing below Rs.100, 000 whilst in rural areas it was 100% for borrowing households. This shows that Sri Lanka is primarily a micro finance market and MFIs can attract more and more customers in the rural areas.

Role of Informal Lending:

The above mentioned study by GTZ also found that despite the presence of so many MFIs informal credit still remained an important source of credit and savings. 32% of the house holds who were members of MFIs have borrowed from informal sources. It was found that friends and relatives accounted for over 53% of credit obtained from informal sources; this was followed by money lenders 20% and traders/shop keepers 14%. The study also showed that informal credit as a % of credit received from MFIs was 15%. The average credit obtained from informal sources was smaller at Rs.10, 862. In fact over 60% of households borrowed less than Rs.5, 000 and 20% even less than Rs.1, 000. The percentage of people using informal credit was highest in plantation sector.

Geographical areas with low outreach:

Despite the significant outreach that Sri Lankan micro finance has due to the large network of bank, co-operative, Samurdhi, NGOs, MFIs and village bank branches yet more remote areas in most rural districts suffer from lack of supply. This is due to the fact that most branches are located in towns or city centers and even microfinance agencies do not work in very remote areas with no road access because of the time and cost involved in forming groups as well as the perception that such areas do not have much economic opportunity, and is populated by the poorest. However, the report to IFAD country strategy (2008) shows that the smaller local organizations operating in very rural areas like Wilgamuwa and Naula Womens Development Federations, which are independent small MFIs face difficulties in growth due to lack of resources and skills.

The demand side survey of GTZ (2008) indicates that savings varied a lot by sector with urban savers averaging Rs.46,274 , rural savers Rs.21,245 and estate sector savers only having an average of Rs.9,972. These transactions were not necessarily only from MFIs but also from commercial banks, which provide small loans. The large network of commercial bank branches in rural areas and large number of Co-operative Banks available in rural areas together with large nation-wide government programs such as Samurdhi have resulted in this high level of savings in the rural sector.

Table 3.20: Sectoral distribution of microfinance clients

Sector	No of households	%
Rural	2,302	78.2
Urban	513	17.4
Estate	130	4.4
Total	**2,945**	**100**

Source: Microfinance demand side Survey (2008)

As per above table 3.20 two other major areas where micro finance is lacking is in the plantations and in the East and North of Sri Lanka. This was shown by the North East Study on Microfinance conducted by GTZ in 2003 and is applicable even today. This study estimated that there are 251 savings accounts per 1,000 population in North East compared to rest of the island which had 451 accounts per 1,000 people. Savings volume was also smaller with an estimate of Rs. 436 per account, which was 1/3 of the amount in savings accounts in rest of the island. However, it cautioned to say that many of them may be dormant accounts. It was even worse when it came to loans as only 32 loans were estimated to be disbursed for 1,000 persons in North East compared to 119 loans per thousand persons in rest of the island. The average loan size in North East was estimated to be Rs.299 compared to Rs. 864 in rest of the island. This study as well as all other studies show that microfinance in North East is at a much undeveloped stage compared to the rest of the island.

The more recent ProMiS study (2008) on "demand side" showed that from a Provincial level analysis that North Western, Uva and Eastern Province had the least access to financial services. From a district wise analysis average borrowing per household was least in Puttlam, Polonanruwa, Badulla and Ratnapura. Least savings per household was in Badulla, Vavuniya, Trincomalee and Batticaloa districts, these 3 are in North East areas. Estate sector was the weakest in access to microfinance services with 25% of families not accessing savings or credit. Then the unsurprising fact that Eastern Province is short of microfinance services was shown by the fact that districts such as Trincomalee has only 60.7% families accessing financial services whilst in Matara it is as high as 95% of households. However, these findings must be taken into account noting that sample size in a province ranged from 110 in North, 176 in North Central to 858 in West and that of a district ranged from 30 for Vavuniya, 58 for Pollanaruwa to 357 for Colombo.

Products Related Issues in Outreach:

A major gap from a demand side is the abundance of income generating loans and paucity of lending for other credit needs. The microfinance revolution initiated by Grameen and implemented in other parts of the world focused primarily on income generation loans. Thus even in Sri Lanka the most prominent loan products available from SEEDS, SANASA, Samurdhi and such initial microfinance projects and programs were income generation loans. Some of them have been diversifying their products but were found to be inadequate. Here too most loans were of 2 or 3 fixed terms such as 6 months, 1 year or 2 year. One another very demanding product offering by many MFIs having village banking models is the emergency loan which is approved over the counter for members. Such loans are short in term such as 1 -3 months and carries high rate of interest such as 5% per month. The absence of other loan products has resulted in the poor getting repeat loans without commensurate expansion of their economic activity. e.g. for the same village shop initially getting Rs.10,000 and now getting even as much as Rs.150,000 even though the shop has not grown much more than 2 or 3 times. Much of the credit is misused for other purposes but MFIs ignored this as long as loans were repaid.

It took more than 15 years for the microfinance sector to move from this position and it is only now that a few microfinance agencies have realized that "one product fits all" is not a good way to market credit. It is only now that at least few agencies do market research and product development. However, even then most poor families do not have access to micro loans for emergencies, for health purposes, for purchasing household goods or electrifying houses.

Table 3.21: The main purposes borrowing

Purpose	Number of loans (%)
Agriculture	18.8
Business/Enterprise	16.7
Construction/Housing	28.8
Assets/Durables	8.0
Consumption	3.3
Emergencies	16.7
Settlement of loans	4.1
Other	3.6
Total	**100**

Source: Microfinance demand side Survey (2008)

Another outcome of this emphasis on income generating loans is that a vast majority of borrowers are more economically active self employed or as micro businessmen and the poorest are wage laborers, and primarily agriculture wage labour does not have access to credit.

Processes Related Issues in Outreach

The demand side survey (2008) identified collateral requirements and excessive documentation as the main barriers to accessing credit. Regarding savings the main barriers identified by customers were low interest rate and long processing time. A summary of expectations of clients from MFIs are given in table 3.22 below.

Table 3.22: Expectations of Financial Institutions

Expectation	% of House holds
Low interest Rate On Loans	59.8
Simple And Quick Loan application Procedure	44.7
Easy Access/Proximity	40.3
Can Obtain Individual Loans	32.7
No collateral Requirement	25.1
Customer Friendly bank staff	17.7
Flexible repayment	14.0
Loan size tailor made to my needs	13.2
No Restrictions on loan use	12.1
Provision of Advisory services /technical Advice	7.2
No Need to repay Loan	3.1
Mobile banking services	2.9
Others	2.5
No response	24.8

Source: Microfinance demand side Survey (2008)

Impact of Microfinance

4.1 Impact of Microfinance on Clients (Demand Side)

Evidence of thousands of microfinance clients in Sri Lanka demonstrates that access to financial services enables poor people to increase household income, build assets, and reduce their vulnerability to the crises that are so much a part of their daily lives. The report by Dirk Steinwand and David Bartocha on ‘How microfinance improves lives in Sri Lanka (2008) states that microfinance is a multifaceted benefactor that affords them the means to rebuild their lives, plan for their future and that of their children, empower them with self esteem, integrate in to social fabric by enjoying access to social networks and making contributions towards welfare of their families and that of the community. The impacts of microfinance are a mix in most cases where one impact leads to another. For an example increased income is used for improvement of the house or children education etc. The impact of MF documented by various authors is of different kinds which can be classified as following aspects:

a) Establishing livelihood and Income Increase:

The most immediate impact the MFIs foresee among their clients are the economic benefits such as increase in income. The Impact survey and procedural audit of the project for the: “Empowerment of the poorest of the poor women and young girls in Sri Lanka Project” of Women’s Development Foundation (WDF) in Hambantota conducted in January 2008 by Dulan de Silva and Sunimal Alles found that 52 of the 73 microfinance borrowers (71%) interviewed report an increase in sales and profits. The study “Microfinance in Sri Lanka: A Household Level Analysis of Outreach and Impact on Poverty” done by Tilakaratna, G., Wickramasinghe, U., & Kumara, T in 2005 found that as much as 44.2% of the microfinance clients have achieved an increase in income, whilst 53.6 % have not. This survey has further studied on income earning by clients at different income levels by dividing the clients in to 5 quintiles according their income levels.

The highest income quintile had 57.9% of borrowers who stated there was an increase in income whilst in the poorest quintile only 38.8% borrowers had an increase in income. In the poorest quintile 53.6% reported no increase in income whilst 2.2% reported a decrease in income. This indicates that high income clients have greater potential to have increased income from microfinance than those who have less income. However another study done by Prof: Colombage (2004) in more poverty proven districts in the country namely Hambantota and Moneragala districts found that there was no significant difference in the growth of income generated from micro enterprises of clients of microfinance institutions and of other micro entrepreneurs. 27.94% of microfinance clients reported an increase in income whilst 24.11% of non clients also reported an increase in income. But only 1.47% of clients reported a substantial increase in income whilst 0.89% of non clients declared a similar effect.

Outreach of Financial Services in Sri Lanka (2008) a nation-wide “demand side” survey conducted in 2,945 households in all districts except war torn districts of Killinochi, Mullaittivu and Manner reveals that 36.9% of the microfinance clients improved their income whilst 2 % stated it increased substantially as a consequence of taking credit. This indicates that microfinance is a better tool for income enhancement of poor in peaceful areas than war torn areas. When analyzed by the type of loan 54.7% of those who received "business enterprise loans" stated that income increased with 3.3% stating that it increased substantially. This study also found that 15.2% of the clients have generated new employment opportunities. Dulan de Silva and Sunimal Alles (2008) found that 117 jobs were created or stabilized for an investment of Rs.2.56 million in microfinance loans, which counts for Rs.21, 923 investments per employment by WDF (Janashakthi) in Hambantota.

Case study

Name: Panugalgoda Sarvodaya Shramadana Society
Name of Member: Pallalle Hettiarachchige Mega Wasana
Address:"Ratnagira", Dikkumbura, Ahangama

Family details
Mega Wasana is the eldest child in the family. She was only two years of age when her father expired and her younger sister was only 6 months at that time. She lives with her mother and sister.
Mega's mother was employed in World Vision. She grew up with the assistance of her mother and her relatives. Although she passed the "A" Level examination she did not possess sufficient marks to enter the university. She commenced working in garment factories in Horana and Koggala. Thereafter she opted to commence self employment.

Business activities and achievement made
She had participated in many workshops such as sewing, beauty culture etc. However, under the able guidance of Mr. Wijetunga, SEEDS Enterprise Services Regional Manager, Mega underwent a training to sew T-shirts. After the training she approached the SEEDS office in Matara to obtain a loan. Since Mega belonged to the Galle district the SEEDS office in Galle gave her a loan of Rs. 50,000/-. The sewing business commenced with one machine for Rs. 10,000/- and over lock machine for Rs. 44,000/-. With these machines she successfully produced readymade garments, curtains and children's costumes for school functions. With the profit earned Mega bought a Juki machine for Rs. 25,000/-. Her younger sister was engaged in screen printing and this encouraged her business.
The business which commenced in her house at first has expanded and now Mega is making arrangements to build a business centre of her own along the roadside. In order to fulfill this dream she has again obtained a loan of Rs. 100,000/- from SEEDS.

Future Objectives
Building a suitable business centre and setting up a small factory and providing employment for a few village youth.

Mega's views on SEEDS
Although she had attended many business workshops it was only SEEDS, which came forward to give a helping hand to her. She also commended SEEDS accelerated lending program.

The most common objective of all the MFIs was to establish micro enterprise livelihood opportunities for poor. The report on Impact of micro-finance on micro-enterprises: A comparative analysis of Samurdhi and Non-Samurdhi micro-enterprises in Sri Lanka by M.M.M Aheeyar (2005) had found that 67% of Samurdhi beneficiaries and 86% of SEEDS beneficiaries actually had functioning micro enterprises. 28% of Samurdhi and 51% of SEEDS beneficiaries showed increased revenues and 37% of Samrudhi and 73% of SEEDS showed increased profits. The study also found that size of the loan had a bearing on success rate of the business. Loans less than Rs.10, 000 had less chance of success with less than 50% succeeding. Furthermore, Dulan de Silva and Sunimal Alles (2008) found that 8 of those who borrowed from Janshakthi for the first time to start a business 7 had succeeded in the business while only one has failed. Another very clear finding was that people were showing the same small enterprise for which they received Rs.5, 000 ten years ago and was now receiving over Rs.50, 000 in loans but with no comparable expansion in business. The most negative impact was the fact that 21 borrowers out of 73 interviewed in the study did not show an increase in sales or profits and in fact either did not start to use (loan I believe) at least. As such while microfinance is well-proved as an effective tool for micro enterprise development, the tool should be used in an appropriate manner to achieve desired results as is common to any tool people use in their life.

Case study

Mr. Palaniyandy Jothival – Sundry Worker (Tea sacks)

Nuwara Eliya District, Central Highlands

MFI: Lak Jaya Microfinance Limited

Life on Dunsinane tea estate was greatly improved for 40 year old Mr. Jothival in late 2003. He has worked on this 600 hectare estate filling and transporting sacks of green leaf tea for most of his life. He and his wife, her mother and sister and their four children all live together under the same roof.

When Lak Jaya granted a substantial loan in three batches to Dunsinane in September 2003, Mr. Jothival wasted no time in applying for a loan of 15,000 rupees (115 Euro). His plans to fix his leaking roof and ceiling could finally be carried out.

With such a large family to shelter, Mr. Jothival decided to build a wattle and daub extension ten years ago. The tiny area that once contained the living, sleeping quarters, kitchen and dining area is now exclusively used as a living space. With the help of the loan, Mr. Jothival says he can maintain everything better – even using part of the extension as storage space for building material and fertilizer for the carrots and leeks he grows behind his house.

Dunsinane’s medical officer and his team run regular health checks and hygiene awareness campaigns around the estate. Mr. Jothival recognizes that with the extra space and room to dispose of waste responsibly, his family can maintain a higher level of hygiene.

They are at lower risk from contracting respiratory diseases and tuberculosis which often plague people living in the wet and windy climate of Dunsinane.

Another finding on effectiveness of microfinance tool in microneterprise development is from Otto Hospes et al (2002) ‘An evaluation on Micro-Finance Programs in Sri Lanka as supported through the Dutch Co-Financing Program with a focus on SEEDS”, which concluded that SEEDS microfinance is alleviating poverty, not in the sense of uplifting the economic status of the poor people but in the sense of strengthening their economic resilience and securing their livelihood. SEEDS help poor people not to fall into the poverty trap, characterized by a process of impoverishment and loss of critical assets.

b) Improving Housing Conditions

Quality of life goes hand in hand with the quality of living conditions and both are a part of a value added future for poor. Improved housing conditions strongly impact the physical and emotional wellbeing of a family and microfinance has played its part in maintaining this wellbeing of thousands of Sri Lankan families. Either through direct housing or related loans for the improvement of living condition or indirectly through an increased household income, which is then invested in to improving housing conditions microfinance has been instrumental in adding value to the lives of microfinance clients. Tilakaratna, G., Wickramasinghe, U., & Kumara, T (2005) have shown in their study titled Microfinance in Sri Lanka: A Household Level Analysis of Outreach and Impact on Poverty" that 38.3% of microfinance borrowers reported an improvement in housing whilst only 21% of those in the control group who had not taken microfinance showed an improvement in housing. From the microfinance clients 61.2% reported no improvement and 0.5% stated there was a decline in housing quality.

The following table elaborates improvement in housing and related aspects of microfinance clients before and after microfinance intervention by PAMP project implemented by Central Bank of Sri Lanka. This indicates living in own house that has increased in space, condition of the houses also has improved after microfinance intervention.

Table 4.1 : Change in house ownership and house condition of PAMP borrowers.

Indicators	% Families	
	Before	**After**
(1) House ownership		
- Own	75.8	87.5
- Parents	21.8	11.7
- Rented	1.2	0.8
- Other	1.3	0.1
(2) House Condition		
i. Roof		
- Tile	55.3	66.5
- Asbestos	6.9	16.9
- Tin Sheet	15.9	9.0

- Cadjan	18.3	4.7
- Other	3.6	2.8
ii. Floor		
- Cement	61.9	83.1
- Clay	34.0	13.7
- Other	4.1	3.2
iii. Drinking Water		
- Pipe born inside house	8.7	23.5
- Common tap outside house	3.8	3.7
- Well inside the garden	41.4	38.4
- Common well	28.5	20.4
- Other	17.5	14.0
(3) Electricity	46.3	78.3
(4) Sanitary toilet	62.9	89.6

Source: Impact Assessment Survey – Central Bank of Sri Lanka

One of the successful microfinance interventions in Sri Lanka with documented impacts on poverty is the RERED project, which promoted Solar home systems for rural households. This project has provided solar home systems for electrification for 98,738 households by middle of 2006. The main benefit has been in improving the quality of life through better lighting, enabling children to study longer under better lighting, facilitating the work of women (Mid term Review REFRED).

c) Improving Other Physical Assets

The establishment sustainable livelihood either an enterprise or otherwise and improvement in housing conditions described above are physical assets generated as a direct result from microfinance. Furthermore, microfinance has contributed to the increase in other physical assets beyond those two major impact areas. Tilakaratna, G., Wickramasinghe, U., & Kumara, T (2005) found that 13.3% of the microfinance clients achieved an increase in “assets” due to participation in microfinance. Here too the richer quintiles had better results with the richest quintile showing an increase in assets of 27.4% and the poorest only 4.3%. Savings itself is a physical asset. With regard to savings 49.1% of the microfinance clients reported an increase in savings since participating in microfinance, 48.7% reported no change whilst 2.2% stated that savings declined.

Another major finding by Dulan de Silva and Sunimal Alles (2008) is that 35 of the 73 borrowers of Janshakthi report adding to household assets. These include purchases of TVs, furniture, jewelry, bicycles and even three wheelers. However, it is difficult to attribute how much of this was from increase in profits of the business and how much from the use of loan funds and how much from other sources. It is very clear from the size of some loans majority of which was Rs.50, 000 that people were getting more than required for the business. The report gives an example of one borrower from Kudagoda Bank Branch who took Rs.50,000 for fruit and vegetable sales, which is clearly a figure far more than she needs and her family has also bought a bicycle and furniture for the house after the loan.

d) Empowering Women (Gender Impact)

There are very strong evidences to prove that women are empowered to take more resource management decision making responsibilities at household level and obtaining improved social responsibilities on top of greater interaction with the society. A classic example is Janashakthi (WDF) in Hambantota, which is one of the largest MFIs in the country, which is owned and managed by poor women in the area with a very transparent governance structure. There are thousands of similar smaller MFIs, Village bank type MFIs such as Sarvodaya societies, SANASA Societies, Gemidiriya societies and Samurdhi societies, which are managed by women.

Evaluation report on BRAC – Sri Lanka (2009) shows that BRAC's work has changed the dependence on such informal sources for capital. This in itself has empowered the women as they are no longer dependent on others for their capital needs. They do not have to pawn jewelry or take money from shop keepers or relatives making them very insecure. Secondly, they have a guaranteed and sure access to capital thus removing uncertainty and permitting a confident basis to stay in business and even expand. This is a major empowerment both socially and economically of these women.

The evaluation report indicates that another major contribution towards women's empowerment is the large numbers of young educated girls from the area itself who have received productive employment thanks to BRAC. All 127 credit officers are women, 15 of the 17 branch managers are women. As these girls are recruited from the project area all of them can travel from home for work. For majority of them this is their first job and they have developed in areas such as leadership, management, accounting, attention to detail, personal relationships thanks to BRAC's work. BRAC's work has empowered them significantly and some of them are fit even for higher positions both in BRAC or other organizations.

However, the level of women taking role as an entrepreneur is found to be mixed in results. Janashakthi (WDF) evaluation (2008) found that though all the members are women and thus all borrowers are women, the majority of the businesses are done by males or are largely under their control. The women did only 16 of the 73 micro enterprises, whilst 34 were done by males and 23 by the family. The study further elaborates that this is also probably the situation in majority of microfinance programs in Sri Lanka such as SEEDS etc where women are majority of the borrowers. However a woman being the borrower does help their empowerment in many ways including:

a) They have an important financing role in the family business or husbands' businesses and this increases their importance in the family.

b) The exposure to a role in the group, bank and WDF has increased their social role and has endowed them with an important role outside the family.

c) The large number of women in leadership roles, in staff and even as Chief Executive and President of WDF has made them leaders in the community and even in the island.

Another impact difficult to measure is the partnership between husband and wife in financing and doing the business and impact of gender. Even if majority of the businesses were done by men the women played a major role in assisting to finance it by being members of WDF, going for meetings, saving and receiving the credit.

The report on "Who does Microfinance Fail to Reach? Experimental Evidence on Gender and Micro enterprise Returns"-(2007) de Mel et al provides insights on gender perspectives on income generation resulting from microfinance. The returns to capital were zero among female-owned micro enterprises but in excess of 9 per cent per month for male-owned enterprises. They also found that large returns for males show that on average, male-owned enterprises are more likely to generate the return on investment necessary to repay micro loans. The low returns for women owned businesses do not appear to be a result of females taking the grants out of the business and spending them on household investments. Nor are they due to differences in ability of male and female owners. Part of the effect is due to females working in different industries than males, but they found female returns to be lower than male returns even for females working in the same industries as men. However, one of the main criticisms against this study was that it was not based on accepted form of microfinance as the financial treatments considered in this study were not loans but grants.

e) Environmental Impact

The goal no 7 – ensures environmental sustainability is one of the two millennium development goals adopted by micro credit summit campaign as important and relevant for microfinance.

RERED is a project for microfinancing for the purchase of solar home systems for poor in remotely rural areas where grid electricity is not provided. RERED project evaluation (2007) found that nearly 19 million liters of kerosene have been saved by the borrowers from the first quarter of 2003 till 30/09/06 as a result of replacing Kerosene lamps by solar home panels for electrification by the microfinance loans to finance panels. This is the equivalent of 54.5 million kg of Carbon Dioxide (CO2). The saving in kerosene would increase and the improvement in the home environment and health as a result of less CO_2 in the air family members breathe would be a continuing benefit from the Project.

f) Ensuring Education

Sri Lanka has a comparatively high literacy rate as education is mandatory. Yet there are some for whom education, 'the pearl of great piece' is out side their range of affordability and are compelled to miss out on schooling due to economic reasons.

Case study

Mr. Jayathilake – Reservoir Fisherman
Hambantota District, Southern Province
MFI: Agro Micro Finance

Lunuganwehara Reservoir has been the place of work for Mr. Jayathilake for the last 23 years. Four nights a week he takes his canoe out on the reservoir and catches large and small fresh water fish using nets. On a good night he catches around 20 kilograms – about 1,600 rupees (12 Euro) worth. As chairman of the Fisheries Society in his area, he represents the 200 fishermen who earn their living from the reservoir and he voices their concerns to the government. Mr. Jayathilake heard about the training and loan scheme offered by Agro Micro Finance in early 2006. "I had always rented my canoes before. I wanted to have two of my own – one for myself and the other for my eldest son who goes fishing with me," he remarks. "So I took out a loan of 50,000 rupees (380 Euro) and bought a pair of second-hand fiberglass canoes and some new nets."
Mr. Jayathilake has since seen his profits more than double and has managed to put away savings for his three children's schooling.
"A good education is the ticket to a better life," he says. As well as building a new extension to his simple home with his now higher profits, Mr. Jayathilake will soon apply for a second loan to buy a motorcycle and another canoe to rent to other fishermen.

Case study

Children at Punchi Taru ("Little Star") pre-school
Anuradhapura District, North-Central Province
MFI: Pragathi Sewa Padanama

"My savings box is yellow and I keep it under my bed!" says five year old Hiruni. "Mine is blue and it's on top of the cupboard where it's safe," says Nishal, five. "I have two boxes! I filled up my red one, so now I have a new green one," says four year old Nadeesha proudly.
The thirty children at Punchi Taru ("Little Star") pre-school are all young savers. At this stage in their lives, they are just having fun slotting 1, 2 and 5 rupee coins into their colourful savings boxes every day. Although they may be too young to realize it, this is a vital time in their education about the value of savings and dealing with money.
The Pragathi Sewa Padanama is a small MFI with two branches in Anuradhapura. Among other services, they provide savings schemes for school children from low-income families up to the age of eighteen. Founded in 1994 with a mere seven members, the Pragathi Sewa Padanama now has over 6,000 and holds the saving accounts of over 500 children in this area.
"Starting from pre-school, the kids regularly put spare coins into their savings boxes. Whatever they save in a month is counted by our field officers and the amount is recorded in the child's own passbook," says Mr. Priyantha of the Pragathi Sewa Foundation. "When they turn six, they then join as a member of a children's society where they remain up to their eighteenth birthday. It's only at eighteen that they can withdraw their savings and use them towards higher education or to fund a small business."
"Our greatest goal is to mould future successful citizens," says Mr. Priyantha. "Those who understand the role savings play in building a better future for themselves and their families."
As the pre-schoolers of Punchi Taru have demonstrated, a thrift culture begins and develops in the youngest of minds.

The report on how microfinance improves lives in Sri Lanka (2008) elaborates with case studies on how microfinance clients have used their increased profits they earned; thanks to microfinance for ensuring a steady education and a brighter future for children.

Case study

Mr. Don Dadallage Gunadasa & Mrs. Sirimathi
Malika Munasinghe – Carpenters
Habaraduwa District, Southern Province
MFI : Habaraduwa Participatory Development Foundation

"We work as a team"
Before the tsunami Mr. Gunadasa could never afford to buy machinery and therefore had to rent from others. Besides gaining access to financial services such as micro-loans, being members of the Habaraduwa Participatory Development Foundation (HPDF) has benefited this family's social situation and taught them how to manage their money better. They feel that they are part of a supportive team of eleven within their CBO (community based organization). "We all help one another and support those members who are in a difficult social or financial situation. At weekly meetings we discuss any problems we have and find solutions together. We each contribute 10 rupees (8 Cents) towards the 'group savings' and 20 Rupees (16 Cents) a month towards social security. So far we have collected around 4,400 rupees (34 Euro) and can withdraw from our share any time we need to. We also have personal savings of over 25,000 rupees (192 rupees) in our HPDF savings account," says Sirimathi.
The value that the Gunadasas place on being part of the HPDF goes beyond savings and loans. They feel their future is protected beneath the umbrella of their CBO.

Case study

Mrs. P. Easwari - Pastries and Quick Meals
Batticaloa District, Eastern Province
MFI: Sareeram Sri Lanka National Foundation

House reconstruction after the 2004 tsunami, even with government assistance is an expensive piecemeal effort due to the ever-increasing cost of building materials. Easwari found herself in the same situation. For ten years now she has run a small eatery selling bread rolls filled with vegetables, fish or meat and inexpensive quick meals of "kothu rotty", "wade" and boiled manioc, popular with the rural folk. Her husband, who is a peasant farmer, brings in a modest income to cushion the family expenses. But their joint effort is in no way sufficient to meet the expenses of running a household of five children and reconstructing a house too. Resigned acceptance is not a part of Easwari's philosophy of life. Spurred by the belief that if there is a will there is a way, Easwari applied herself to the task of finding it. Sareeram Sri Lanka National Foundation, a microfinance company that had opened in her area, seemed the best answer so she applied for assistance. With the loans she received, one to the tune of 75,000 rupees (500 Euro), she replenishes the firewood required for the stove and meets the on-going expenses for provisions needed to prepare food for the eatery. Easwari makes 500-600 bread rolls each morning, and in the evening, food for around 50 people.
It is hard work, but she is industrious and pragmatic. The profits from this business go towards reconstruction and if the house and their lives could be reconstructed, then the effort, she feels, is surely worthwhile. The family is happy that they are slowly but steadily getting ahead, and thankful to the financial assistance they received from Sareeram without which they would not have been able to achieve what they have.

g) Reconstructing Lives after Natural Disasters

When the December 2004 Tsunami devastated large parts of coastal area it destroyed their loved ones, homes, livelihood and property they built. Their hopes, confidence and courage asserted itself and they started living again. Microfinance played a major role in helping to rebuild lives of those affected people. Special loan schemes were introduced with reduced interest rates giving quick access to financial services on easy repayment terms. Though it was not a financial service MFIs in the east has provided relief services to Tsunami affected people in those areas for 6 months where as for 3 months such services were provided by MFIs in the south (post Tsunami microfinance: 2008), The same report shows that MFIs did not provide any cash grants afterwards, which is called revival period when micro loans with reduced interest rates were resumed. This proves that microfinance was an effective tool for reconstruction of livelihoods after Tsunami.

h) Supporting Lives in Conflict Affected Areas.

Sri Lanka has been affected by the conflict for approximately 30 years and to many families this tragedy was an every day experience. Those in the conflict affected areas in the North and East were faced not only with escalating commodity cost but also with scarcity of resources, lack of formal employment and sense of uncertainty for the future. Access to financial services in these circumstances gives them the much needed support to endure these trying conditions. Microfinance in conflict in Sri Lanka by Fabian Tritschler and David Bartocha -2007) describes that microfinance plays an important role of social and political development within conflict affected environment in North and East of Sri Lanka. It has provided poor people to easily deposit and withdraw savings, microfinance offers very strong feature to cope with external shocks and general insecurity.

4.2. Impact on MFIs (Sustainability of Microfinance Sector)

The sustainability in the 4 different types of MFIs is discussed in this chapter. They are national and regional MFIs, village banks, CRB's and Regional Development Banks.

Regional and National MFIs:

Profit and Loss of MFIs

The profit and loss data of MFIs were available for most of MFIs in the form of audited accounts up to 2007. Certain MFIs which close their accounts for the 31st March 2009 have got audited accounts by the time the data was collected for this study. The table 8.1 below indicates profit and loss information for each MFI for the 3 years from 2006 to 2008.

Table 4.2: Profits/Losses of top 20 MFIs during 2006-2007

MFI	2006	2007	2008
1. Agro Micro Finance	(756,088)	(247,842)	n/a
2. Arthacharya Foundation	n/a	n/a	n/a
3. BMI		(4,442.996)	(1,879,669)
4. BRAC Sri Lanka	(84,578,261)	(57,607,606)	n/a
5. Child Fund			4,971,034
6. Colombo District Business Development Coop Bank	223,170	400,940	282,510
7. Habaraduwa PDF	2,241,494	4,697,609	n/a
8. HELPO	232,283	(39,908,248)	n/a
9. Janashakthi Bank	15,378,090	34,084,784	n/a
10. Lakjaya	1,074,038	4,153,019	(1,015,377)
11. Pragathisewa Foundation	386,050	1,773,803	1,492,271
12. Samurdhi Authority	1,231,000,000	2,223,000,000	(360,000,000)
13. Sareeram	n/a	n/a	n/a
14. SEEDS	50,803,110	72,178,180	80,002,602
15. Sewa Finance	(6,498,611)	(1,053,774)	n/a
16. Vision Fund Lanka	(43,037,799)	(39,470,243)	n/a
17. Women & Child Development Foundation	(145,371)	(4,335,600)	n/a
18. Women's Bank	n/a	2,674,720	65,601,000
19. YMCA Batticaloa	(261,661)	243,751	806,779
20. Samastha Lanka Praja Sanwardana Mandalaya	160,916	252,718	572,882

Source: audited accounts and MFI survey

The above table provides profit and loss of top 20 MFIs in Sri Lanka during the last 3 years. Only SEEDS Janashakthi, and Women's Bank, which were in existence for more than 15 years in the country has generated significant profits consistently over the 3 years. (The draft accounts of Janashakthi show profits although audited accounts are not released for 2008 so far)

Of the 20, only 7 MFIs have had operating profits in 2008. Of the loss making ones, Samurdhi and Lakjaya were profitable in the previous years and made losses in 2008. The possible reason for such a result for Lakjaya could be due to expansion of new branches in 2008. In the Samurdi authority, the salaries of branch staff are not included in the accounts as it is paid as government salaries from the Treasury. There is a general understanding that Samurdhi is unprofitable even for 2006 and 2007 in the event of subsidy by the government is adjusted. However, there was no hard evidence or information to prove this argument. From the remaining unprofitable MFIs, Agro microfinance, BMI, BRAC Sri Lanka, Seva Finance, Vision fund Lanka are dedicated MFIs that started operating during the last 2-5 years. All of them show decreasing losses during the last 3 years. BRAC and Vision fund Lanka have received substantial amount of donor grants during these years to absorb these losses too. BRAC Sri Lanka was very active in Tsunami rehabilitation programs during 2005 and 2006, which are also shown as expenses in the accounts and separation of those costs are difficult in those years.

These profitability figures may not be exactly comparable between MFIs due to the differences in policies associated with the expenditure accounting. The policies that can have major implications are:

1. Different provisioning policies adopted by MFIs. Some MFIs make a provision as a percentage of disbursement (Ex BRAC – Sri Lanka) and some makes provision as per risk levels (Ex: SEEDS, Janashakthi) and some MFIs do not provide at all for loan losses (Pragathiseva Foundation).
2. Inclusion of Credit plus and other non financial services costs. (Ex: Janashakthi has staff for social mobilization and their costs are also included in expenses).
3. Non provision for all the relevant taxes (Financial VAT is not provided by SEEDS Janashakthi whereas it is provided by SEWA finance and Vision Fund Lanka).

If those irregularities were corrected most of the MFIs will have reduced profits and increased losses too.

Trends in changes in profitability and efficiency ratios of MFIs

a) Change in Operational self Sufficiency (OSS)

There are few MFIs that calculate and report their OSS. Following table shows most recent available such information. The ratios were available in published form only up to 2007, therefore trends for 3 years since 2005 was studied.

Table 4.3: Calculated OSS for 2005 -2007.

MFI	OSS		
	2005	2006	2007
1. Samastha Lanka Praja Sanwardana Mandalaya	108	113	111
2. AgroMicrofinance	74%	97%	89
3. Arthacharya Foundation	112	125	125%
4. Berendina Microfinance Institute			27%
5. BRAC – Sri Lanka	6%	21%	47%
6. Lakjaya	117%	n/a	107%
7. Sareeram	41%	60%	130%
8. SEEDS	102%	96%	108%
9.Sewa Finance		53%	99%
10. Janashakthi (WDF)	130%	136%	180%

Source: www.mixmarket.org and WWB – APU for Janashakthi

The same form of published data is available only from 10 MFIs. The data is also 1 year old where the reports are made for 31st December 2007 or 31st March 2008 depending on the end of the financial year for the MFI. From this data it shows only 6 MFIs has OSS over 100%.

b) Financial Self Sufficiency (FSS) and Return on Assets (ROA)

Table no: 4.4- FSS and ROA in MFIs

MFI	FSS	ROA	Reported data
Samastha Lanka Praja Sanwardana Mandalaya	n.a	1.25	31st December 2007
AgroMicrofinance	n/a	-5.2	31st March 2008
Arthacharya Foundation	n/a	n/a	
Berendina Microfinance Institute	n/a	n/a	
BRAC – Sri Lanka	n/a	-15.9	31st December 2007
Lakjaya	n/a	n/a	
Sareeram	n/a	n/a	
SEEDS	88.5%	0.85	31st March 2008
Sewa Finance	n/a	-.66	31st March 2008
Janashakthi (WDF)	129%	2.58%	31st December 2007

Source: www.mixmarket.org and WWB – APU for Janashakthi

Only Janashakthi has FSS over 100% and both Janashakthi and SEEDS report positive return on assets. Most of MFIs does not calculate or report FSS and ROA.

c) Operating expenses/ loan portfolio

Table no: 4.5: OE/LP ratio of MFIs during 2005-2007

MFI	2005	2006	2007
Samastha Lanka Praja Sanwardana Mandalaya	9%	8%	10%
Agro Microfinance	30%	27%	27%
Arthacharya Foundation	2%	n/a	n/a
BMI			n/a
BRAC- SL	n/a	51%	31%
Lakjaya	12%	n/a	n/a
Sareeram	15%	15%	n/a
SEEDS	7.3%	10%	10%
SEWA Finance		n/a	16%
Janashakathi	26%	16%	11%

Source: www.mixmarket.org and WWB – APU for Janashakthi

The OE/LP ratio has been lowest for Samastha Lanka Praja Sanwardana Mandalaya and for SEEDS where it was less than 10%. There are few MFIs having reasonably lower ratio but the figures cannot be good indicators as they are not reported consistently over the 3 years. The average effective interest rates for loans varied around 24% to 26% in those years, where the ratios would have been an acceptable one for those MFIs already discussed. However, the ratio was very high for BRAC and Agro microfinance, which were the MFIs having low OSS also in the above tables. The MIX market study "Performance and Transparency" (2006) found that average Sri Lankan MFI spent US$ 16 per borrower –just two thirds of what it costs the average South Asian Institution. Moreover it only costs 19 cents to maintain each dollar in loans outstanding, compared to 22 cents across South Asia.

d) Case load (borrowers per staff member)

Table no: 4.6 : MFI case loads 2005- 2007

MFI	2005	2006	2007
Samastha Lanka Praja Sanwardana Mandalaya	66	52	65
Agro Microfinance	43	68	82
Arthacharya	81	n/a	80
BMI			146
BRAC- SL	19	119	120
Lakjaya	n/a	n/a	n/a
Sareeram	63	55	55
SEEDS	188	204	174
Sewa Finance		114	189
Janashakthi	38	82	84

Source: www.mixmarket.org and WWB – APU for Janashakthi

It is evident from the above table that the number of borrowers per staff member has been very low in almost all MFIs in the above table compared to the world's best practice levels of 400 clients for a staff member.. This is one of the main reasons for un-sustainability in the MFIs. The ratio goes as below as 52 for certain MFIs. The credit plus and other non financial services of MFIs are the major reasons for such a low case load.

e) Portfolio Quality: Portfolio at Risk - PAR (30 days)

Table 4.7: PAR 30 of MFIs 2005-2007

MFI	2005	2006	2007
Samastha Lanka Praja Sanwardana Mandalaya	4.5%	4.3%	3.8%
Agro Microfinance	24%	21.1%	n/a
Arthacharya	n/a	n/a	n/a
BMI			0%
BRAC- SL	n/a	4.8%	3.9%
Lakjaya	0.35%	n/a	n/a
Sareeram	10%	12%	0.04%
SEEDS	20%	20.3%	14.5%
Sewa Finance		0%	2.%
Janashakthi	0%	0%	0%

Source: www.mixmarket.org and WWB – APU for Janashakthi

As per the above table except SEEDS and Agro microfinance all other MFIs reporting their PAR has fairly good loan portfolio quality. One of the immediate results of the low PAR is increased profits. However, as most of those MFIs do not generate profits, these figures should be used with caution on accuracy of those data.

Village Banks

Following table provides data on profitable and unprofitable village banks. It can be seen that 72% Sarvodaya Societies and 95% Gemidiriya VSCOs are profitable entities. Usually the time taken for a village bank to reach sustainability could be rather higher than other MFIs due to the limited scale of operation and low levels on knowledge and expertise and also due to other inherent issues and aspects discussed in the section on microfinance models. The data pertaining to number of profitable Sanasa societies were not available.

Table 4.8: Profitability of village banks

Type of Village Bank (VB)	Total number of VBs	No of Profitable VBs	% Profitable VBs
Sarvodaya Societies	2,296	1,653	72%
Gemidirya VSCO	1,034	985	95%
Sanasa Societies	3,709	n/a	
Total	**7,039**		

Source: Sanasa statistics, SEEDS MIS and Gemidiriaya MIS

Information from 1,764 SSS indicated that these societies have overall PAR 20 days 21%. Sanasa societies report 119 million rupees of past due against the total outstanding of Rs 522 million. This indicates approximately 22% are in past due category. The Gemidiriya reports 95% repayment rate. However, it can be seen that loan collection performance is weak in most of the village banks.

Cooperative Rural Banks

As reported in the outreach section, there are 1,608 CRBs operating in the country. There is no information on profitability of these CRB branches or the cooperative societies under which those CRBs are managed to review in this report. However, there is an increasing retained profit of all the CRBs together in the country. The retained profits as of December 2006 was Rs 3.2 billion whereas the same figure was 3.1 million in 2005.

Development Banks

The seven development banks are profitable over the years. However, as described in the outreach section, microfinance as per the definition used in this report is only a limited portion of their total financial business.

Following table no 8.8 shows the Operating Self Sufficiency (OSS) and Return on Assets (ROA) reported in the mix market by five of these development banks. It can be seen that all the ratios indicate reasonable profitability levels in four banks. This trend remains same in other banks too.

Table 4.9: OSS and ROA of Development Banks in 2007.

Bank	OSS	ROA
Rajarata Development Bank	112.5%	0.4%
Ruhuna Development Bank	144.1%	n/a
Sabaragamuwa Development Bank	n/a	n/a
SANASA Development Bank	114.4%	1.24%
Wayamba Development Bank	162.44%	4.95%

Source: www.mixmarket.org

It is interesting to observe that most of profit drivers or efficiency indicators are very favorable in development banks. Following table 8.9 provides few such efficiency ratios reported in the Mix market. These development banks are cost efficient, highly efficient in HR management and also maintain higher portfolio quality which makes these banks profitable.

Table 4.10: Profit Drives of Development Banks in 2007

Bank	OE/ L P	Case load	PAR (30 days)
Rajarata Development Bank	9.74%	116	5.83%
Ruhuna Development Bank	n/a	389	6.31%
Sabaragamuwa Development Bank	n/a	n/a	n/a
SANASA Development Bank	6.07%	202	4.05%
Wayamba Development Bank	2.67%	387	3.29%

OE/LP: Operating expenses/ loan portfolio, Case load :borrowers per staff member , PAR - Portfolio at Risk:
Source: www.mixmarket.org

4.3 Role of Subsidy

There are at present different types of subsidies on microfinance industry in Sri Lanka. They can be classified as follows.

1. Donor grants for operational expenses: There are few NGO – MFIs receiving grants for operating expenses of the MFI. The NGO MFIs such as Janashakthi receive grants for mainly for expansion work. WVI, Sareeram and YMCA – Batticaloa, BRAC and HELPO also receive grants. BMI and SEEDS also received grants though it is a negligible amount in relation to total operating expenses.

2. Donor grants for equity: Number of MFIs receiving assistance for equity. They are mainly for NGO type MFIs. Some examples are BMI, WVI, Sareeram that received assistance for equity and some will continue to receive such assistance in the future too. Gemidiriya Village Banking Societies (VSCO) receives its full capital from Gemidiriya Foundation as a grant. The total amount disbursed so far is Rs 1.4 billion.

3. Loans at subsidized interest rates: There are numbers of wholesale funding or refinancing schemes, which provide loans to MFIs at subsidized interest rates. NDTF provided at 9% declining balance and it is scheduled to be further reduced to 7% from July 2009. PAMP project provide funds to RDB’s at 4.5% interest rate which goes to end clients at 16%.

4. Government and donor paid staff support for MFIs: Samurdhi authority has deployed 14,000 staff members to implement microfinance program. This cost is not build into accounts of Samurdhi microfinance program, which distorts the operational performance of Samurdhi as an MFI. Gemidiriya has 60 staff paid by Gemidiriya Foundation working on its microfinance program.

5. Donor supported Technical Assistance: Donors provide training and various kinds of technical assistance to improve the performance of MFIs and the industry at large. GTZ funded ProMiS project is one most active in the sector at the moment. However, ProMiS adopts a policy of cost sharing for all the TAs including training targeted at individual MFIs. ADB funded Rural Finance Sector Development project concluded at the end of 2007 also provided similar support mainly for Samurdi, NDTF and CRBs. There are many such TA providers either on full cost or on sharing basis such as ACTED, WWB, German Bank Foundation active in Sri Lanka.

Microfinance Regulatory Regimes

5.1 Type of Laws within which MFIs are registered.

The term regulation refers to the law or laws in Sri Lanka, which deals specifically with microfinance organizations. However, the term 'regulated' implies the institutes under the supervision of Central Bank of Sri Lanka. None of top 20 MFIs referred to in this report is regulated by the Central Bank. But they are registered under law of the land and they are legal entities. However, Samurdi is an institute established under a special act of parliament. Women's Bank and SANASA societies, which are coming under the cooperative act, are also regulated in some sense by the government. Six Regional Development Banks and SANASA development bank are also those, which are largely in microfinance though they do not fit into MFI definition used to identify top 20 MFIs, which are regulated by central bank of Sri Lanka. The other institutes regulated by Central Bank of Sri Lanka such as commercial banks and finance companies are also in microfinance but they are a small percentage of micro loans in the overall portfolio of such institutes.

Laws applicable to an MFI and the degree of their applicability are dependent on the nature of the entity and the type of micro financing.

The legislative enactments that would in general apply to a MFI are

- Money Lending Ordinance
- Pawn-brokers Ordinance
- Companies Act
- Banking Act
- Finance Companies Act
- Finance Leasing Act
- Exchange Control Act
- Cooperative Societies Act
- Societies Ordinance
- Voluntary Social Service Organizations Act
- National Housing Act
- Mortgage Act
- Debt Recovery (special provisions) Act/ Debt Conciliation Ordinance/Recovery of Loans by Banks Act
- Inland Revenue Act/ Value Added Tax (VAT) Act

Regulation has been an issue of deep discussion in the Sri Lanka microfinance industry in the recent past. This was very much at present due to issues related to legality of mobilization of public deposits by unregulated institutes. In Sri Lanka there is no separate Microfinance Act or law, which specifically addresses microfinance activities in the country. In 2006/7 Government worked with Asian Development Bank and other stakeholders to develop a draft Act but this has been put on hold by the government for over 2 years. Majority of MFIs in Sri Lanka generally carry on microfinance business within one of the following legislation structures.

- A company incorporated under the Companies Act:-
    - limited liability company
    - unlimited company
    - company limited by guarantee
- A licensed commercial bank/licensed specialized bank (“LCB”/”LSB”)
- A licensed finance Company.
- A licensed leasing company
- A co-operative society
- A voluntary social service organisation (“VSSO”)
- A society registered under Societies Ordinance
- A building society
- Statutes established by special act of parliaments.

Table 5.1 below gives some examples of current registrations of MFI’s in Sri Lanka.

Table 5.1: Parliamentary Act’s under which MFI’s are registered

Type of MFI or Micro Finance Programs	Legal Statues (Act of parliament within which MFI is registered)	Salient Features of regulation	Cost of Regulation
Guarantee Limited Companies (Ex SEEDS, BMI, Vision Fund Lanka)	Companies Act , No 7 of 2007	Savings cannot be mobilized, 7 minimum ordinary members required. MFI with a social objective and dividends cannot be given to directors. No starting capital required.	Insignificant such as Rs 25,000 initial cost for paper work and registration fees.
Private Limited Companies (Seva Finance, Lakjaya)	Companies Act , No 7 of 2007	Savings cannot be mobilized. 2 minimum ordinary members required. MFI with a commercial objective and dividends can be given to shareholders.	Insignificant such as Rs 25,000 initial cost for paper work and registration fees
Samurdhi Banks	Samurdhi Authority of Sri Lanka Act No 30 of 1995	Government body with social objective, savings mobilization is allowed.	Not applicable
TCCS (SANASA), Cooperative rural banks	Co-operative Societies Law No. 5 of 1972 (as amended)	Savings from members and non members, loans only to the members, minimum 25 members required to ensure feasibility. Payment of dividends is possible. Annual audits and supervision is done by the government.	No initial statutory payments. 10%of the annual profit should be paid to the Cooperative fund of the Government.
NGO MFIs (majority) (Ex: WDF, Arthacharya Foundation)	Social Service Organizations (Registration and Supervision) Act No. 31 of 1980 (“the VSSO Act”)	Organisations, which have social development interventions at national level or regional level in addition to MF are usually registered under this body. Annual budgets and progress reports should be submitted to NGO secretariat of the government.	No significant statutory payment required.

Village Banks or CBO's (Ex: Sarvodaya Shramadana Societies)	Societies Ordinance No. 16 of 1891 (as amended)	Village level self help organizations having usually members over 25. Savings can be mobilized by Sarvodaya societies, which were found in Sri Lanka mostly as monitory board had been given approval for the same.	No significant statutory payment required. Sarvodaya Society should have minimum capital of Rs 10,000 registration.
Village Banks under peoples company (Ex: Gemidiriya VSCO)	Companies Act , No 7 of 2007	50 members required minimum. Public or member savings are not possible.	Rs 25,000 initial cost for paper work and registration fees. This is a significant sum for village banks
CBO (Ex: Arthacharya Society)	Social Service Organizations (Registration and Supervision) Act No. 31 of 1980 ("the VSSO Act")	Village level self help organizations having usually members over 25. Savings cannot be mobilized even from the members.	No significant statutory payment required
Regional Development Banks (Licensed specialized banks ("LSBs") not exclusively micro finance only)	Banking Act No 30 of 1988 as amended by Banking Amendment Act No .30 of 1995	All banking transactions excluding opening and maintaining current (or "checking") accounts and foreign currency accounts for customers.	Significant in terms of paper work, which cost about Rs 700,000. Annual licensing fee Rs 200,000. Minimum of RS 1.5 billion capital should be maintained.
LOLC Microfinance Company	The Finance Leasing Act No. 56 of 2000 ("Finance Leasing Act") –	Finance leasing business" is defined in the Finance Leasing Act as, the business of investing money for the provision of equipment under a finance lease.	Significant in terms of paper work. Fee – Rs 25,000 initially and Rs 5,000 annually afterwards.
Central Finance Company	The Finance Companies Act No. 78 of 1988 ("Finance Companies Act")	The Finance Companies Act defines "finance business" as the business of accepting money by way of deposit, the payment of interest thereon and a) the lending of money on interest; or b) the investment of money in any manner whatsoever; or c) the lending of money on interest and the investment of money in any manner whatsoever	Significant in terms of paper work. Licensing fee Rs 25,000 initially and Rs 5,000 annually afterwards. Minimum of RS 250 million capital should be maintained.

Source: Microfinance law Study by De Serams and Company (2009), www.cbsl.gov.lk, and interviews with subject specialists

Note: Under MFI's formed under Companies Act there are two types of agencies such as SEEDS Child Fund, which are not for profit guarantee companies and Lak Jaya , Sewa Finance and Ceylinco Grameen Credit which are "for profit" private companies.

Despite a draft Micro Finance Act that has been around for over 3 years stating that NGOs must create separate MFIs thus separating microfinance work from other work, this has actually happened only in 3 INGO programs (World Vision, Berendina and CCF) and 4 local NGOs (Sarvodaya, Agro Mart, Sewa Lanka and Pragaththiseva Foundation) with only few more like Arthacharya Foundation planning to create separate MFIs. LOLC, which was mainly in micro lending for solar home systems for electrification has also established a separate MFI recently. However, outside of these agencies such as WDF, Lak Jaya and BRAC have programs that initiated specializing in microfinance .This shows that still very few players in the NGO sector at national level have a specialized microfinance programs.

Three key Issues that affect MFI's due to existing laws are:

A. Deposit Mobilization

- Section 76A (1) Banking Act states that "The business of accepting deposits of money and investing and lending such money shall not be carried out except by a company which has the prescribed equity capital and under the authority of a license issued by the Monetary Board for such purpose under Part IX A of the Banking Act".(i.e. license to operate as a LSB)
- Exceptions to the requirement –
  - Company registered under the Finance Companies Act
  - Registered Cooperative Society
  - Building Society incorporated under National Housing Act
  - Licensed Commercial Bank
  - Nonprofit organization established/ registered under any law, accepting deposits only from registered members, and which has obtained the written permission from Monetary Board to accept such deposits and invest/ lend the monies so accepted.

B. Foreign investment in MFIs

Foreign investment in microfinance business is restricted under the Exchange Control Act as well as the Money Lending Ordinance. A regulation issued under the Exchange Control Act prohibits foreign entities/persons from investing in the shares of companies carrying on the business of money lending. The Money Lending Ordinance provides that no person may carry on the business of money lending if such person is –

A. an individual who is not a citizen of Sri Lanka
B. a foreign company
C. a foreign firm unless approved for such purposes by the Minister of Finance.

C. Restrictions on obtaining foreign loans

In general, the approval of the Controller of Exchange is required for any person in Sri Lanka to:

A. borrow any sum in foreign currency from any person (other than a Licensed Commercial Bank)
B. possess foreign currency
C. to make any payment to or to the credit of a non-resident

Approval of the Controller is required for any person (other than a LCB) to lend foreign currency to any person in Sri Lanka. However, general permission has been granted for the release of foreign currency in respect of "current transactions" but payment of capital and interest under a loan would be a "capital transaction" for which exchange control permission is required.

5.2 Challenges NGO's and NGO MFI's face due to inadequate Regulations

The biggest challenge faced by NGOs and NGO commenced MFIs to conduct microfinance work is that neither under Companies Act nor under Society Ordinance is it possible for them to take deposits from the public. These are the two main Acts under which NGOs and NGO commenced MFIs are registered. This constraint on taking deposits is a major deterrent to growth of microfinance sector in Sri Lanka as this constrains NGO's and MFI's ability to raise capital in the form of savings. The draft Micro Finance Act had provision to remove this constraint by registering all microfinance agencies under the proposed Act and allowing them to take deposits. But the non implementation of the Act has resulted in this constraint remaining and affecting the growth of microfinance. As a result some MFIs are pursuing the licensing under banking act or finance companies act.

Absence of a National Policy on microfinance has resulted in government and its agencies taking different stances towards NGO's work in microfinance. In the 1990's government encouraged savings to be done by NGOs through the Janasaviya Trust Fund (JTF), a government Trust, funded by World Bank. In fact, one requirement for NGOs to be eligible for JTF funding for microfinance was savings mobilization. The trust even gave training support to NGOs to enhance their savings. Then Small Farmers and Landless Credit Program managed by the Central Bank itself promoted NGO savings and gave this as a requirement for accessing credit under this project financed by IFAD and CIDA.(source: Discussion paper Microfinance and Government's Responsibility by Sathis de Mel)

Despite that in 1992/3 when government had a fall out with the leader of Sarvodaya they requested SEEDS a subsidiary of Sarvodaya to refund savings it has taken from depositors to Sarvodaya Societies. But later in late 1990's there was a letter issued by Central bank, in which it stated that Sarvodaya societies can take savings from its members under the SEEDS supervision. Now once again due to fraudulent acts of few Finance Companies and Credit Card Companies government is coming hard on NGOs for accessing deposits from the poor despite the fact that majority of these NGOs are not profit making entities and are only serving the poor by accessing savings..

Another challenge facing the sector is the difficulty in accessing credit or capital from International funding agencies due to the constraints placed by Exchange Control and other acts to access such capital. In fact, LakJaya a privately funded MFI was to receive US$ 5 m from Catalyst Micro Finance Institute (CMI), a Dutch based investor and a partner of ASA, one of the World's best MFI's based in Dhaka. However, after US$ 1.5m has been sent as equity for Lakjaya now government's Board of Investments (BOI) the body that oversees foreign investments rule that this investment is illegal as foreign companies cannot participate in "money lending". There is an urgent need to have a legislation to make them favor the growth and stability of the sector.

There are very stringent regulations on repatriation of funds abroad including remittances of loan repayments, which discourage many overseas based international agencies from investing in micro finance in Sri Lanka.

The term 'self regulation' is not commonly used by MFIs in Sri Lanka. WA Wijewardena, the Deputy Governor of Central Bank of Sri Lanka on his paper on microfinance policy and regulatory framework experience and perspectives of South Asian region concludes that the best method of ensuring stability solvency and viability of MFIs is to promote self regulation with such organizations checked by market discipline. Government regulation on MFIs should be effected only as a supplement to this approach. However, certain NGO MFIs adopts practices of self regulation by undertaking annual external audits and frequent internal audits and monitoring, which assess and ensure healthiness of the MFIs. However, only very few MFIs do it in very prudent manner such as taking timely action to rectify issues identified through these processes. Only very few MFIs measure basic microfinance performance indicators at minimum level such as PAR and OSS. Still there are MFIs that measure cumulative repayment rate for collection efficiency, which is proven to be an ineffective indicator for MFIs. However, there is an increasing trend to measure and use such best practice indicators among MFIs particularly in new MFIs.

Competition in Microcredit Market and the Issues of Overlapping

The competition among MFIs was not much discussed in the literature. This may be an indication that there is no significant competition among MFIs. One of the studies, which highlighted competition, was Review of Post Tsunami Microfinance in Sri Lanka (Girija Sri Nivasan 2008). It identified that all the MFIs faced the competition from other MFIs except Peoples Bank after Tsunami especially during the year of 2005. However, this report acknowledges that the MFIs in southern Sri Lanka have been facing competition for a decade even before Tsunami in 2004.

The payment of salaries above market rates, very soft and quick lending without prudent screening of credit worthiness, products with low interest rates were the factors that led to competition at that time. The nature of the competition has been attrition of staff, client dropouts, which lead to disruption in the market and thus it was found to be an unhealthy competition. The context in 2005 was different from the present context but one can see some aspects of those elements of competition still prevalent at different levels in different areas and among different MFIs.

As found in the chapter 3 on outreach, the micro credit sector in Sri Lanka comprises a widely dispersed heterogeneous set of institutional and non-institutional arrangements. There are multiple layers of Government, Non- Government and Cooperative sector services providers, and a recent trend of commercial banks downscaling to serve the upper-segment of the microcredit market.

6.1 Nature and impact of competition in the micro credit market

6.1.1 Nature of the Competition

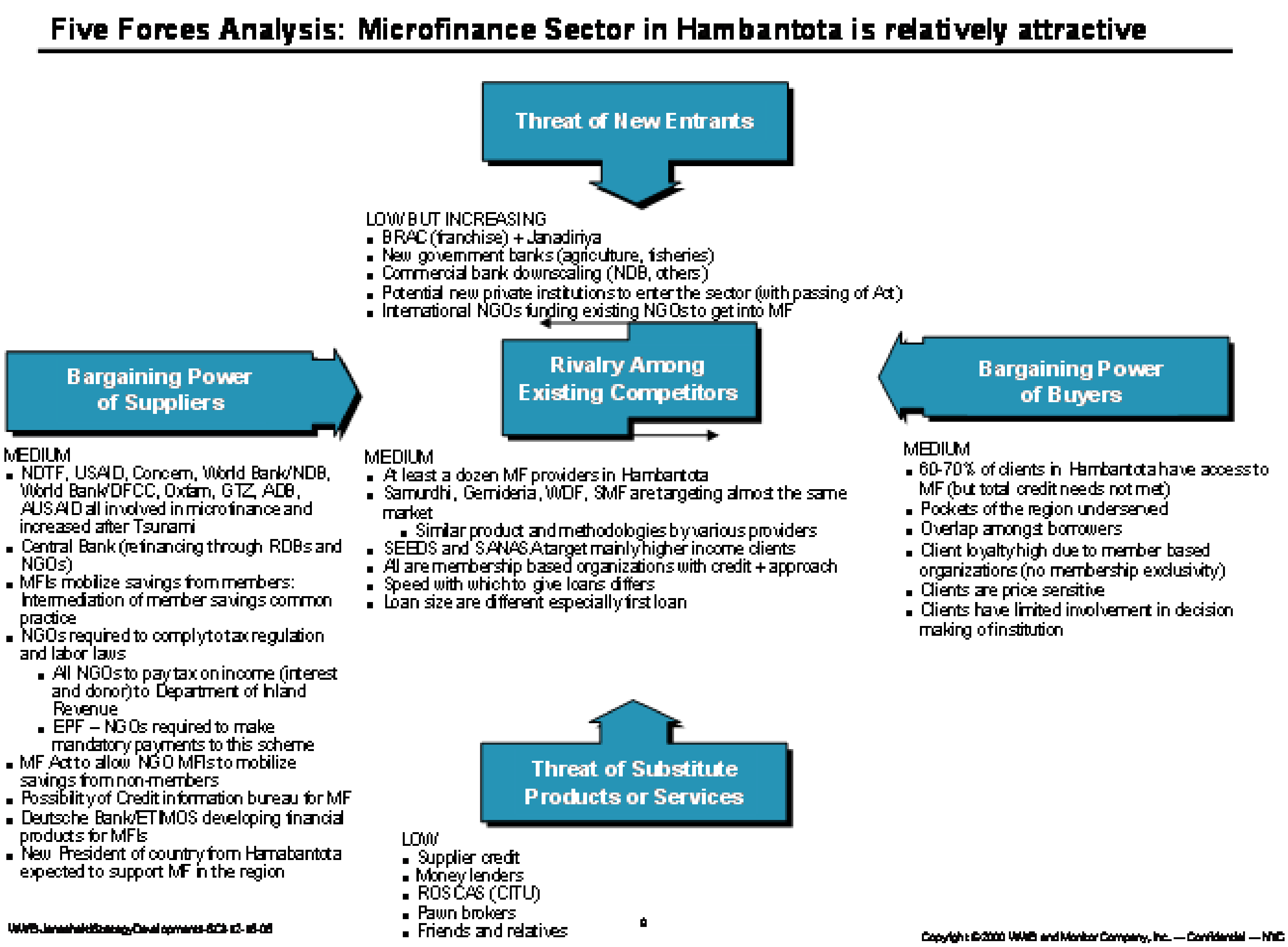
The table 6.1 below indicates that all of the major players have had significant portfolio growth in the recent past. The new data found in this report indicate that this trend has continued during 2007 and 2008 as well. The market is mainly limited by the availability of financial resources than the demand for credit. Therefore the competition is mainly centered on deposit mobilization. In addition to micro credit providers the National Savings Bank and all commercial banks are aggressively mobilizing savings from the microfinance market, which affect the availability of deposit resources for micro credit providers to provide credit services to much needed microfinance clients. However, it should be noted that both CRBs and Samurdi are net deposit mobilizers than credit providers and hence the surplus deposits are not an indication of limited demand rather reluctance and incapacity on the part of the service providers to meet credit demand. Both CRBs and Samurdhi invest their deposits in Government securities and other higher paying deposit instruments.

It is important to note that none of the major players in micro credit market consider that competition is one of the major challenges for their growth and sustainability and more importantly many of them consider limited funding sources as the number one challenge for their growth. However, poor quality loan portfolios, weak institutional structures and exchange rate risks are some of the major barrier for accessing global micro credit resources to the sector.

Table 6.1: Microcredit and deposit Growth 2004-2006

	Deposits 2004	Loan portfolio 2004	Deposits 2006	Loan Portfolio 2006	Loan portfolio growth
RDBs	10,240,920	12,909,525	18,750,757	19,418,585	50.42
CRBs	22,276,954	8,144,916	25,311,550	14,620,570	79.50
Samurdhi	11,761,000	3,692,000	20,810,360	7,785,081	110.86
NGO MFIs*	2,083,931	2,139,695	NA	4,433,000	107.17
Sanasa\TCCSs	2,309,506	2,069,080	3,936,818	4,025,124	94.53
Total	48,672,311	28,955,216	68,809,485	50,282,360	73.65

Source: GTZ Pomis -Micro finance Industry report 2009; Girija Srinivasan, Review of Post -Tsunami Microfinance in Sri Lanka May 2008; CGAP, Country Level Effectiveness and Accountability review, February 2006. 2006 NGO MFI data is related to 10 largest NGO MFIs only.



Source: Strategy document 2006-2009 – WDF – Hambantota

The figure reflects the level of competition from and among five forces in the microfinance market in the district of Hambantoata in Sri Lanka. None of the forces were putting up a stiff competition. The competition among existing MFIs was identified as medium. The clients (buyers) and funders (supplies) were also influencing at medium level. However, the threat from new entrants and substitute providers such as companies leasing household equipment etc to the same microfinance market are found to be less in the microfinance market. This is more or less generally applicable for the country as a whole except for north and the east.

6.1.2 Impact of the competition

In general the competition is good for the clients where they will get more to choose from and improved services due to competition. The competition will reduce the market interest rate as service providers compete for the clients. However, there has not been a significant change in the market interest rates of the major players as a result of competition. Contrarily, there has been an upward trend in the interest rate charge in the NGO MFI sector. This is also a proxy indicator that there is still no major competition in the credit market.

The competition also should impact profit margins of service providers. There is increasing trend in improving profits of MFIs. Development bank accounts also have improved their profits. Therefore, competition cannot be viewed as a factor affecting the profitability in the sector in the current context.

6.2 Impact of overlapping membership in the micro credit sector

Of the 4.2 million total families in Sri Lanka, less than 50% could be considered to be the micro credit market. The table below indicates that approximately over 10,400 microcredit service points in the country suggesting that there is one service point for every 200 families. The similar finding was reported in the Microfinance Industry report (2009) by GTZ PoMiS. The distribution of the service points are although not even, there is a reasonable spread of the MF branches throughout the country. The only exceptions are the very remote areas of all districts, plantation areas and conflict affected North districts except Jaffna,

Table 6.2: microfinance service points in Sri Lanka

Service providers	# Service points
MFIs	1,465
Village banks	7,039
CRBs	1,628
Development Banks	281
Total	**10,413**

Source: data collected in the study

Many of the sample surveys on access to credit found that large percentage of families have multiple memberships and access to credit and savings institutions.

Samurdhi is a government sponsored poverty reduction program with total country coverage with larger percentage of the poor families as members of Samurdhi banks. As access to credit through Samurdhi banks are very limited, many of these families are also the Members of local, regional and national MFIs, CRBs and Sanasas. In addition many low income family members have multiple memberships in Sanasa, Samurdhi, CRB and other MFIs.

Multiple memberships are factors to be considered in determining the creditworthiness and borrowing capacity of the clients. Clients are unlikely to disclose the outstanding borrowings from other sources. Therefore it is important for credit officers to use community knowledge to eliminate excessive borrowing risk of the clients. It is also a best practice to not to offer credit or membership to willful defaulters of other credit institutions.

Challenges Facing Microfinance Sector in Sri Lanka

7.1 Lack of Appropriate Regulation for MFIs

MFIs operate within a number of legal frameworks as described in the chapter 5 regulation. Only 3 MFIs listed in top 20 have the legal right to mobilize savings. Sathis De Mel (2009) in his discussion paper on Microfinance and Government's Responsibility shows that savings has been recognized as a key financial product required by the poor. MFIs were strong and very successful in savings mobilization which is a very powerful instrument in mobilizing the poor. The objective of economic empowerment of the poor necessitated them to be free of debt and dependency on money lenders. Savings was seen as the tool to enhance one's own resources as well as confidence on her way out of indebtedness and poverty. Savings was also used as a form of informal collateral as well as an indicator of financial discipline. The savings is a strong capital base for MFIs. Although the acts of parliament within which most of the MFIs are registered do not provide legal power, savings mobilization were promoted among MFIs by donors as well as government managed poverty alleviation projects such as NDTF (then called JTF) and small landless farmers credit (ISURU) project. Though this issue was highlighted in many studies such as commercialization of microfinance (2002) indicating that the government fails to enforce laws against microfinance NGOs mobilizing savings deposits and offers no clear legal path for those institutions subject to prudent supervision. From the recent past, due to the failure of certain private sector as well as NGOs and CBOs to honor the withdrawal of deposits by savers, the government is now attempting to strictly control and prevent savings by MFIs not authorized to do so. This is a major issue facing MFIs including 17 of the top 20 MFIs listed in this paper. The microfinance act, which was drafted and was on discussion for the last 2 to 3 years from time to time, has not come out so far. As this is a serious challenge some MFIs are pursuing the option of licensing as finance companies or development banks. Only very few can pursue these options as they are costly and need specific capital requirement and changing legal statutes as public companies etc.

7.2 Weak Portfolio Quality

The weak portfolio quality has been an issue in the industry for many years. The concern over portfolio quality increased in the industry in the recent past. From the 20 MFIs listed in this paper only 10 in the Mix market or those that use other tools measure and report portfolio at risk (PAR). Eight out of those 10 MFIs, which report PAR, 3 MFIs have PAR (30 days) over 5% (refer table 8.6). The issues are lack of understanding on importance of portfolio quality, lack of appropriate loan tracking mechanisms and cultures within MFIs to ensure on time repayments. The culture among clients for delayed payments aggravates the issue even for MFIs having proper systems and procedures regarding portfolio quality to implement them in the field. The CBO or village banking methodology where the governance and management of the MFIs are also from the community itself, and consist of close relatives and neighbors of borrowers, also make it difficult to take action against default.

7.3 Issues in the Village Banking Model

One of the biggest challenges Sri Lanka faces is the weakness of the most prevalent model which is the “Community banking model’ as described in the section relating to models. Sri Lanka commenced serious micro finance programs such as SEEDS, ISURU, TCCS expansion and Janasaviya as early as mid 1980’s. However, countries which began much later such as Pakistan have qualitatively much better MFIs such as Kashf Foundation. Bangladesh too is way ahead of Sri Lanka from a quality point of view in addition to quantity. The key reasons for this situation are the constraints placed by society or community based model that was used previously and is being used currently by SEEDS, TCCS, ISURU, Seva Finance and by smaller NGOs. Some justify this approach as bringing about both social and economic empowerment. But results of 20 years of work have shown that this model is one of the most important reasons for the poor quality of microfinance sector in Sri Lanka. SEEDS experience shows that approximately 40% of the societies that commenced microfinance activities have become inactive. The situation in SANASA societies is similar although the information is not available in a transparent manner. Most of these societies except Sarvodaya societies do not measure at least the repayment rate, which is a ratio easy to calculate though it is not a very sound indicator of efficiency. Similarly most of them do not know the quality of the portfolio, which is the best indicator to measure the quality of portfolio performance. Therefore, this model does not enable best practices of the sector being used; it depends on weak and changing governance of the society leadership. Even now annually large number of SEEDS and TCCS societies wind up due to poor leadership, governance and management. However, the Janashakthi and Samurdhi, which has modified village banking model with centralized management, while empowerment and social development elements are also inbuilt in the methodology found better results. In contrast to this the simple group or cluster approach followed by most Bangladeshi MFIs including ASA, BRAC and Grameen has seen better results during last 2-3 years. A few Sri Lankan MFIs have started following this model and this includes Ceylinco Grameen, BRAC Sri Lanka, Lak Jaya and Berendina Micro Finance Institute. It should be noted that both Lakjaya and Ceylinco Grameen at present face problems but these problems are not due to the issue in the model and both are related to the governance related issues.

7.4 Fragile Institutions

Lack of sustainability in MFIs .This is elaborated in the sustainability section in the paper.

7.5 Lack of Transparency

As shown in the MIX market study on performance and transparency (2005) even basic data on outreach and profitability data are not available in certain MFIs, making it difficult to assess performance levels and sustainability of operations in the sector. Most institutions lack adequate management information systems (MIS) and are unable to track their loan portfolios and other performance measures. What little data are available rarely adhere to international standards and instead track cumulative indicators, which do not accurately capture institutional performance. The Microfinance Practitioners Association does not collect performance data in regular intervals on member performance although initial survey and data base is established. Only very few institutions are familiar with international best practice reporting standards for microfinance. Another related issue is that the measures of portfolio quality often varies across organizations, some measure PAR at one day and others track this indicator after 90 days, which makes comparisons of performance difficult.

7.6 Inadequacy of IT knowledge

Another challenge faced by the sector is automation. Most of MFIs large and small moved for automation in the recent past. GTZ- ProMiS supported 8 MFIs including 3 RDB's with the banking software called 'Micro-Banker'. Other locally developed banking software such as SENOVA and SOTFWATCH and RAJEEDA are also used by many small and medium size MFIs. While this effort has improved the efficiency of MFIs it is noted that there are large number of known and unknown issues faced by users. An example of an unknown issue is that loan loss provisioning is not featured in most of these software programs. The major reason is inadequate microfinance related technical know-how with MFIs as well as software companies. Lack of understanding on MFI's accounting principles and practices and need of loan tracking systems by the software producers has resulted in poor quality products. If these concerns are not addressed immediately there is a danger in managing inaccurate FIS and MIS in MFIs. There were certain efforts to design tailored software for larger MFIs, which have not brought positive results over the last 2-3 years due to the same reasons.

7.7 Public Sector Involvement in Retail MF

Widespread involvement of public sector with heavy subsidy on operational costs specially Samurdhi where all staff and administration costs are subsidized by government. This is a major challenge and many Banks and more in the private sector have not commenced microfinance programs due to this challenge of competing with subsidized programs of the government. NGO MFIs and co-operatives are working amidst this type of challenge as Samrudhi is a huge program, which covers every single Grama Niladari division (lowest administrative division) and is a sizable competitor for all MFIs in the country. Fortunately some of the stringent policies adopted by Samurdhi still leave space for others to compete successfully.

7.8 Lack of suitable Human Resource

Another major factor affecting the sector is lack of competent staff. Due to the paucity of training programs in this sector there are very few trained staff and experienced staff. At senior level such as Managing Director or Operations Director it is extremely difficult to recruit staff due to lack of such experienced senior staff in the sector. However, there are few recent initiatives such as provision of CGAP microfinance training in local languages, microfinance diploma programs offered by Colombo University and Institute of Bankers to address this issue.

7.9 Inadequate Credit 'Plus Services'

Another gap identified in the GTZ demand side survey was the absence of "Credit Plus" services. The survey showed that only 5 % of those who received microfinance had actually received credit plus services in terms of skills training, marketing and technology assistance. Only Samurdhi and SEEDS supplied this service at reasonable level whilst other MFIs and Banks were very poor in providing credit plus services. Of new entrants Berendina Microfinance Institute has an innovative "credit plus' approach where services are provided based on demand. Many who want to follow a credit plus approach such as Agro Micro Finance suffer from lack of funding to be inclusive. Lack of “credit plus” services result in beneficiaries not making the best use of available credit and thus impact of credit has been low.

Financing Microfinance

There are different sources of funding for microfinance institutions in Sri Lanka. The main ones are donor grants, savings, soft loans, commercial loans and equity investments. The donor grants are on decline now and they are mostly now available for Northern and Eastern parts of Sri Lanka. However, many NGO MFIs have donor grants received previously as their equity in the organisation. The most recent official record of donors for MF is the CGAP - CLEAR study in 2005. This study identified 15 donors active in funding microfinance sector in Sri Lanka. Among them 2 donors namely CONCERN WORLD WIDE and RELIEF INTERNATIONAL have already closed their operation. The other 13 still operating are ADB, CIDA, ETIMOSE - an Italian microfinance Agency, EC, GTZ, JBIC, KFW, NORAD, PLAN, Stromme Foundation, UNDP, USAID and WB. These are only the agencies, which had an in country office. In addition agencies such as IFAD, NOVIB and Berendina Stichting too funded micro finance. Some of these donors are no longer very active in the micro finance sector. Some of these donors provide soft loans, which are discussed in the next sections of this report.

Savings are mobilized from the members of MFIs. The regulated banks mobilize savings from their members too. However, savings mobilization by non regulated MFIs even from their members are restricted now to a lager extent. Therefore, certain such MFIs collect funds from their clients under different labels such as loan contribution, security deposits etc which are however a part of the capital for those MFIs.

The following table provides the comparative analysis of liquidity of different types of MFIs in Sri Lanka in 2005. This paper focuses mostly on NGO/ Companies and Samurdhi, which provides loan as per the microfinance definition used in this report. The ratio in NGO/Companies has been almost 1:1 where as Samurdhi has 4:1 savings to loans. Samurdi finances its loans only from the savings. But NGO/Companies have large amount of other sources of funds in loan portfolio and substantial portion of their savings are kept in other forms of investments in banks and other financial institutes.

Table 8.1: Liquidity by institutional type

Liquidity by key actors*		
	Amount of Deposits	**Loan Portfolio Outstanding**
RDBs	10,240,920	12,909,525
Sanasa Dev Bank	2,309,506	2,069,080
Co-operative Rural Banks	22,276,954	8,144,916
NGOs/Companies	2,083,931	2,139,695
Samurdhi	11,761,000	3,692,000

*In `000 LKR Source: CGAP CLEAR (2006)

The soft loans are the also increasingly becoming popular in Sri Lankan MFIs. Most MFIs depend on National Development Trust Fund (NDTF), a government owned Apex, which provides wholesale loans to MFIs. As per the Central Bank Annual report 2008 NDTF has lent Rs 1,402 million to 189 partner MFIs. Of the total loan disbursements, 91% has gone out side western province, which is relatively poor, and belongs to rural areas of the country. The loans are only for income generation purposes. The disbursement during 2007, NDTF has Rs 1,102 million.

The poverty alleviation microfinance project (PAMP), which is managed by Central Bank of Sri Lanka has disbursed Rs 514 million during 2008. These loans are also for income generation purposes. These loans were disbursed through regulated banks such as regional development banks and selected partner commercial banks as participatory financial institutes. The second phase of this project called PAMP –II was to commence in early 2009 as per the central bank report 2008. The phase II is yen 2,575 million out of which yen 2,100 million is for credit project which is financed by Japan International Cooperation Agency (JICA) .

Stromme Micro Finance Institute (SMFI) is another wholesaling lending institute similar to NDTF, which also provides technical assistance. It has 40 NGO partners. SMFI has disbursed Rs 1,193 million for the microfinance sector.

Ecumenical Loan Fund (ECLOF) is another international source of funding for this sector. ETIMOS- the Italian agency having an office in Sri Lanka also provides whole sale loans to MFI. ECLOF has disbursed Rs 131 million during the year 2007, (ECLOF annual report 2007).

Etimos has number of partners in Sri Lanka. International donors such as Rabo Bank Foundation also provide soft loans to MFIs.

The other form of funding is equity investments though it is not much popular so far. Catalyst Microfinance Institute based in Netherlands has invested US 1.5 million equity in Lakjaya credit company. Similarly new emerging MFI- LOLC microfinance is a company, which has equity investments from an investor in the Netherlands. FMO is the development bank of the Netherlands government. LOLC has already got technical TA from ACTED for designing its microfinance model of the new company.

Donor agencies such as World Bank, ADB, JBIC and IFAD provide credit lines for specific target groups, through specific projects. (e.g. the Dry Zone Livelihood Support and Partnership project of IFAD) which has a credit line meant only for very poor dry zone farmers and non farm business in chosen dry zone districts. Another example is the Poverty Alleviation Microfinance Project (PAMP) funded by JBIC. These credit lines are given at a subsidized rate of 4% or even less to the country, and to isolated communities that were not touched by the formal network in order that they can have access to credit. There is an increasing trend of commercial borrowing from local and international sources during the last one to two years. The commercial borrowing is important to the microfinance sector as the donor money is not adequate to meet the demand for microfinance services. For an example SEEDS has borrowed from NOVIB in the Netherlands and as well as from Peoples Bank, Hatton National Bank and Lankaputhra bank in Sri Lanka.

The other side of financing of microfinance is related to the provision of Technical Assistance to MFIs. During the last 5 years there were two such major projects implemented in Sri Lanka. One was called rural finance sector development project funded by ADB, which was to bring technical assistance to the volume of US $ 27.29 million. (inception report – rural finance sector project). GTZ also was an important source of finance for TA for

MF industry during the last 3 years. The Promotion of Microfinance Sector (ProMiS) of the GTZ has provided Technical Assistance (TA) for MFIs for computerization, staff training, developing (TA) providers to the sector, developing microfinance network in Sri Lanka, helping MFIs to develop and re-engineer their processes and facilitating number of studies such as demand and supply side studies, regulations of MFIs. The total project budget was Euro 8 million and for the first phase which will be concluded end 2009 it was Euro 4 million budget (www.microfinance.lk).

A study undertaken by SMFI in 2008 has found that approximately Rs 4,348 million has been invested in the microfinance industry for loan funds and capacity building in the recent past in addition to SMFI's own investment of Rs 1,193 million.

Central Bank Annual report 2007 has reported that there are number of other credit lines available through Central Bank of Sri Lanka or other respective line departments for microfinancing. From a more formal microfinance point of view the main existing credit lines are:

- Second Perennial Crops Development Project-Government Funds – This is for commercialization of perennial crops.
- Tea Development Project – Government Funds – To assist enhance tea small holders' income by developing the necessary infrastructure.
- New Comprehensive Credit Scheme – Funds of participating Banks together with interest subsidy by government - Provision of working capital for small farmers and for purchase of agriculture commodities under forward contracts.
- Krushi Navodaya Scheme – Funds of participating Banks and interest subsidy of government- Provision of medium term loans for activities in agriculture and animal husbandry.
- Matale Regional Economic Advancement Project – IFAD – to raise the income of rural and non farm families in Matale by providing funds for small and medium enterprises.
- Sabargamuwa Provincial IRDP-Government – Upliftment of living conditions of the people in the project area by promoting income generation activities.
- Dry-Zone Livelihood Support and Partnership Program – IFAD – Poverty alleviation and income generation amongst the poor families in selected dry zone areas.
- Small holder Plantation and Entrepreneurship Development Program – IFAD and USAID- Improving livelihoods of marginalized small holders of tea and other perennial crops in Uva.