Microfinance Industry Report
SRI LANKA

2009

Produced by GTZ ProMiS in collaboration with The Banking With The Poor Network

Ministry of Finance and Planning

gtz

B.W.T.P. Banking With The Poor Network

Citi Foundation

Sri Lankan - German Development Cooperation

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i. About GTZ

As an international cooperation enterprise for sustainable development with worldwide operations, the federally owned Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH supports the German Government in achieving its development policy objectives. It provides viable, forward looking solutions for political, economic, ecological and social development in a globalised world. Working under difficult conditions, GTZ promotes complex reforms and change processes. Its corporate objective is to improve people's living conditions on a sustainable basis.

GTZ is a federal enterprise based in Eschborn near Frankfurt am Main. It was founded in 1975 as a company under private law. The German Federal Ministry for Economic Cooperation and Development (BMZ) is its major client. The company also operates on behalf of other German ministries, the governments of other countries and international clients, such as the European Commission, the United Nations and the World Bank, as well as on behalf of private enterprises. GTZ works on a public-benefit basis. All surpluses generated are channeled back into its own international cooperation projects for sustainable development.

GTZ employs a 10,000 member staff in more than 120 countries of Africa, Asia, Latin America, the Eastern European countries in transition and the New Independent States (NIS). Around 9,000 of these staff are national personnel. GTZ maintains its own offices in 67 countries. Some 970 people are employed at its Head Office in Eschborn near Frankfurt am Main. In addition, 365 staff members work for supra-regional projects based at various locations within Germany.

ii. About the BWTP Network

The Banking With The Poor Network is a network of some 30 national policy institutions, commercial banks and NGO's from nine countries in Asia - namely Australia, Bangladesh, India, Indonesia, Nepal, Pakistan, Philippines, Sri Lanka and Vietnam. The BWTP Network objective is to link microfinance with the financial system and to support the provision of inclusive financial services in Asia. It pursues this objective through capacity building, information sharing, policy dialogue, advocacy and research.

The Foundation for Development Cooperation (FDC), based in Singapore, provides the Secretariat for the Network.

The BWTP Network and FDC partners with the Citi Foundation to strengthen the Microfinance sector in Asia. The production of industry assessments is a part of the BWTP Network's participation in the Citi Network Strengthening Project.

The Citi Network Strengthening Project supports the development of Industry Assessments for national and regional level networks. The purpose of the BWTP Network Industry Assessments is to provide an overview of the microfinance sectors in which the BWTP Network operates. These assessments aim to extend beyond the performance of individual institutions, and focus on the development of the microfinance market as a whole by being both descriptive and analytical in nature. The aim of these assessments is to provide an outlook on each industry that is a valuable resource to the BWTP Network, its members and the wider microfinance community.

iii. Acknowledgements

The Sri Lanka Microfinance Industry Report was produced by Ms. Roshini Fernando, Senior Microfinance Specialist of GTZ - ProMiS (Promotion of the Microfinance Sector) with research support from Ms. Tharmini Kularajasingam and in collaboration with the BWTP Network. Special thanks are due to Dr. Dirk Steinwand, former Senior Advisor of GTZ-ProMiS, during whose tenure this assignment was initiated. His guidance and valuable advice contributed substantially to the successful completion of this report. We also thank Dr. Nimal Fernando who reviewed the document and provided many excellent suggestions for its improvement. Thanks are also due to Mr. David Bartocha, Ms. Cristina Modoran, the Lanka Microfinance Practitioner's Association, officials of the Central Bank of Sri Lanka and all those who contributed to the production of this document by providing their time, views and feedback.

Our thanks go to Mr. Jamie Bedson, BWTP Network Lead Coordinator and Asia Regional Representative at The Foundation for Development Cooperation (FDC) and Dr. Dagmar Lumm, Senior Advisor, GTZ-ProMiS, for their support throughout the assignment.

iv. Acronyms and Abbreviations

- **ADB** Asian Development Bank
- **ATM** Automated Teller Machine
- **BWTP** Banking With The Poor Network
- **CBSL** Central Bank of Sri Lanka
- **CGAP** Consultative Group to Assist the Poor
- **CLEAR** Country-level Effectiveness and Accountability Review
- **CRB** Co-operative Rural Bank
- **CRIB** Credit Information Bureau
- **CSR** Corporate Social Responsibility
- **DCS** Department of Census and Statistics
- **FAO** Food and Agriculture Organization
- **FI** Financial institution
- **GDP** Gross Domestic Product
- **GTZ** Deutsche Gesellschaft für Technische Zusammenarbeit (German Agency for Technical Cooperation)
- **ICT** Information and Communication Technology
- **IT** Information Technology
- **JBIC** Japan Bank for International Cooperation
- **LCB** Licensed Commercial Bank
- **LMPA** Lanka Microfinance Practitioners' Association
- **LSB** Licensed Specialized Bank
- **MBA** Master of Business Administration
- **MFI** Microfinance Institution
- **MIS** Management Information Systems
- **MIX** Microfinance Information Exchange
- **MPCS** Multi-Purpose Co-operative Society
- **NDTF** National Development Trust Fund
- **NGO** Non Governmental Organization
- **PAMP** Poverty Alleviation Microfinance Project
- **PaR** Portfolio at Risk
- **ProMiS** Promotion of the Microfinance Sector
- **RADA** Reconstruction and Development Authority
- **RDB** Regional Development Bank
- **RFSDP** Rural Finance Sector Development Programme
- **ROSCA** Rotating Savings and Credit Association
- **RRDB** Regional Rural Development Bank
- **SBS** Samurdhi Bank Society
- **SEEDS** Sarvodaya Economic Enterprise Development Services
- **TCCS** Thrift and Credit Co-operative Society
- **TSP** Technical Service Provider
- **UNDP** United Nations Development Programme
- **WDC** Women's Development Co-operative

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1. Country Profile

Located at the southern tip of India, Sri Lanka has a population of 20.01mn. Compared to other South Asian countries, Sri Lanka displays relatively favourable socio-economic indicators. GNP per capita is $ 1,599[1], the 2nd highest in South Asia after the Maldives. The population living below the National Poverty Line is officially 15.2%[2] although the World Bank estimates it to be around 34% based on their international poverty line of $2/day.[3] Based on an average household size of 5 persons, the World Bank estimate translates to around 1.3 million poor households. Average life expectancy at birth is 75 years and the overall literacy level is 92.5%, with female literacy at 90.6%. However, these figures mask wide regional disparities. Economic activity is concentrated in the relatively prosperous Western Province which accounted for over 50% of GDP in 2006, while all other provinces in the country each contributed less than 10% of GDP. Moreover, more than 70% of the country's population is concentrated outside the Western Province. In the 2007 Key Indicators of the Asian Development Bank, Sri Lanka has a higher Gini coefficient than other South Asian countries such as India, Pakistan or Bangladesh, implying a more unequal distribution of income[4].

1 Central Bank of Sri Lanka Annual Report 2007
2 Department of Census and Statistics, Sri Lanka – Household Income and Expenditure Survey 2006/07. The national poverty line is at Rs. 2,233/- per person per month (approx. $0.67/day).
3 World Bank PovCalNet October 2008 (Sri Lanka estimate based on 2005 data).
4 2007 Key Indicators, Asian Development Bank

A summary of key economic and social indicators for Sri Lanka is given in Table 1 below. See Annex 1 for a more comprehensive list of indicators.

Table 1

Indicators	2005	2006	2007
Total Population ('000)	19,668	19,886	20,010
Population Annual Growth rate (%)	1.00	1.10	1.10
Population below poverty line (Poverty Head Count Index) (%)	22.7 (2002)	15.2	15.2
Literacy rate (%) (2003/2004)	92.5	92.5	92.5
Percentage of population living in rural areas (%)	(1981) 72.2	(1981) 72.2	(1981) 72.2
Life Expectancy	(2004)		
Male	71.7	71.7	71.7
Female	77.0	77.0	77.0
GNP per capita (US$)	1,226	1,402	1,599
GNP growth rate (%)	6.0	7.5	7.1
Inflation rate (%)	11.6	13.7	17.5
Annual average exchange rate (Rs./US $)	100.50	103.96	110.62

2. Financial Sector

Sri Lanka's financial system is comprised of a variety of institutions which include the Central Bank of Sri Lanka (CBSL), commercial banks, specialized banks, finance companies, specialized leasing companies, insurance companies, unit trusts, merchant banks, venture capital companies, authorized primary dealers, stock brokers and dealers, and contractual savings institutions such as the Employees' Provident Fund and the Employees' Trust Fund. These institutions operate within the formal financial markets such as the money market, bond market, foreign exchange market and the equity market and are supported by a financial infrastructure consisting of the payments and settlement systems and an applicable legal framework.[5] There are also a number of rural banks, thrift and credit co-operative societies, pawnbrokers as well as microfinance institutions (both NGOs and companies, collectively referred to in this report as NGO-MFIs) in operation. In addition, there is a thriving informal financial system which includes a large number of moneylenders, ROSCAs, etc.

Table 2 provides a breakdown of the total assets and deposit liabilities of the major financial institutions comprising the financial sector.

The commercial banks dominate the financial system. There are currently 23 licensed commercial banks operating in Sri Lanka. Of these, the largest in terms of assets and outreach, are the state-owned

5 Central Bank of Sri Lanka – Financial System Stability Review 2007.

Table 2

Total Assets and Deposit Liabilities of the Main Institutions in the Financial System June 2007[5]

	Assets		Deposit Liabilities	
Financial Institution	Rs. bn.	% Share	Rs. bn.	% Share
Central Bank of Sri Lanka	544.5	13.5	n.a	n.a
Institutions Regulated by the Central Bank	3,111.5	77.2	1,669.3	98.2
Deposit Taking Institutions	2,459.3	61.0	1,669.3	98.2
Licensed Commercial Banks	1,964.4	49.0	1,335.4	78.5
Licensed Specialized Banks	371.6	9.2	267.0	15.7
Registered Finance Companies	123.3	3.1	66.9	3.9
Other Institutions	652.2	16.2	n.a.	n.a.
Employees' Provident Fund	516.0	12.8	n.a.	n.a.
Primary Dealers	53.0	1.3	n.a.	n.a.
Specialized Leasing companies	83.2	2.1	n.a.	n.a.
Institutions not Regulated by the Central Bank	376.2	9.3	31.1	1.8
Deposit Taking Institutions	33.4	0.8	31.1	1.8
Rural Banks	28.5	0.7	26.4	1.6
Thrift and Credit Co-operative Societies	4.9	0.1	4.7	0.3
Contractual Savings Institutions	309.4	7.7	n.a	n.a
Employees Trust Fund	71.9	1.8	n.a	n.a
Private Provident Funds	112.6	2.8	n.a	n.a
Insurance Companies	124.9	3.1	n.a	n.a
Other Specialized Financial Institutions	33.4	0.8	n.a	n.a
Merchant Banks	31.3	0.8	n.a	n.a
Venture Capital Companies	1.4	0.0	n.a	n.a
Unit Trusts	5.2	0.1	n.a	n.a
Stock Broking Companies	4.8	0.1	n.a	n.a
Credit Rating Agencies	0.7	0.0	n.a	n.a
Total	**4,032.2**	**100.0**	**1,700.4**	**100.0**

Bank of Ceylon and Peoples' Bank. Various moves to radically reform and restructure these two banks have usually been resisted by political groups and also the trade unions of the two institutions.

Of the remaining licensed commercial banks, 9 are locally owned and the other 12 are foreign banks.

The banking sector is becoming increasingly competitive, encouraging the introduction of modern technology and other innovative means of improving service quality in a bid to stay ahead. The availability of modern services such as automated teller machines, credit cards, and telephone banking services continues to increase rapidly. Competition has also encouraged financial deepening as formal financial institutions seek to reach lower income clients.

6 Central Bank of Sri Lanka; GTZ-ProMiS "Microfinance Institutions in Sri Lanka"; Insurance Board of Sri Lanka; Sanasa Federation.

While the licensed commercial banks engage primarily in traditional banking activities, licensed specialized banks (LSBs) engage in more narrowly defined business functions. LSBs are not permitted to offer current (checking) accounts but are permitted to offer savings accounts. Among the 15 LSBs are the 6 Regional Development Banks (RDBs) established under an Act of Parliament for the purpose of developing and promoting economic activity in specified regions. The operations of the RDBs cover all districts of Sri Lanka except those of the conflict affected Northern Province and some districts of the Eastern Province which have been similarly affected. Other LSBs such as the state-owned Lankaputhra Development Bank and the SME Bank, which were merged into a single entity with effect from January 2008, also have a similar mandate to the RDBs and serve principally small and medium scale entrepreneurs.

Table 3

Deposit and Loan Portfolios of Financial Institutions[6]

Category		Volume (Rs. Million)	Number of Accounts
I. Licensed Commercial Banks			
	Savings and Deposits	1,458,536 (end Mar 08)	n/a
	Loans	1,379,413 (end Mar 08)	n/a
II. Licensed Specialized Banks			
	Savings and Deposits	288,018 (end Mar 08)	n/a
	Loans	171,254 (end Mar 08)	n/a
III. Registered Finance Companies			
	Savings and Deposits	78,202 (end 2007)	n/a
	Loans and advances	106,211 (end 2007)	n/a
IV. Thrift & Credit Co-operative Societies			
	Savings and Deposits	3,870 (end 2007*e*)	n/a
	Loans	3,564 (end 2007*e*)	214,803
V. Co-operative Rural Banks			
	Savings and Deposits	31,998 (end 2007)	6,608,318
	Loans	21,712 (end 2007)	1,314,862
VI. Samurdhi Bank Societies			
	Savings and Deposits	17,614 (end Jun 2007)	5,873,224
	Loans	7,785 (end Jun 2007)	656,330
VII. Insurance Companies			
	Total sum Insured (Life Insurance)	408,016 (end 2007)	1,923,550
	Total premium collected (Life Insurance)	18,148 (end 2007)	
	Net premium (General Insurance)	22,687 (end 2007)	

e estimated

The single largest LSB is the state owned National Savings Bank.

Registered finance companies, of which there were 31 as at end June 2007, are permitted by CBSL to accept public deposits, unlike the leasing companies. However, the Finance Leasing Act was recently amended to allow leasing companies to raise funds from the public through the issue of debt securities. Leasing companies are generally affiliated to banks or finance companies in order to meet their funding requirements.

In addition to the commercial banks, specialized banks and finance companies, there is a network of other deposit taking institutions in the form of rural banks and thrift and credit co-operatives. These are member owned and are permitted to mobilize deposits from, and extend loans to, their membership. They include 1,628 Co-operative Rural Banks (CRBs), which represent the banking arm of the Multi-Purpose Co-operative Societies (MPCS); and 8,440 Thrift and Credit Co-operative Societies (TCCSs), first established in the early 1900s and later revived as the SANASA system. There is also a network of 1,038 Samurdhi Bank Societies (SBSs) which are operated through the Samurdhi Development Programme, a government initiative aimed at poverty reduction. All these institutions play an important role in providing financial services to the rural sector and to low income groups.

As at end December 2007, the licensed commercial banks and licensed specialized banks operated through a total of 4,830 branches. The SBSs and CRBs operated through 2,666 branches. SANASA officially lists close to 8,500 outlets but less than half of these are operational. Annex 2 sets out the branch distribution of banks and other financial institutions operating in the country.

Table 3 indicates the portfolio volumes for the different types of financial institutions which make up Sri Lanka's financial sector.

3. Regulators

The Central Bank of Sri Lanka (CBSL) regulates and supervises the commercial and specialized banks, finance companies, leasing companies and primary dealers, while the Securities and Exchange Commission of Sri Lanka is responsible for supervising the stock exchange, stock- broking and dealing firms, unit trusts, venture capital companies, investment managers, margin providers and credit rating agencies. The Insurance Board of Sri Lanka supervises insurance companies and brokers. CBSL is also responsible for overseeing the major payment and settlement systems.

The specific laws applicable to financial sector institutions in Sri Lanka are:

- **Banking Act No.30 of 1988** (amended by Act No. 33 of 1995, Act No. 2 of 2005, Act No. 15 of 2006 and Act No. 46 of 2006). This law applies to licensed commercial banks and licensed specialized banks. Banking licenses are issued by the Monetary Board of CBSL with the approval of the Minister of Finance. Regulation and supervision is carried out by the Bank Supervision Department of CBSL.
- **Finance Companies Act No.78 of 1988** (amended by Act. No.23 of 1991). This law applies to all registered finance companies. License to carry on business is issued by the Monetary Board of CBSL. Regulation and supervision is carried out by the Department of Supervision of Non-Bank Financial Institutions of CBSL. In 2005, CBSL permitted registered finance companies to start accepting public deposits.
- **Finance Leasing Act No. 56 of 2000**. This law applies to all leasing companies. Leasing business cannot be engaged in without a certificate of registration. Regulation and supervision is carried out by the Department of Supervision of Non-Bank Financial Institutions of CBSL. Leasing companies are not permitted to accept public deposits but recent amendments to the law allow the issue of debt securities to the public. Many leasing companies are affiliated to banks or registered finance companies.
- **Regulation of Insurance Industry Act No. 43 of 2000**. There are currently 16 companies licensed under this Act. The Insurance Board of Sri Lanka which is established under the Act, is responsible for regulation and supervision. Insurance broking firms are also required to register with the Insurance Board. There is also a network of insurance agents, appointed and registered by insurance companies and insurance brokers.[7] These agents play a key role in marketing insurance products.
- **Unit Trusts**, of which there are 5, are licensed and supervised by the Securities and Exchange Commission of Sri Lanka under the Unit Trust Code.

Other important laws which govern the financial sector are the Monetary Law Act, the Exchange Control Act, the Payment and Settlement Systems Act, the Financial Transactions Reporting Act, the Securities and Exchange Commission of Sri Lanka Act, the Local Treasury Bills Ordinance and the Registered Stock and Securities Ordinance.[8] The Regional Development Banks Act No 6 of 1997, the Cooperative Societies Act No. 5 of 1972, and the Samurdhi Authority Act No. 30 of 1995, govern institutions which are involved in the provision of microfinance services. The next chapter addresses the issue of regulation of the microfinance sector in more detail.

7 http://www.ibsl.gov.lk
8 Central Bank of Sri Lanka

4. Microfinance in Sri Lanka

The microfinance movement in Sri Lanka dates as far back as 1906 with the establishment of Thrift and Credit Co-operative Societies (TCCSs) under the Co-operative Societies Ordinance introduced by the British colonial administration. These were the first credit co-operatives to be established in Sri Lanka. The societies fulfilled a wider role during the early decades of the 20th century, being involved also involved in procurement of inputs and distribution of products, a role eventually taken over by the Multi-Purpose Co-operative Societies (MPCSs) which were originally established during the 1940s as Consumer Co-operative Societies and renamed Multi Purpose Co-operatives in the 1950s.

The network of TCCSs was weak and in decline by the late 1970s and there were plans to wind up many societies. It was that this time that a revival of the movement was initiated by the charismatic P.A.Kiriwandeniya, with the TCCSs being re-organized under a new name: SANASA. The SANASA TCCSs are member owned societies, grouped together as a Federation but coming under the purview of the Department of Co-operative Development. Parallel to the SANASA TCCSs are the MPCSs and their financial service arms, the Co-operative Rural Banks (CRBs). The MPCSs and CRBs also fall under the purview of the Department of Co-operative Development.

Commencing in 1985 the Government established 17 Regional Rural Development Banks (RRDBs) through an Act of Parliament. These institutions were given the task of reaching remote rural areas and smallholders who lacked access to financial services from commercial banks. The RRDBs covered all districts of Sri Lanka with the exception of the North and East. Their success, however, was limited by internal structural weaknesses and excessive geographical fragmentation, which prevented them from reaching a critical mass. In addition, the banks lacked sound lending and monitoring policies, and operations were difficult to improve and standardize. A significant restructuring and recapitalization took place in 1998-1999 and the RRDBs were consolidated into the six Regional Development Banks (RDBs) which exist today. This involved granting RDBs more autonomous management, allowing a broader ownership base, and having board members appointed by shareholders, with the intention of creating more professionalism of operations and, thus, their viability and sustainability in the long-term.[9]

The Government of Sri Lanka recently announced plans to merge all six RDBs into one Development Bank which would operate nationwide. However, at the time of writing this report, the merger is still to take place.

The late 1980s and 1990s saw the entry of several local and international NGOs into the microfinance business. Many of these NGO-MFIs originally combined microfinance activities with other social and community development activities. However, in the very recent past there has been an emerging trend of separation of the microfinance and non-microfinance activities of some of these institutions.

The Government plays a key role in the delivery of microfinance services. Various Government initiatives in the microfinance sector have been implemented from time to time. These are addressed in more detail in the section titled "Government Policy". According to the "Mahinda Chintana", the 10 year development framework of the present government, around 65% of microcredit in Sri Lanka is provided through the government. The Samurdhi Development Programme which was introduced in 1995, replacing the previous Janasaviya Programme, is the largest of these initiatives. The Programe has a savings and credit component which is administered through the network of 1,038 member-owned, Samurdhi Bank Societies (SBSs).

Following the tsunami which struck Sri Lanka in 2004, there was an influx of foreign aid to the country, of which a substantial amount was channeled to the microfinance sector. While many donors worked through established microfinance institutions, some funded the establishment of multi-sectoral livelihood programmes which included microfinance components. These were largely unsustainable in the long-term and had some detrimental effects on the sector in the short term through their mix of grants and subsidized loans and the resulting damage done to the established credit culture. Regional microfinance institutions such as BRAC of Bangladesh

9 National Microfinance Study of Sri Lanka, 2002 by Gant, de Silva, Atapattu and Durant; Fitch Ratings, Sri Lanka Special Report, Regional Development Banks, November 2006.

also entered the sector after the tsunami and rapidly scaled up to become a significant player among NGO-MFIs, achieving an outreach of 75,000 microfinance clients in just 4 years.

A recently emerging trend is the entry of commercial banks and registered finance companies and other large corporate entities into the microfinance business. Hatton National Bank's "Gami Pubuduwa" ("Village Awakening") microfinance programme is probably the oldest microfinance programme among the licensed commercial banks, having been established in 1989 and disbursing over Rs. 3.5 Bn (approximately US$ 35 Mn) to around 70,000 micro entrepreneurs over the years. Some recent entrants are aggressively moving into the sector and have the resources and infrastructure to scale up rapidly. However, for many commercial banks and finance companies, microfinance is more a Corporate Social Responsibility (CSR) or image building activity.

As mentioned below in the section on regulation, the absence of a cohesive regulatory and supervisory system for the microfinance sector is one of the barriers to the future growth of the sector. With donors moving out of the Sri Lankan microfinance sector, funding becomes a key issue, especially for NGO-MFIs, which are restricted by law from accepting public deposits and further restricted from obtaining off-shore debt and equity funding due to prevailing exchange control restrictions. Accessing local funding is also somewhat of an issue as local banks and other funding agencies are still reluctant to lend to or invest in the microfinance sector due to the perception of high risk.

Regulation of the Microfinance Sector

The absence of a cohesive regulatory and supervisory system for the microfinance sector has been one of the barriers to the growth of the sector. Various providers of microfinance, especially those which are owned by or linked to the state, are regulated and supervised by different entities e.g. the SBSs are regulated by the Samurdhi Authority of Sri Lanka; the CRBs are regulated by the Department of Co-operative Development; the RDBs, as licensed specialized banks, fall under the purview of CBSL. However, the methods and standards of supervision vary widely and the absence of a single regulatory and supervisory authority has resulted in the lack of uniform standards and development of a common direction. Furthermore, there are a large number of NGO-MFIs which are entirely unsupervised and whose microfinance activities are not governed by specific regulations. To remedy this situation, CBSL drafted a Microfinance Institutions Act (MFI Act), by which it was proposed to regulate and supervise microfinance institutions (MFIs). However, a large number of microfinance providers would still have been excluded from under the proposed Act as all the RDBs, registered finance companies, building societies, co-operative societies and some not-for-profit organizations were exempted from the requirement to obtain a license to operate from CBSL. The SBSs were not mentioned at all and it was not clear whether they would be regulated by the Act. MFIs which were required to obtain a license under the Act were also expected to meet certain capital requirements depending on their scale of operations. The proposed Act would have permitted the licensed MFIs to accept public deposits. This is currently not possible for institutions other than those which are regulated and supervised by CBSL (e.g. the RDBs and registered finance companies) or those established as co-operative societies and building societies which are restricted to accepting deposits from their members.

The proposed MFI Act, if it had been implemented, would also have exempted licensed MFIs from the provisions of the Money Lending Ordinance. Microfinance is currently classified as a money lending business and therefore restricted from obtaining offshore equity investment into such business. This has a negative impact on a number of large, better performing, unregulated MFIs which are unable to access offshore equity capital which could enable them to scale up their operations.

The attempt to introduce a regulatory and supervisory system for the microfinance sector has been going on for a number of years. Many MFIs and other sector stakeholders have expressed concern over some provisions in the draft document released by CBSL. However, at the time of writing this report, the draft MFI Act has been withheld for restructuring and possibly, significant amendment. It is not known when the amended Act would be available and submitted to Parliament for approval.

5. Microfinance Providers

Microfinance Providers

Sri Lanka's microfinance sector is served by a diverse range of institutions. These can be segregated into the following broad categories. (A brief profile of the institutional types may be found in Annex 3).

- Regional Development Banks and other licensed specialized banks
- Co-operative Rural Banks and other co-operatives
- Thrift and Credit Co-operative Societies (TCCSs/ Sanasa societies)
- Samurdhi Bank Societies (SBSs)
- NGO-MFIs
- Other financial institutions (this category includes commercial banks, registered finance companies, etc, which offer some microfinance services).

Network of Microfinance Outlets

The CGAP CLEAR Review of 2006 estimates that there are over 14,000 providers of microfinance in Sri Lanka. This includes the network of Sanasa societies of which there are officially 8,440. However, more than 50% of these are inactive, according to Sanasa. In reality, therefore, the number of active providers of microfinance is probably less than 14,000. An island-wide survey of microfinance institutions (hereafter referred to as the MFI survey) commissioned by the GTZ - ProMiS (Promotion of the Microfinance Sector) programme in 2006/2007 reveals a network of at least 10,000 outlets which are active across the country.

A breakdown of this is given below:

Table 4

Type of institution	No. of outlets
RDBs	215 branches
Other licensed specialized banks Sanasa Development Bank	36 branches
Samurdhi Bank Societies	1,038 societies
CRBs & Women's Development Co-operatives	1,684
Sanasa/TCCSs	3,794 active societies
Other MFIs (NGOs/Limited liability companies/companies limited by guarantee)	2,500[10]
Total (excluding banks & other financial institutions)	**9,267**[11]

10 Based on the outlets maintained by the largest MFIs

11 Banks such as People's Bank, Bank of Ceylon, Hatton National Bank, Sampath Bank, and non-bank institutions such as LOLC are also known to offer microfinance products. Some institutions offer their microfinance products through their entire branch network and others only through selected branches. People's Bank, with 324 branches, offers their People's Fast microfinance loans through their entire branch network. Information gathered through the MFI survey indicates that around 1,200 branches of Banks and Other Financial Institutions offer microfinance products. When all these outlets are added to the figure above, the total number of available microfinance outlets increases to over 10,000.

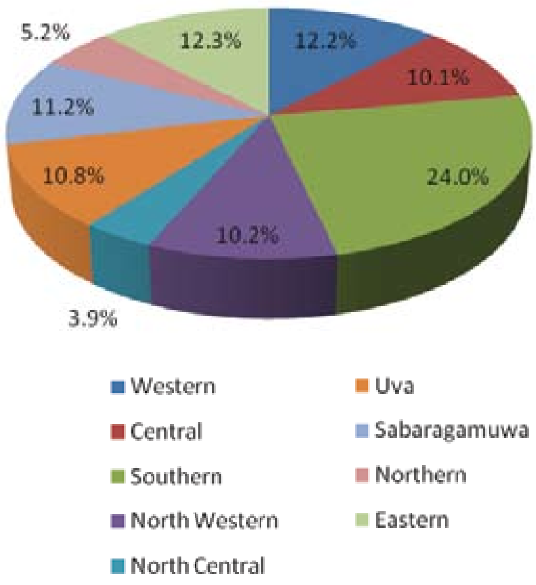
Regional Coverage

The regional and sectoral distribution of microfinance outlets is depicted in Figures 1 and 2 below, based on the MFI survey.[12] Although 3 of the country's 25 districts could not be covered (see footnote), the MFIs which were covered by the survey include all the large providers of microfinance in the country, therefore the data given below is considered to be quite comprehensive.

The regional distribution depicted in Figure 1 covers 7,141 microfinance outlets of the MFIs which participated in the survey. It includes all the RDBs, all the SBSs and the 3,794 active societies of Sanasa. It also covers over 85% of CRBs and 83 NGO-MFIs. Given our estimate of c. 10,000 microfinance outlets in the country, the regional distribution depicted below covers at least 70% of outlets. There is clearly a strong presence of MFIs in the Southern Province, with nearly a quarter of outlets located there. On the other hand, the predominantly agricultural North Central Province is relatively underserved accounting for 3.9% of outlets. The conflict affected Northern Province accounts for 5.2% of outlets based on the information from the survey. However, this is likely to be understated as all districts of this province could not be covered.

12 It should be mentioned that 3 districts in the North (namely Kilinochchi, Mullaittivu and Mannar) could not be included in the survey due to the unfavourable security situation in these areas. Further, MFIs with a client base of less than 500 (less than 100 in the Northern and Eastern provinces), were excluded from the survey.

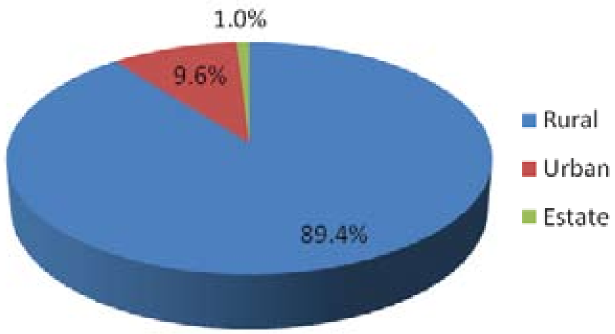
Figure 1 - MF Outlets by Province



Sectoral Distribution of Outlets

Microfinance in Sri Lanka is clearly concentrated in rural areas. Almost 90% of the 7,141 outlets represented in Figure 2 are located in areas classified by the Department of Census and Statistics as "Rural". Less than 10% of outlets are located in urban areas and only 1% in the estate sector. This latter fact especially, points to a vacuum in terms of availability of microfinance services in the estate sector where the poverty headcount is nearly 17 percentage points higher than the national average. In fact, according to data published by the Department of Census and Statistics, while the national poverty headcount index has decreased from 22.7% in 2002 to 15.2% in 2006/07, in the estate sector the index has increased from 30% to 32% during the same period.[13]

Figure 2 - MF Outlets by Sector



13 Household Income and Expenditure Survey 2006/07 – Department of Census and Statistics Sri Lanka

Distribution of Outlets vs. Poverty Distribution

The 2006/2007 Household Income and Expenditure Survey of the Department of Census and Statistics (DCS) sets the National Poverty Line for Sri Lanka at Rs.2,233/- per person per month. Based on this, the percentage of persons whose monthly income is below the poverty line has been estimated by the DCS for all provinces except the Northern Province which could not be surveyed due to the prevailing conflict. In the Eastern Province, the Trincomalee District was excluded for the same reason. While these exclusions have an impact on the data, and therefore caution should be exercised when drawing conclusions, it is clear that at least on the surface, the Southern Province appears heavily over-served relative to poverty levels. On the other hand, the Central and Sabaragamuwa Provinces appear to be quite under-served relative to their poverty levels. It is noted that the picture for the Eastern Province appears to be flawed, as the impression created is that this province is quite over-served by microfinance institutions as the DCS data indicates that it contributes least to total poverty levels in the country. This is highly unlikely as this is a province that has been conflict affected for several years and it is likely that the large number of displaced people as well as the exclusion of the Trincomalee District from the survey has distorted the results of the DCS survey.

Table 5

Province	Outlets (%)	Contribution to total poverty (%)[14]
Western	12.9	16.8
Central	10.7	20.4
Southern	25.4	12.1
North Western	10.8	12.2
North Central	4.1	6.0
Uva	11.4	12.3
Sabaragamuwa	11.8	16.6
Eastern	13.0	3.6

14 Poverty Indicators, Household Income and Expenditure Survey 2006/07 – Department of Census and Statistics, Sri Lanka.

Client Outreach

The total client base of MFIs is difficult to estimate as many institutions do not maintain records on a client basis but on an account basis e.g. loan and savings accounts separately. Since one client could have multiple accounts with the institution, the total number of accounts probably overestimates the client outreach of the institution. This problem, which is at individual MFI level, is further complicated for microfinance sector as a whole, due to individuals having accounts with multiple institutions[15]. As a rough guide, the data on microfinance clients gathered in the MFI survey is presented below:

- **RDBs –** the RDBs estimate, on average, 86% of their business is microfinance. The microfinance client base is estimated at 1.85 million people However, only one of the six RDBs collects data on clients while the remaining five estimate their client base from the number of accounts.
- **SBSs -** serve a total of 2.3 million members and another 227,000 non-member clients. Non-members can hold savings accounts with the SBSs but are not entitled to loans.
- **CRBs & Women's Development Co-operatives (WDCs) –** Data on the number of clients reached is not available but Central Bank data indicates c. 1.5 million loan accounts and 6.5 million savings accounts across 1,608 CRBs as at Dec 2006. Even allowing for multiple accounts, it is likely that the CRBs reach around 4-5 million people.
- **Sanasa/TCCSs –** The total membership of the Sanasa TCCSs is estimated at 866,611 as at end 2006. In addition, the TCCS Union of Jaffna, which is independent of the Sanasa movement, is estimated to reach a client base of 12,000.[16]
- **Other MFIs (NGOs/Limited liability companies/ companies limited by guarantee) –** based on the MFI survey and other published information, the outreach of the NGO MFIs and other MFIs is estimated to be at least 1,000,000 clients.

15 A household survey conducted by the Institute of Policy Studies Sri Lanka in 2006/07 found that around 50% of households access multiple financial institutions.

16 Microfinance – NGO Institutional Needs Assessment Survey – ADB RFSDP Project, May 2006

Detailed information is not available on the formal financial sector institutions such as banks which have ventured into microfinance. According to the MFI survey, the microfinance client base of this group (excluding the mammoth People's Bank) is 935,000. However, the definition of microfinance among this group of institutions could be different to commonly accepted definitions.

Even allowing for overlapping of clients across the different institutions, there seems to be considerable breadth of microfinance outreach in Sri Lanka. The depth of this outreach, i.e. the extent to which microfinance reaches down through the poverty levels, is addressed in the following section.

Depth of Outreach

The income distribution of microfinance clients according to data gathered in the MFI survey is presented in Table 6 below.

From the available information, it appears that the SBSs and the NGO-MFIs have the greatest depth of outreach, with 85% and 50.4% of clients respectively having a monthly household income of less than Rs. 3,000/-. For the NGO-MFIs, nearly 82% of their clients have a monthly household income of less than Rs.5,000. The RDBs clearly serve a different market segment, with over 50% of their clients falling into the Rs.5,000-20,000 range of monthly household income.

Product Portfolio

A diversity of products is not seen in the microfinance sector. Although many institutions have broad product portfolios, these essentially consist of a proliferation of loan and savings products which differ mostly in name but offer more or less the same features, although the loan period may differ.

Licensed specialized banks such as the RDBs and Sanasa Development Bank are permitted to mobilize deposits. Institutions registered as cooperative societies are also permitted to accept member deposits. However, in practice, many NGO-MFIs do also accept deposits on a limited scale. Many microfinance providers impose compulsory savings requirements as a pre-condition to obtaining a loan.

The loans and advances and deposit base of the large institutional groups of microfinance providers is indicated in the following table:

Table 7 - Loan Portfolio and Deposit Base

	Loans (Rs.000)	Deposits (Rs.000)
RDBs*	19,418,585	18,750,757
SBSs	7,785,081	20,810,360
CRBs**	14,620,570	25,311,550
Sanasa/TCCSs***	4,025,124	3,936,818

Note: sufficient information is not available on 'Other MFIs'.

** RDB Annual Reports 2006*

*** Central Bank of Sri Lanka Annual Report 2006*

**** Sanasa Statistical Report 2006/2007. Figures quoted are for end 2006*

Table 6 - Income Profile of Microfinance Clients

	< Rs.3,000	Rs.3,000-5,000	Rs.5,000-10,000	Rs.10,000-20,000	Rs. 20,000-40,000	> Rs. 40,000
RDBs	19.3%	18.3%	24.2%	28.3%	7.5%	2.3%
SBSs*	85.0%					
CRBs/WDCs	n/a	n/a	n/a	n/a	n/a	n/a
Sanasa/TCCSs	20.1%	29.4%	26.3%	14.7%	5.3%	4.3%
Other MFIs**	50.4%	31.5%	13.3%	3.0%	1.6%	0.3%

*n/a – not available   * a breakdown was not provided for the remaining 15% of SBS clients   ** based on the information provided by 64 MFIs*

The SBSs and CRBs, in particular, exhibit a low level of financial intermediation with deposits exceeding loans by around 2 to 2.5 times.

Pawning is offered by the RDBs, Sanasa, CRBs and other MFIs such as SEEDS as well as licensed commercial banks. The People's Bank has a particularly large pawning portfolio and the RDBs as a group have a larger number of pawning accounts than loan accounts.

Products such as micro-insurance are offered by very few institutions. Some retail the products of registered insurance companies while others have developed their own products, although according to the law it is necessary to be registered with the Insurance Board of Sri Lanka in order to carry out insurance business. Likewise, leasing is offered by very few institutions since the law requires a special license to be obtained in order to engage in leasing. The high capital requirements which are a pre-condition for engaging in both insurance and leasing business virtually exclude traditional MFIs from obtaining licenses for these activities.

Lending Conditions

Collateral

While a few microfinance providers (some RDBs, Sanasa and CRBs) require physical collateral, especially for higher value loans, virtually all rely on collateral substitutes such as guarantors and compulsory savings balances. Others retain an installment of the loan as security or charge a nominal sum which goes towards a general "loan security fund". Some CRBs and NGOs interviewed in the MFI survey also required the purchase of insurance to cover the loan capital.

Interest rates

Information gathered in the MFI survey indicates annual interest rates on loans from around 6% to a maximum of 36% (some NGO-MFIs). The 6% loans represent subsidized credit lines made available by the Central Bank after the tsunami to participating financial institutions (PFIs) at 3% with the proviso that the rate to the end borrower would be 6%. One or two CRBs and Sanasa societies report lower than 6% lending rates but it is unlikely that these are actually annual rates.

In general, the institutions calculate interest on declining balances but there a few which adopt the "flat method" of calculating interest, making effective interest rates higher than what is reported. Generally, there is a lack of transparency about the method of calculating interest and clients can be misled by reported rates which appear to be "cheaper".

Institutions offering pawning facilities charge a higher rate for this service, ranging from 14% to 24% per annum. However, it should be noted that the transaction costs for this service are typically lower than for other loans.

In comparison, the average interest rate offered on savings accounts and fixed deposits (usually not exceeding one year) broadly averages around 6% per annum on savings accounts although the interest rate on fixed deposits can go up to as high as 18%-19% per annum in some cases.

It is to be noted that in an environment where annual inflation rates averaged over 15% in 2006 and 2007 and climbed even higher subsequently, both lenders and borrowers are earning very low or negative interest rates.

Loan period

Loans are given for periods ranging from 1 month to around 5 years (usually for housing loans). However, a small number of institutions (some CRBs and Sanasa societies) report longer term loans going up to 10-12 years.

6. Access to Financial Services

The following is based on a survey of approximately 3,000 households across 22 districts of Sri Lanka in 2007[17]. The results of the survey indicate that 82.5% of households have obtained financial services from FIs, by depositing their savings in an FI and/or obtaining a loan from an FI. Further, nearly 50% of households have accessed multiple FIs for their financial needs. The utilization of savings facilities is considerably higher than the utilization of credit – nearly 75% of households have saved with an FI compared to only 47% of households having obtained loans from an FI. The former is confirmation of the strong savings culture in the country.

However, the overall figures hide the disparities which exist at various levels. In the estate sector, 25% of households have not utilized the services of an FI compared to 17.5% and 15% of rural and urban households respectively.

Type of Institution Accessed

The state banks play a key role in providing financial services. It was found that 72% of households which had utilized the services of FIs had accessed the state banks. The People's Bank, in particular, plays a dominant role in this regard. Domestic private banks have been accessed by 30% of households utilizing financial services and interestingly, 25% of households which have utilized financial services have done so through the Samurdhi Bank Societies (SBSs). Since the SBSs are essentially microfinance institutions targeting very low income households, this is an indication of the outreach of microfinance.

The outreach of microcredit is also evident in the fact that a higher proportion of households who have obtained loans from an FI, have obtained them from MFIs such as the RDBs, SBSs, Sanasa and NGO-MFIs, compared to the domestic private banks and foreign banks. Interestingly, 26% of households with loans have obtained them through the SBSs. However, the state banks as a group remain the largest provider of credit, with People's Bank being the dominant institution. The CRBs, despite a large network of outlets, seem to play a relatively less significant role. Only 5% of households who have obtained loans have accessed the CRBs for this purpose.

With regard to savings, again the state banks dominate, particularly the People's Bank (48% of households with savings) and also to a lesser extent, the Bank of Ceylon (36% of households with savings). The domestic private banks also play a significant role (utilized by 30% of households with savings) as do the SBSs (21% of households with savings) and RDBs (12% of households with savings).

Borrowings and Savings of Households

The average loan size for a household during the 3 years preceding the survey is less than Rs.100,000 (c. Rs. 84,000). Over 80% of households have borrowings not exceeding Rs. 100,000. However, there are marked differences across sectors and regions. In the estate sector, over 87% of households have borrowings below Rs. 50,000. Average loan size in an urban household is more than 10 times the average loan size in the estate sector and more than twice that of a rural household. Similarly, in the relatively more affluent Western Province, average loan size is c. Rs 162,000, almost twice the national average and almost 6 times higher than in the predominantly agricultural North Central Province where the average loan size is around Rs. 27,000.

Over 80% of households have savings of less than Rs. 50,000. The national average is c. Rs. 22,000. However, the disparities at the sectoral level are not as large as in the case of loans. The average savings of an urban household is around twice the national and rural averages and four times that of an estate household. However, since the savings here represent financial savings and estate households could be saving in other forms (e.g. jewellery), savings picture for

17 The survey was conducted for GTZ-ProMiS (Promotion of the Microfinance Sector) by the Institute of Policy Studies (IPS), Sri Lanka. The objective of the survey was to assess the extent of utilization of financial services offered by formal and semi-formal financial institutions (FIs) in Sri Lanka, with a special focus on microfinance services. The definition of FIs for the survey, encompassed not only commercial banks, finance companies and leasing companies but also CRBs, Samurdhi Bank Societies and NGO-MFIs.

The districts of Kilinochchi, Mannar and Mullaitivu in the Northern Province could not be covered due to the prevailing conflict situation in the area.

estate households may be somewhat understated. Although a large number of households in the country save with FIs, the average savings deposits are relatively small probably due to a combination of low savings capability and using other options for placing surplus funds e.g. in real estate, jewellery, etc. It is interesting that on a provincial level the highest average deposit size (more than double the national average) is in the conflict affected Northern Province.

Access to Financial Services by Gender

There are interesting patterns in the access of financial services by gender. Formal financial sector institutions such as the licensed commercial banks, both state-owned and private, the RDBs and finance and leasing companies, account for a majority (c. 61-68%) of male borrowers. On the other hand, institutions such as the SBSs, TCCSs, NGO-MFIs and Co-operatives (other than the CRBs) account for predominantly (c.60-67%) female borrowers. Since the latter group of institutions consists of microfinance providers, this is confirmation that microfinance in Sri Lanka serves mostly a female clientele.

A similar pattern emerges for savings with 60-66% of females preferring to save with the SBSs, TCCSs, NGO-MFIs and Co-operatives, while males showed a preference for the state-owned and private commercial banks.

Differences were found in the average borrowings according to gender. On average, males borrow 2.5 times more than females whereas the corresponding ratio for savings is only 1.3.

Purpose of Borrowing

Close to 30% of the number of loans taken by households and 40% of the value of loans taken are for construction. Loans taken for activities in the primary sectors of agriculture, livestock and fisheries account for nearly 20% of the number of loans taken but a considerably smaller percentage of the value of loans taken (c.6%). On a sectoral level, construction loans remain the most important in both the urban and rural sectors in terms of number and value. However, in the estate sector, the primary purpose of borrowing (both by number and value of loans) is for emergency purposes.

Use of Informal Credit

Although informal credit is believed to be quite widespread, the survey indicates that only 18.3% of households have borrowed from informal sources such as moneylenders, family, friends, neighbours, traders, landlords and Rotating Savings and Credit Associations (ROSCAS). In the estate sector, the use of informal credit is slightly higher than average (20.8%) while in the urban sector it is slightly lower (16.6%).

The role of the moneylender as a source of informal credit seems to be less important than is popularly believed. Family, friends and neighbours accounted for 62% and 72.9% of informal credit by number and value of loans respectively compared to 26.4% (number of loans) and 20.5% (value of loans) from moneylenders.

The main reason for borrowing from informal sources is to meet emergency needs. 45% of the number of loans and 22% of the value of loans taken from informal sources were stated to be for this purpose. 75% of those accessing informal sources of credit cited easy access/the ability to borrow money quickly as the principal reason for accessing informal credit while 67% also cited the lack of collateral requirements. Both are easily understandable in the light of the finding that informal credit is obtained mostly to meet emergency financial requirements.

Access to Financial Services Summarized

Several key points emerge from the findings of the household survey:

- Outreach of financial services is quite high with 82.55 of households having used the services offered by financial institutions
- There is a strong customer preference for state-owned institutions, probably due to the perception of safety and stability associated with these institutions and also due to easy accessibility as most of these institutions have widespread and extensive branch networks.
- Microfinance clearly plays an important role as a large proportion of households surveyed were found to have accessed microfinance institutions for credit although a lower number had utilized the savings facilities offered. One reason for the lower utilization of savings facilities of this group of institutions is that many MFI are prohibited by law from accepting deposits and are usually limited to member deposits only.
- Average borrowings and loan sizes are very much indicative of a microfinance market. Analysis by gender indicates that microfinance in Sri Lanka, as in many parts of the world, serves a predominantly female clientele.
- Informal sources of credit such as moneylenders are less significant than is popularly believed and are used primarily during emergencies where quick cash is required.

7. Meso Level Support for the Microfinance Sector

The CGAP Country-level Effectiveness and Accountability Review (CLEAR) for Sri Lanka states that the meso level of the financial system plays an important role in supporting the consolidation and expansion of retail providers and promoting transparency. The Sri Lankan financial sector in general has a fairly well developed meso level infrastructure. The sector is supported by a regulated capital market; rating agencies which have affiliations with international and regional agencies; a credit bureau; and ample accounting and audit capacity which include the large international accounting firms as well as a number of local firms. Specialized financial training is available, as is general management training, through universities and other educational institutions, some of which are affiliated to international universities. Modern information and communication technology is widely used in the formal financial sector.

Training/Consulting

In the microfinance sector, however, meso level resources are relatively scarce. Training facilities such as the Centre for Banking Studies of the Central Bank of Sri Lanka, the Bankers Training Institute and the Distance Learning Center offer various short training programmes in microfinance. The University of Colombo offers a 6 month diploma programme in microfinance but in general, academic courses in microfinance offered by the universities are very limited. Currently, a GTZ supported diploma programme in microfinance is in the process of being developed jointly by the Institute of Bankers of Sri Lanka and the Frankfurt School of Finance & Management.

Leading MFIs such as SEEDS and SANASA have their own specialized microfinance training centres but these facilities are used for their own staff. The co-operative sector and Samurdhi system also have their own staff training institutes.

In addition, various small and medium sized consulting firms offer general management consulting and entrepreneur development services to microfinance institutions and their clients. However, training and consulting service providers have traditionally been donor dependent as many MFIs have limited resources of their own to spend on training and capacity building. Furthermore, among the numerous small MFIs, there is limited recognition of the need for these services.

Networks

The sector is represented by the Lanka Microfinance Practitioners Association (LMPA) (http://lankamicrofinance.com), a network of MFIs. The association has a membership of around 80, consisting primarily of NGO-MFIs and also some meso level service providers. Originally known as the Lanka Microfinance Network, the association has been in existence since 2006 but is still very much in the early stages of development. The association is supported by GTZ and Plan Sri Lanka.

The LMPA has established a dialogue with policymakers and regulators and is working on developing a policy framework for the sector which would be presented to the relevant authorities. An initiative to build up a sector database along the lines of the MiX Market database is also underway and could serve as a foundation for future research studies on the sector.

Disclosure of information/ Credit bureaus

While information disclosure and transparency are still issues in the sector at large, there is increasing transparency among some of the leading MFIs. This has been driven by donor requirements and also by the need to access new sources of funding as the MFIs scale up their operations. Currently, 15 Sri Lankan MFIs report to the MiX Market. Sharing of credit information of clients is not practiced. The Credit Information Bureau (CRIB) of Sri Lanka counts among its members all the licensed commercial banks, the licensed specialized banks (includes the RDBs), leasing companies and finance companies. Membership of the CRIB is mandatory for these institutions. However, other than the RDBs and other leasing and finance companies which may have small microfinance operations, other MFIs are not members of the CRIB. This could change in the future if legislation governing the sector is introduced and membership becomes mandatory.

Apex funding agencies

There are 3 wholesale funding agencies operating in the Sri Lankan microfinance sector. These are the government owned National Development Trust Fund (NDTF), Stromme Microfinance, backed by the Stromme Foundation of Norway, and Consorzio Etimos, a funding agency based in Italy.

Audit

Audited financial information is available for the large and medium size MFIs. The SBSs are audited by the Samurdhi Authority and the CRBs and Sanasa societies are audited by the Department of Co-operative Development. Institutions such as the RDBs and MFIs incorporated under the Companies Act, are required by law to be audited annually. Donor requirements are usually a contributory factor in NGO-MFIs having their accounts audited. Sector knowledge among auditors is somewhat limited, and donors and other stakeholders have often mentioned the importance of building microfinance knowledge among the audit community. Furthermore, the quality of audit varies – the Samurdhi Authority and Department of Co-operative Development have limited resources relative to the number of SBSs/CRBs/TCCSs, and this could have a bearing on the depth and quality of the audit and the timely release of the audited statements.

The cost of engaging private audit firms is a deterring factor for smaller MFIs who do not have donor support to meet these costs. This was a matter of concern raised by many MFIs during the dialogue initiated by CBSL to obtain feedback on the draft MFI Act. The Act would have required all licensed microfinance institutions to submit audited financial statements to the regulatory authority after the close of each financial year.

Information Technology

The use of communication and information technology in the microfinance sector is quite limited. Until recently, even the large MFIs operated on a manual basis. Computerization of operations was introduced mostly within the past 5 years. Even now, though some MFIs have computerized their operations, few make optimal use of the system and few have a proper MIS. The limiting factors are low computer literacy as well as lack of awareness and training on how to analyze and interpret the information generated and use it as a tool in planning and decision making.

The MicroBanker (MBWin) software, a microfinance specific software was introduced by GTZ to several RDBs and some NGO-MFIs. A support centre for MBWin was also established locally. In addition, there are other locally developed software solutions for microfinance which are being used by some MFIs.

Internet access is limited among MFIs for a variety of reasons, principally cost, lack of necessary infrastructure (especially for MFIs located in rural areas) and the language barrier due to limited knowledge of English among MFI staff.

8. Government Policy

At present, there is no specific national policy for the microfinance sector in Sri Lanka. In consequence, there is no institutionalized mechanism to coordinate microfinance interventions with other policies which have been formulated for rural development and poverty alleviation[18]. Microfinance interventions have typically been included in general poverty alleviation programmes. Successive governments have introduced various programmes aimed at reducing poverty such as the Jansaviya programme of the 1980s followed by the Samurdhi programme introduced in the mid-1990s and more recently this issue was addressed in the Mahinda Chintana, the 10 year development framework of the present administration. According to the Centre for Poverty Analysis, a local research organization focusing on poverty related development issues, the effectiveness of these different programmes has been hindered by "political patronage and misallocation of resources"

The Mahinda Chintana mentions various strategies for development of the microfinance sector, among them the development of a national policy and strategy for the sector which would be formulated in coordination with relevant government agencies and in consultation with sector stakeholders. It states that *"the absence of a unique policy and supervisory framework has allowed the proliferation of fundamentally unsustainable MFIs, which weakens governance, diminishes the institutional autonomy, exacerbates the lack of enforcement of financial prudence and does not provide for transformation of MFIs and NGOs into depository institutions or regularize their savings activities".*

An early initiative to draft a policy document did not produce any results although an initial document was prepared after a dialogue with stakeholders. At present, the LMPA (practitioner network), is in the process of formulating recommendations for a future policy for the sector.

18 Mahinda Chintana : Vision for a New Sri Lanka

In setting out the goals for the microfinance sector, the Mahinda Chintana states that *"Sri Lanka will have a flourishing and strong microfinance sector in the next decade. It will involve the provision of sustainable and poverty focused financial services, which include loans to micro and small enterprises as well as to poor households for the most various needs. The mobilization of savings, transfers, and insurance services will also be undertaken in an effective and efficient manner."* The document goes on to state *"As a result of these developments, both unemployment and poverty in the country will drop by 2 percent".*

The strategies mentioned for achieving these goals include, in addition to development of a national policy, establishment of a regulatory and supervisory mechanism for MFIs through the Central Bank of Sri Lanka, reform of government run/controlled MFIs (the apex NDTF, CRBs and SBSs), capacity building at the meso level and strengthening of apex microfinance agencies. However, despite this plan being developed for the period 2006-2016, at the time of writing this report two years into this period, limited progress has been made on implementing these strategies.

9. Donor Support for Microfinance

Donor support for Sri Lanka's microfinance sector increased substantially following the 2004 tsunami which left the country with over 35,000 dead and over 800,000 displaced. The disaster was one of the worst in Sri Lanka's recorded history and the country was ill equipped to deal with its aftermath. A substantial part of the coastal areas was affected, covering 13 of the 25 districts. The Reconstruction and Development Authority (RADA) estimated that around 150,000 people lost their livelihoods due to the disaster. About 80% of those affected lost their main source of income, while 90% lost their main productive assets. Micro and small businesses in the fisheries, tourism, textiles, coir and carpentry industries were the most affected.[19]

In the wake of the disaster, there was an influx of donor funds into the country. These included funds for microfinance to be used during the rehabilitation and reconstruction phase after the initial relief phase. Large multi-lateral and bilateral agencies such as the ADB, JBIC and UNDP provided funding for microfinance through the Central Bank and the bulk financing apex agency, the NDTF. Some donors worked directly through existing NGOs and MFIs, but others created new microfinance programmes, especially in the south where existing MFIs already had a significant presence. The sustainability of such programmes is doubtful and at the time of writing this report, many of them have wound up operations. In many instances, microcredit was usually a component of multi sector programmes funded by the donors. As highlighted by CGAP, multi-sector programmes can damage the market as they are usually not designed by people with financial expertise. Funds were channeled through a mix of grants and subsidized credit, resulting in some damage to the existing repayment culture and the establishment of unsustainable lending practices.

A donor network was established under the co-ordination of GTZ, to work towards co-coordinating microfinance interventions by donors, sharing information in order to avoid overlapping of activities and unequal distribution of funds among the affected areas. This information was made available on the website www.microfinance.lk . According to the 2006 CGAP CLEAR Review more than 30 international agencies support microfinance in Sri Lanka, with about US$ 200 million committed up to 2005 and over US$ 85 million committed for 2005 and beyond[20]. However, with most of the post-tsunami commitments coming to an end, Sri Lanka's microfinance sector has seen a considerable reduction in donor funding since 2007.

Outside of the post-tsunami funding for microfinance, donor support to the sector has come from multi-lateral and bilateral agencies such as the ADB, JBIC and GTZ. The Poverty Alleviation Microfinance Project (PAMP) funded by JBIC was administered by the Central Bank and channeled funds to end borrowers through the RDBs. A second phase of the PAMP is due to commence soon.

The ADB funded Rural Finance Sector Development Programme (RFSDP), committed to provide US$ 77 million for strengthening of key sector institutions in rural areas. The programme was designed with the objective of establishing a sustainable rural finance system through policy adjustments and improvement of the operations of rural finance sector institutions by providing the necessary training in rural finance, efficient service delivery, sector supervision, and outreach expansion.

The large programme consisted of several components, namely, Conductive policies; Supportive legal and regulatory framework; Institutional reforms for sustainability; Strengthening the demand side; and Expansion of rural finance in conflict-affected areas. Activities under these components included building of sector capacity, specifically focusing on the NDTF, CRBs and SBSs; developing financial infrastructure; restructuring of rural finance institutions and development of rural enterprises through the provision of microcredit. Preparation of the Microfinance Institutions Act was also initiated under the RFSDP.

The programme was concluded in December 2007 having achieved limited success. The capacity

19 Review of Post-tsunami Microfinance in Sri Lanka – Girija Srinivasan and IPS, 2008

20 Country-Level Effectiveness and Accountability Review, Sri Lanka – CGAP, 2006 and CGAP Portfolio: Issue 4, July 2006

building activities were probably the most successful as a pool of training resources was built up and various retail level trainings were conducted. However, there was a failure to concentrate these resources within an institutional structure therefore the resources which exist are scattered across the sector and sustainable retail level delivery of training is limited. Proposals for reform and restructuring of major rural finance institutions such as the CRBs and SBSs met with considerable resistance from stakeholders and could not be implemented.

Technical support for capacity building has been limited in comparison to financial support for on-lending. Organizations such as GTZ, ADB, Banking With The Poor Network (BWTP) Stromme Foundation, Etimos, Women's' World Banking and Plan are involved in providing technical assistance to selected institutions. Other donor programmes have also included technical assistance components but these were relatively small in most programmes. Capacity building has also largely involved the use of expensive international resources without focusing on building local capacity. German Development Cooperation funding for the sector through the GTZ ProMiS (Promotion of the Microfinance Sector) programme commits €4 million in technical assistance over a period of 4 years (2005-2009). This programme works on the macro, meso and micro levels and attempts to build local capacity in order to create sustainable local institutions. At the meso level, this has resulted in the establishment of a local IT support centre for the MicroBanker software; building and institutionalizing microfinance training and consulting capacity in local technical service providers (TSPs); and establishing academic programmes in microfinance within local institutions. It is intended through these interventions to reduce dependence on expensive international consultants and service providers which cannot be afforded by local MFIs without donor support.

The BWTP Network provides Sri Lankan microfinance stakeholders with free access to the *Microfinance and Disaster Management Trainer's Manual* for which they held a workshop last year. The document has been translated into the local languages, Sinhala and Tamil. Several Sri Lankan MFIs, the University of Ruhuna and BWTP member organisations such as SANASA have also requested and received free copies of the recently published *Capacity Building for Partnerships in Microfinance Trainer's Manual* and intend to incorporate it into their training programs.

Support from BWTP has included funding of members from Sri Lanka to participate in regional events such as the recently held Asia Microfinance Forum in Hanoi and a BWTP technical assistance meeting which is the precursor to a technical assistance program which will include members from Sri Lanka. BWTP also supported a position for the Lanka Microfinance Practitioner's Association at their recent Asia Network Summit in the hope of providing future support in terms of exchange with more established networks.

Effectiveness of Donor Interventions

The CGAP CLEAR Review of Sri Lanka studied the effectiveness of donor interventions in the country based on CGAP's five core elements for effective aid, viz. Strategic clarity and coherence; Staff capacity; Appropriate instruments; Accountability; Knowledge management. The results of their assessment are summarized briefly below[21]:

- **Strategic clarity and coherence –** There is an increasing awareness of good practice and some consideration of the whole financial system, but overall donors lack a coherent vision for microfinance. While funders such as GTZ and ADB take a "financial systems approach" in their projects, the review finds "a proliferation of different donors in microfinance with different visions that are not well-coordinated. Few donors focus on sustainability".
- **Staff capacity –** There is some technical capacity but it is not sufficient relative to the significant amounts of money being invested in microfinance. Microfinance requires intensive technical inputs, especially when capacity building is a major need as is the case in Sri Lanka. Other than technical

21 Country-Level Effectiveness and Accountability Review, Sri Lanka – CGAP, 2006

implementers like GTZ and ADB contractors, there are no self-described microfinance experts among the donor organizations.

- **Appropriate instruments –** There is an imbalance of money provided for loan funds vs. capacity-building, as well as too much funding through governments and credit components of multi-sector programs. Usually, capital should follow capacity. There is a lack of capacity to absorb all the loan capital funding.

  According to the review, the heavy investment in loan capital is unnecessary given the apparent availability of liquidity in the system. The role of donors should be to facilitate the flow of funds from local markets, and increase the capacity of institutions to meet client needs. However, funding through government which might dictate terms of the loan to the end client (borrower) reduces the room for managers to operate their MFIs in a sustainable manner. The review finds that donor interventions sometimes reinforce the inappropriate role of government as a retailer by funding microfinance through line ministries and supporting various government programs.

- **Accountability –** The review mentions that there appears to be a lack of monitoring and evaluation by donors of their funding in microfinance. It points out that some donors carry out monitoring of their grants by asking for unnecessary information such as the names of borrowers, while not collecting generally accepted performance indicators. The fact that donors do not appear to be doing any serious monitoring of their funds contributes to a lack of transparency in the industry.

- **Knowledge management -** Little coordination between and amongst donors, international NGOs, and practitioners. Despite attempts at coordination through the GTZ co-ordinated donor network, the review finds limited information sharing outside of the Sri Lanka microfinance website (www.microfinance.lk)

10. Key challenges

Despite the long history of microfinance in Sri Lanka and a proliferation of institutions engaged in microfinance activities, it is only in recent years that questions concerning sustainability, transformation and an inclusive financial system have been given serious consideration by practitioners, policymakers and other stakeholders. The challenges facing the sector are many and they exist at all levels, macro, meso and micro.

Macro level

- A key challenge is the **lack of a long term vision** and policy for the sector. This is addressed also in the Government's 10 year development plan, the Mahinda Chintana, which points out that the lack of a policy has resulted in there being no institutionalized mechanism to coordinate microfinance interventions with other policies which have been formulated for rural development.
- The **lack of a regulatory and supervisory framework for microfinance** is a key factor which has been raised by practitioners, donors and other stakeholders. This is a barrier to transformation and scaling-up of many MFIs. The existing system is one where responsibilities for supervision are scattered among different agencies (Central Bank, Department of Cooperative Development, Samurdhi Authority, etc) with standards varying from agency to agency. The NGO-MFIs operate in a grey zone as they are essentially unregulated and unsupervised.
- The Mahinda Chintana recognizes this issue, stating that *"the absence of a unique supervisory and policy framework (for microfinance) has allowed the proliferation of fundamentally unsustainable MFIs…..".* However, despite this official acknowledgment of the need for an encompassing regulatory and supervisory framework, progress has not been made beyond the initial draft document prepared by the Central Bank. One issue delaying the introduction of legislation is concern regarding the supervisory capacity of the Central Bank, given the large number of microfinance providers in the country and the misleading impression that ALL these institutions need to be regulated and supervised.

The CGAP CLEAR Review of Sri Lanka also highlights the following macro level challenges:

- **Inadequate supervision of savings in the SBSs and CRBs.** This is related to the point above. Under the existing system, the CRBs are supervised by the Department of Co-operative Development through provincial-level cooperative commissioners and district officers (therefore essentially self-regulated). Similarly, the SBSs are not externally supervised. The Central Bank has in the past highlighted the risks of SBSs mobilizing large volumes of savings without proper regulation and supervision.
- **Politicization** is a fundamental issue affecting government owned and/or controlled microfinance institutions. Microfinance is often used as a political tool through institutions such as the Samurdhi. Microfinance services are often confused with welfare and there is pressure to give "free" loans or place a ceiling on the interest rate. This has a "crowding out" effect on private microfinance providers who are unable to compete against subsidized interest rates. Prior to elections it is not unusual for politicians and political parties to influence particularly government owned/controlled microfinance institutions to write off some outstanding loans in order to win votes.

Also mentioned in the CGAP CLEAR Review is the reform of pro-poor institutions such as the CRBs. Although the ADB funded Rural Finance Sector Development Programme (RFSDP) attempted to de-link the CRBs from the Multi-Purpose Cooperative Societies and transform them into independent MFIs this was not successful. Attempts to introduce reforms of the Samurdhi system also met with only limited success.

Meso level

- **Funding issues.** The 2006 CLEAR Review cites underutilized apex funds as a challenge facing the sector, stating that disbursement of the main apex funds is low, indicating limited interest or absorption capacity of MFIs. Lack of interest could also be due to the various conditions attached to the funds provided as well as single institution exposure limits which prove to be a barrier for the larger, rapidly growing MFIs which need a larger volume of funds than the apex agencies are willing to lend.

Local commercial funding institutions, which could play a role as wholesale lending agencies are, on the whole, reluctant to get involved in microfinance due to their perception that it is a high risk activity. Donor funding has also reduced considerably with the phasing out of many tsunami related programmes. While a large number of off-shore microfinance funding agencies are available and interested in the well-performing MFIs, the restrictive legal environment and the long and cumbersome process of obtaining approval from the Controller of Exchange serve as deterrent factors for many potential off-shore funders.

› **Insufficient specialized microfinance training facilities** have contributed to many microfinance providers failing to meet the standards required for them to transform into financial institutions and attract the funding they require from commercial investors in order to scale up their operations in an environment where cheap donor funds are fast drying up. The Mahinda Chintana also highlights this issue, stating that *"the lack of institutions for specialized training and research in microfinance is a major issue. The training programmes conducted by certain government agencies and NGOs do not meet the entire requirements of the sector. They do not offer a comprehensive curriculum that is consistent with microfinance best practices, which is a requirement of the majority of MFIs. Some semi-formal MFIs are unaware of their need for such training. Further, the academic courses in microfinance are not found in universities*[22]*. The dearth in training and research activities has contributed to the fragile nature of the sector and weaknesses such as substandard portfolio management, low qualifications of the staff, shortage of clear business concepts, obsolete accounting standards and the rudimentary level of information technology".*

22 The University of Colombo recently introduced a 6 month diploma programme in microfinance, the first to be offered by a local university.

The CGAP CLEAR Review also highlights the limited availability of local specialized microfinance training and the handful of local consultants specialized in microfinance available to serve the sector. This has resulted in over-reliance on expensive foreign training programmes and consultants. Training programmes overseas usually do not reach mid-level and field staff, partly due to the language barrier as such programmes are conducted in English.

› The CLEAR Review mentions that **donors pay limited attention to capacity building,** pointing out the imbalance between donor funding for on-lending vs. capacity building.

› The Lanka Microfinance Practitioners Association (LMPA), a network of mostly NGO-MFIs is still in the very early stages of development. **There is a compelling need for a strong practitioner body** to play an advocacy role and provide a voice for the sector. The LMPA has embarked on some initiatives in this regard but much needs to be done. The LMPA is still dominated by a few large MFIs and there is a need for smaller provincial-level players to have a stronger voice in order to make it truly representative of the sector.

› **Limited knowledge transfer and information exchange within the sector.** This point has various aspects. One is related to language issues since microfinance literature and training materials are available only in English. Some donor funded programmes such as the ADB RFSDP programme and the GTZ ProMiS programme have made some attempts to translate some of this material into the local languages, but the available material remains limited, particularly in the Tamil language which is spoken widely in the North and East. This has the effect of isolating many MFIs from learning opportunities and exposure to regional and international good practices. The LMPA could play a role in this regard by establishing regional linkages through which knowledge transfer can be facilitated. However, the LMPA still has much work to be done in this area.

- **Minimal specialized capacity among audit, rating and information systems firms.** Although there is sufficient general audit capacity in the country, most auditors lack specialized knowledge of the microfinance sector. The SBSs and CRBs/ Sanasa TCCSs are audited by the Samurdhi Authority and Department of Co-operative Development respectively according to specified standards set by these organizations. Many NGO-MFIs are audited by small, unknown audit firms, probably due to cost issues. The quality of this audited information is often not of an acceptable standard, with incorrect classifications revealing a lack of knowledge of the sector.

  Local providers of microfinance specific information systems are few. The MicroBanker (MBWin) system developed by FAO/GTZ has been introduced to many MFIs, including some of the RDBs, through the GTZ ProMiS programme. A local service centre was also established with the support of GTZ. The ADB's RFSDP programme introduced a locally developed software to selected CRBs. Another locally developed microbanking software, Senova, is also used by some NGO-MFIs.

  The two rating agencies operating in Sri Lanka do not have in-house microfinance rating capability and sourcing regional/international resources is expensive. Preliminary inquiries reveal that the microfinance sector has so far not attracted serious consideration from these agencies as few MFIs are at a stage of development where they could attract commercial funders, therefore the rating agencies consider the market too small.

- **Lack of credit information sharing** is highlighted in the CLEAR Review as a challenge for the sector. Especially after the influx of funds following the 2004 tsunami, there was a tendency for MFI clients to take multiple loans, leading to over-indebtedness and the probability of a high portfolio at risk for the MFIs. Membership of the Credit Information Bureau (CRIB) of Sri Lanka is mandatory for licensed commercial banks, specialized banks, leasing companies and finance companies but unless future legislation is introduced which makes membership of the CRIB mandatory, voluntary participation of MFIs is unlikely as there are costs involved which most MFIs are unwilling to incur.

Micro level

- **Quality of human resources.** The quality and skill levels of MFI staff seem to be issues that cut across the institutional types. In the GTZ survey of microfinance institutions, staff issues ranked among the top 5 challenges faced by most MFIs. The cause of the problem however, differs across institutional types. The SBSs face overstaffing as they are frequently used to achieve political objectives by providing employment for political supporters. The Sanasa societies work through a large number of voluntary staff, therefore suitably qualified individuals usually seek better paid jobs as permanent employees elsewhere, leaving less qualified individuals volunteering for positions in the Societies. Relatively poor remuneration and difficult working conditions for microfinance providers working in remote rural areas are also contributory factors in the issue of attracting and retaining quality staff. In the NGO-MFIs most of which originated as social service organizations, the staff still has a more "development and social welfare" approach and are unsuited to the task of managing a financial services business. Basic knowledge of accounting, IT and human resource management is, overall, very low. This has resulted in weak organizations, especially at middle management level.

  Other than in the case of the RDBs which are seen as "formal banks", the rest of the sector suffers due to the general perception that microfinance is not an attractive career option with qualified individuals seeking employment in state banks or private sector companies.

  The introduction of academic programmes in microfinance through universities and recognized institutions such as the Institute of Bankers would go a long way towards making microfinance a more accepted profession and providing more qualified staff for the sector.

- **Involvement of government in retail credit provision** is widespread as more than half of microfinance clients are with government owned or controlled institutions. This paves the way for political interference in these institutions and a mixing of social, political and financial objectives to the detriment of the sustainability of the institution.
- There is **limited focus on sustainability** as the sector has been protected by a large amount of subsidized funding, from government and foreign donors alike, although the latter source is now much reduced. MFIs have therefore been lulled into a state of complacency, paying little attention to questions of long-term sustainability. The large amount of subsidized funds hides the real sustainability picture of the MFIs as measured by financial self sufficiency. Few institutions can be said to be financially self-sustainable. Loan portfolio quality is also poor in many instances – the common practice is to measure the loan recovery rate which provides a misleading perception of portfolio quality. Understanding of concepts such as Portfolio at Risk (PaR) is very limited. In the GTZ survey of microfinance institutions, although many respondents across all institutional types claimed to understand the concept of PaR, the definitions provided were varied and mostly incorrect or not in keeping with internationally accepted definitions.

  Loan loss provisioning is either not practiced at all (this applies mostly to unregulated NGO-MFIs) or, as in the case of regulated entities such as the RDBs, Central Bank prescribed provisioning rates for banks are followed. As these are provisioning rates applicable for commercial and specialized banks, they are not entirely suitable for microfinance business. According to information gathered in GTZ's MFI survey, a small group of NGO-MFIs also adopts the CBSL provisioning rates for banks. Of the MFIs who practice a provisioning policy, a large number adopt a general provision on the overall loan portfolio. Also noteworthy is that many respondents in the survey (all respondents were senior officials of their respective MFIs) confused the concept of loan loss provisioning with loan recovery measures such as legal action.

  Measurement of performance and portfolio quality is made difficult by the fact that most MFIs are not computerized, making it difficult to obtain timely and quality information.
- **Weak corporate governance** is also a cross cutting issue in the sector. Related to the point above, over-interference in government controlled entities can result in ill-qualified individuals with little or no sector experience being placed on the boards of MFIs, and arbitrary interference in management. The CRBs are owned and controlled by the Multi-Purpose Cooperative Societies (MPCSs) which have different objectives. Profits generated by the CRBs are often used to subsidize the MPCS's other activities. In NGO-MFIs which originally began as social welfare organizations, strong founder members or family groups often dominate the institution and have complete decision making power. In many instances resistance from these groups proves a barrier to the introduction of transparent governance procedures.
- **Organization culture** in most NGO-MFIs still leans towards a social welfare mentality. Many such MFIs still adopt an integrated approach, combining microfinance business with community development activities. However, there is a change of mind-set taking place among a handful of MFIs which have separated their microfinance business from their other activities through the creation of independent microfinance institutions. These players have a much stronger focus on cost-efficiency and sustainability.

  The government controlled MFIs are hampered by excessive bureaucracy and hierarchies as well as insufficient performance incentives. As a result, the growth of these institutions has remained sluggish despite their extensive branch networks spread across the country.
- **Lack of transparency and standardization.** There is an overall lack of transparency and reluctance to share even the most basic, non-financial operational information among MFIs, even those who are not direct competitors. This was a major issue during the GTZ survey of microfinance

institutions as many MFIs were reluctant to provide basic information. The non-availability of information is due in part to manual systems being used, resulting in unreliable operational and financial information.

There is an encouraging trend towards transparency as MFIs look towards commercial funding sources in order to grow. Currently 15 Sri Lankan MFIs report to the MiX Market, up from 8 at the time of the CLEAR Review in 2006.

Lack of standardized information is also an issue. Different MFIs have different indicators for monitoring their performance, measuring portfolio quality, etc. Some MFIs, particularly unregulated institutions in the NGO sector, are unaware of what information should be collected and which indicators should be used to monitor their performance.

The LMPA initiative to build a sector database is a welcome step towards making the sector more transparent and introducing some measure of standardization.

- **Limited use of technology**. Despite widespread use of technology in the formal financial sector, its use in the microfinance sector is still very limited. It is only during the past 5 years that computerized systems were introduced even in the RDBs with the installation of the MicroBanker. The use of ICT in improving delivery technologies and reducing transaction costs is being explored only by very few institutions. Very low IT knowledge among the staff of MFIs, particularly in the NGO sector, has been a limiting factor in accessing the full potential of technology to improve information and monitoring systems.

Strengths

While many challenges exist for the sector there are also many strong points in its favor. The key points are summarized below based on the CLEAR Review of Sri Lanka.

- **Diversity of institutions.** There is a long tradition of informal savings and credit in Sri Lanka, especially through grass root initiatives.
- **Significant savings culture.** The CLEAR Review estimates 15 million savings accounts in Sri Lanka with a value of Rs.49 billion. If the entire banking system is considered, (exact figures are not available), indications are that the number is significantly in excess of this as the People's Bank and Bank of Ceylon alone have around 18 million savings accounts. Since this covers the 2 state owned commercial banks only, the total number for all banks would be even higher. According to the Central Bank, the volume of deposits in the financial system (including TCCSs, SBSs and CRBs) amounts to Rs. 1,700 billion as at June 2007. A significant savings culture is also indicated from the GTZ survey on outreach of financial services with 74% of households stating that they save with a financial institution.
- **Large outreach.** A high proportion of the population has access to financial services. In the GTZ outreach survey, 82.5% of households stated that they use the services of a financial institution.
- **Strong financial sector infrastructure.** Sri Lanka has strong financial sector market infrastructure in general: capital markets, stock exchange, debentures markets, credit bureau; auditors; rating agencies; a large pool of chartered accountants; ATMs even in rural areas; several training facilities; high level universities, well- qualified MBAs, etc.
- **Specialized microfinance training emerging.** The University of Colombo and Institute of Bankers have/plan to introduce microfinance diploma programmes. These are encouraging steps towards formalizing the study of microfinance and introducing international standards and best practices through the involvement of internationally recognized institutions such as the Frankfurt School of Finance & Management. In addition, SEEDS, Sanasa and the co-operative system have specialized training facilities. While the standard and quality of training may differ, the recognition of the need to have such specialized training augurs well for the sector.

Annex 1: Sri Lanka Fact Sheet

Indicators	Year		
	2005	2006	2007
Total Population ('000)	19,668	19,886	20,010
Population Annual Growth rate (%)	1.00	1.10	1.10
Economically Active Population (%)	(2004)		4th quarter
Male	66.7	63.7	64.8
Female	33.3	36.3	35.2
National Poverty line (Rs)	1,526 (2004)	2,233	2,233
Population below poverty line (Poverty Head Count Index)(%)	22.7 (2002)	15.2	15.2
Literacy rate (%) (2003/2004)	92.5	95.8	92.5
Male	94.5	94.8	94.5
Female	90.6	96.6	90.6
HIV/AIDS (%)	<0.1	<0.1	<0.1
Percentage of population living in rural areas (%)	(1981) 72.2	(1981) 72.2	(1981) 72.2
Life Expectancy	(2004)		
Male	71.7	71.7	71.7
Female	77.0	77.0	77.0
GNP per Capita (US$)	1,226	1,402	1,599
GNP growth rate (%)	6.0	7.5	7.1
Inflation rate (%)	11.6	13.7	17.5
Interest Rates: Commercial Banks			
Interest Rates on Deposits			
Average Weighted Deposit Rate (AWDR)	6.24	7.6	10.31
Average Weighted Fixed Deposit Rate (AWFDR)	9.25	11.5	15.49
Interest Rates on Lending			
Average Weighted Lending Rate (AWLR)	15.10	16.56	18.08
Interest Rates: Non-Commercial Bank Institutions			
Interest Rates on Deposits			
National Savings Bank Savings Deposit	5.0	5.0	5.0
National Savings Bank 1 Year Fixed Deposit	9.0	11.0	15.0
Interest Rates on Lending			
National Savings Bank	10.0-12.0	12.0-13.0	17.0-18.0
Exchange rates (annual average)			
Rs./US $	100.50	103.96	110.62
Rs./ Euro	125.10	130.63	151.63
Total Employment ('000) & % of Total Population	7,518(38.2%)	7,105 (35.7%)	7,042 (35.2%)
Agriculture (%)	30.7	32.2	31.3
Industry (%)	24.5	26.6	26.6
Services (%)	44.8	41.2	42.1
Formal		38.4	38.0
Informal		61.6	62.0

Source: Central Bank of Sri Lanka

Annex 2: Number of Banks and Bank Branches

Category	End 2006 (a)	End 2007 (b)
Licensed Commercial Banks (LCBs)		
I. Total No. of LCBs	23	23
Domestic Banks	11	11
Foreign banks	12	12
II. Total No. of LCB Branches and Other Outlets	3,537	4,203
Branches	1,737	1,934
Domestic Bank Branches	1,675	1,758
Main Branches	1,171	1,253
Extension/Pay Offices/Service Counters	492	493
Overseas Branches	12	12
Foreign Bank Branches and Other Outlets	62	176
Branches	39	42
Other Outlets	23	134
Student Savings Units	1,800	2,269
Licensed Specialized Banks (LSBs)		
I. Total No. of LSBs	14	15
Regional Development Banks	6	6
National Savings Bank	1	2
Long-term Lending Institutions	3	3
Housing Finance Institutions	2	2
Private Savings and Development Banks	2	2
II. Total No. of LSB Branches and Other Outlets	591	627
Branches	379	402
Regional Development Banks	204	215
National Savings Bank	114	115
Long-term Lending Institutions	11	13
Housing Finance Institutions	28	28
Private Savings and Development Banks	22	31
Other outlets	34	47
Student Savings Units	178	178
Total No. of Bank Branches and Other Outlets	4,128	4,830
Total No. of Automated Teller Machines (ATMs)	1,155	1,422
Total No. of Electronic Fund Transfer Facilities at thePoint of Sale Machines (EFTPOS)	8,753	12,214
Banking Density: No. of LCB Branches per 100,000 Persons	8.7	9.7

Sources: Central Bank of Sri Lanka; Insurance Board of Sri Lanka; Samurdhi Authority Sri Lanka; CGAP Sri Lanka CLEAR Review

Number of Other Financial Sector Institutions

Category	2006	2007
I. Registered Finance companies		31
II. Specialized Leasing Companies		20
III. Primary Dealers		11
IV. Merchant Banks		10
V. Stock Broking Companies		20
VI. Unit trusts		14
VII. Venture Capital Companies		7
VII. Employees Provident Fund		1
VIII. Co-operatives		
Co- operative Rural Banks		1,628
Thrift Credit Co-operative Societies(Branches)		8,440
IX. Public welfare Organizations		
Samurdhi Bank (Branches)	1,038	
X. NGO	250 (estimated)	
XI. Insurance Companies		16

Sources: Central Bank of Sri Lanka; Insurance Board of Sri Lanka; Samurdhi Authority Sri Lanka; CGAP Sri Lanka CLEAR Review

Annex 3: Profile of Microfinance Institutional Types

- **Regional Development Banks and other licensed specialized banks –** There are 6 RDBs (Kandurata, Rajarata, Ruhuna, Sabaragamuwa, Uva and Wayamba) each covering a geographical region of the country. The Northern Province and part of the Eastern Province are not covered. Government owned, the RDBs cater to the higher end of the microfinance market and the SME sector. Sanasa Development Bank is the only other licensed specialized bank with a focus on microfinance. Owned by the Sanasa Thrift and Credit Co-operatives (TCCSs), it serves as the apex bank for the Sanasa system and also engages in direct retail level activities.

- **Co-operative Rural Banks (CRBs) and other co-operatives –** There are over 1,600 CRBs owned by the Multi-Purpose Cooperative Societies. In addition, there are other co-operatives which engage in microfinance, notably the Women's Development Co-operatives. All these are member owned societies registered with, and supervised by, the Department of Co-operative Development. Despite having a large deposit base (they are permitted to accept member deposits), their lending activity is relatively low (Rs. 32 Bn deposit base and corresponding loan portfolio of Rs. 22 Bn in 2007). Profits earned by well-performing CBRs are used to subsidize the losses of their parent MPCS.

- **Thrift and Credit Co-operative Societies (TCCSs/ Sanasa societies) –** The TCCSs are the oldest microfinance providers in the country. They were re-organized into a federation under the Sanasa banner during the late 1970s. However, most TCCSs in the North remain independent of the Sanasa movement and have their own federation. Both Sanasa and non-Sanasa TCCSs are registered with, and supervised by, the Department of Co-operative Development. The Sanasa TCCSs advance loans largely from mobilized savings but also have access to credit facilities from the Sanasa Development Bank. The Sanasa TCCSs have shown stagnant or declining performance over the past 5 years and a programme to strengthen and modernize the societies is currently underway.

- **Samurdhi Bank Societies (SBSs) –** Samurdhi Bank Societies (SBSs) were established in 1996 as part of the National Samurdhi Programme, a wide-ranging governmental poverty alleviation programme targeting youth, women and the disadvantaged. The SBSs target the very low income population (defined as households having an income of less than Rs. 1,500 a month). The SBSs are essentially self-supervised. The Central Bank has cited the risks of SBSs mobilising large volumes of savings without proper regulation and supervision. The SBSs have outlets throughout the country, including the conflict affected Northern Province. However, heavy subsidizing by the government and political interference in the Samurdhi system have resulted in wide-spread inefficiencies which cast doubts on their ability to be sustainable without government support.

- **NGO-MFIs –** A large number of local and international NGOs are engaged in microfinance activities and some have now spun off their microfinance operations into separate entities. NGO-MFIs operate in a grey area where their microfinance business is concerned. Whether registered with the Department of Social Services or established as companies under the Companies Act, the microfinance operations of these institutions are neither regulated nor supervised. This group of institutions is also restricted by law from mobilizing deposits although in practice many of them do so. A few of the larger MFIs in this group are ready to take the next step of transforming into financial institutions but face a number of regulatory barriers.
- **Other financial institutions –** This group covers the commercial banks, finance and leasing companies who have entered the microfinance business. Among this group, the more significant players are the government owned People's Bank and the privately owned Hatton National Bank, Sri Lanka's oldest commercial bank. One or two insurance companies have also entered the micro insurance business. However, for many of the institutions in this group, their microfinance activities fall within the sphere of corporate social responsibility.

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- Sanasa Federation
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- World Bank website – http://web.worldbank.org/

Annex 5: Useful Contacts

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Website: www.samurdhi.org

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Colombo 05, Sri Lanka.

Tel: 94-11-2369044/ 2369045/ 2369042
Email: sanasafe@sltnet.lk
Website: www.sanasafe.lk

Department of Co-operative Development
No: 27, 5th Floor
C.W.E. Building
Vauxhall Street
Colombo 02, Sri Lanka.

Tel: 94 -11- 2478374
Website: www.coop.gov.lk

Promotion of the Microfinance Sector (ProMiS)
Level 16, East Tower
World Trade Centre
Colombo 01, Sri Lanka.

Tel: 94-11- 4963773/4
Email: info@microfinance.lk
Website: www.microfinance.lk

Banking With The Poor Network
c/o The Foundation for Development Cooperation
(Singapore) Ltd
22 Cross Street
#02-55, South Bridge Court
Singapore 048421.

Tel: 65- 6438 4112
Email : info@bwtp.org
Website: www.bwtp.org

The World Bank
1st Floor, DFCC Building
73/5, Galle Road
Colombo 03, Sri Lanka.

Tel: 94-11- 2448070/1
Website: www.worldbank.org

Asian Development Bank
Sri Lanka Resident Mission
49/14-15, Galle Road
Colombo 03, Sri Lanka.

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Email : adbslrm@adb.org
Website:www.adb.org

Plan Sri Lanka
Plan Sri Lanka Country Office
No 6, Claessen Place
Colombo 05, Sri Lanka.

Tel: 94-11-2508644/ 2588252/ 2588185/ 451295
Website: www.plan-lanka.lk

Japan Bank for International Cooperation
Level 13, Development Holdings
42, Navam Mawatha
Colombo 02, Sri Lanka.

Tel: 94-11-2300470
Website: www.jbic.go.jp

Stromme Microfinance Asia (gte) Ltd
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Rajagirirya, Sri Lanka.

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Email : postkrs@stromme.org
Website: www.stromme.org

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Website: www.cgap.org

Other Publications

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(Vietnam, Indonesia, Nepal,
Sri Lanka, Bangladesh
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Available on CD ROM and online.

Available from the BWTP Network website
www.bwtp.org

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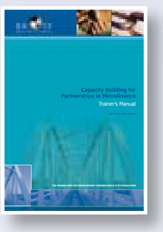

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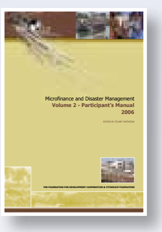

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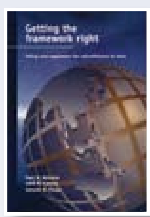

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ISBN: 0-9586728-3-0

Available from the BWTP Network website
www.bwtp.org

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