Microfinance in Sri Lanka:

General Background

Sri Lanka is an island in the Indian Ocean also called Ceylon and many other names. It is about the size of Ireland. It is about 28 kilometres (18 mi.) off the south-eastern coast of India with a population of about 20 million. Density is highest in the south west where Colombo the country's main port and industrial centre, is located. The net population growth is about 0.7%. Sri Lanka is ethnically, linguistically, and religiously diverse.

- **Population** 20,359,439 (2012 census)
- **Density** 325/km (2012 census)

- Main Districts: Colombo (2.3 mn), Gampaha (2.3 mn), Kurunegala(1.6 mn), Kandy (1.4 mn), Kalutara (1.2mn)
- Currency : Sri Lankan Ruppee (SLR or Rs)
- Fiscal Year : 1st January-31st December
- **Development Indicators:**

Population below poverty line: The poverty headcount index for 2012/13 was 6.7 and was decreased from 8.9 in 2009/10. From 1990/91 to 2012/13 the long term overall poverty index has shown a downward trend. In 2012/13 approximately 1.3 million individuals were in poverty, for the previous survey year 2009/10 it was 1.8 million representing a 0.5 million decline from 2009/10 to 2012/13. The total poor households were 5.3 percent from total and it was approximately 0.3 million house-holds in 2012/13

Official Poverty Line (OPL) for 2012/13 is Rs. 3,624 that is real per capita expenditure per month for a person fixed at a specific welfare level with the expenditure of consumption of food and non food items.

Poverty disparities: Even though poverty has declined to a greater extent at national level in the last few decades, poverty disparities still exists across the provinces and districts. Although Poverty headcount index in Sri Lanka was 6.7 in estate sector it was 10.9, rural 7.6 and urban 2.1. In Estate sector is generally higher than those of urban and rural. At province level the lowest poverty headcount index is 2.0 percent which represents 116,000 poor people in the Western province and the highest is 15.4 percent which represents 190,000 poor people in Uva province. Meanwhile at district level the lowest poverty headcount index has been reported in Colombo while the highest has been reported from Mullaitivu district.

- GNI per capita (Atlas method, USD): 3170 (2013)
- Total Adult Literacy Rate(2008-2012) : 91.2 (UNICEF)

Growth rate	0.913% (2012 est.)
Birth rate	17.04 births/1,000 population (2012 est.)
Death rate	5.96 deaths/1,000 population (July 2012 est.)
Life expectancy	75.94 years (2012 est.)
• male	72.43 years (2012 est.)

• female	79.59 years (2012 est.)
Fertility rate	2.17 children born/woman (2012 est.)
Infant mortality rate	9.47 deaths/1,000 live births (2012 est.)

- HDI: Category: High Human Development HDI: 0.750, 100 rank among 187 countries (2013)

Historical Evolution

Indicator	2014
Nominal GDP (USD bn)	74.94
Real GDP Growth (%)	6.4
Consumer Price Inflation (avg, %)	3.3
Exchange rate (avgvs USD)	130.56
External Debt (year-end, USD bn)	43
External Debt (as a % of GDP)	57.4
FDI (USD mn)	1,685
FDI (as a % of GDP)	

The microfinance movement in Sri Lanka started under the British Colonial administration in 1906, with the establishment of Thrift and Credit Co-operative Societies (TCCS) under the Co-operative Societies Ordinance. These were the first credit co-operatives established in Sri Lanka that undertook the tasks of procurement of inputs and distribution of products, etc. during the early decades of the 20th century. This role was 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.

However, by the late 1970s, there were very limited numbers of TCCSs, and those in existence were not performing well. During that time, the TCCS movement was revived by the charismatic Dr. P.A.Kiriwandeniya, under a new name: SANASA.

In 1985 the Government established 17 Regional Rural Development Banks (RRDBs) covering all districts of Sri Lanka with the exception of the North and East, to reach small and medium entrepreneurs in remote rural areas. A significant restructuring and recapitalization took place in 1998 - 1999 and the RRDBs were consolidated into the six Regional Development Banks (RDBs) which were again merged into one entity in 2010 as Regional Development Bank.

The late 1980s and 1990s saw the entry of several local and international NGOs into the microfinance business. During this period the Janasaviya subsidiary program was introduced by the government as one of the main poverty alleviation mechanisms later replaced by the Samurdhi Development programme in 1995 consisting of the network of 1,038 member-owned Samurdhi Bank Societies (SBSs). During the late 80s commercial banks and financial institutions entered the microfinance market, where Hatton National Bank's (HNB) “GamiPubuduwa” (“Village Awakening”) microfinance programme is probably the oldest microfinance programme.

The Tsunami, which struck Sri Lanka in 2004, saw the influx of foreign aid to the microfinance sector, which was either a grant or subsidized loans. Many microfinance programs combines with multi-sectoral livelihood programmes during this phase, prove 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 had negative impact on credit culture in the country.

A recently emerging trend is the entry of commercial banks and registered finance companies and other large corporate entities into the microfinance business, notable among them is Lanka Orix Microcredit Limited (LOMC).

Types of MFIs

The Sri Lankan microfinance sector comprises a range of institutions which are monitored and supervised by several different legislations. The main types of the microfinance institutions include:

Regional Development Banks (RDBs) and other Licensed Specialized Banks (LSBs): There is one Regional Development Bank (established in 2010), which was formed with the merger of 6 RDBs targeting the small and medium enterprises. Apart from that, Sanasa Development Bank is the only other licensed specialized bank with a focus on microfinance. They come under the supervisions of the Central Bank.

Samurdhi Bank Societies (SBSs): Samurdhi bank societies (SBSs) were established in 1996 as part of the governmental poverty alleviation program. The Samurdhi Authority of Sri Lanka regulates SBSs. In July 2007, there were 1038 SBS.

Divineguma Act No 01 of 2013 to provide for the establishment of a Department to be called and known as the department of Divineguma development by amalgamating the Samurdhi Authority of Sri Lanka established by Act 30 of 1995, Southern Development Authority of Sri Lanka established by Act 18 of 1996, the Udarata Development Authority of Sri Lanka established by Act 26 of 2005; to establish Divineguma Community Based Organisations at rural level and to provide for a co-ordinating network at the district level and national level; to establish Divineguma Community based banks and Divineguma Community Based Banking Societies; to repeal Samurdhi Authority of Sri Lanka Act 30 of 1995, Southern Development Authority of Sri Lanka Act 18 of 1996 and Udarata Development Authority of Sri Lanka Act 26 of 2005 and to provide for matters connected therewith or incidental thereto.

Co-operative Rural Banks (CRBs) and other co-operatives: There are 1,608 CRBs, of them 8 CRBs were independent CRB societies and the rest 1,600 have been managed under 302 multipurpose cooperative societies (MPCS). They are regulated by the Department of Co-operative Development.

Thrift and Credit Co-operative Societies (TCCSs/ SANASA Societies): The TCCSs are the oldest mediums of providing microfinance, and many were re-organized into a federation under the Sanasa during the late 1970s. However, most TCCSs in the North remain independent of the Sanasa movement and have their own federation. Sanasa TCCS have access to Sanasa Development Bank.

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. They are registered as NGOs, guarantee or private companies. They are unsupervised and their microfinance activities are not governed by any specific regulations.

Other Financial Institutions: Commercial banks, Finance and Leasing companies who have entered the microfinance business are main type of institutions in this category. Among them, the more significant players are the government owned People's Bank and the privately owned Hatton National Bank, Commercial bank, and Finance companies as LOMC. They come under the supervisions of the Central Bank.

Major highlights of the sector

Outreach

When it comes to spread of outreach, there is an only estimate available for total number of clients and outstanding loan balance (OLB) as information is not available for the entire sector. Only 20 MFIs report to the MIX market and until recently, even the large MFIs operated on a manual basis.

Of the 4.2 mn total families in Sri Lanka, less than 50% could be considered to be the micro credit market. According to GTZ ProMiS 2009 Industry Report, there are over 10,400 microcredit service points in the country suggesting that there is one service point for every 200 families. The distribution of the service points are although not even, there is a reasonable spread of the microfinance branches throughout the country with the exception of the very remote areas of all districts, plantation areas and conflict affected North districts except Jaffna.

RDB and Licensed Specialized Banks: The RDB estimate, on average, 86% of their business is microfinance. The microfinance client base is estimated around 1.85 mn. The RDB was formed by merging regional development banks of the island's regions of Rajarata, Ruhuna, Wayamba, Uva, Kadurata and Sabaragamuwa in July 2010. For 2009, the total credit distribution of the 6 regional banks (before amalgamation) is around Rs 29,090 mn (USD 253 mn) .

SANASA development bank which is registered as a public company in companies act and in banking act as a licensed specialized bank has operations in all most all the districts in Sri Lanka. Currently, SANASA lends through Primary Thrift and Credit Societies (PTCCS) and to individuals and has an outreach of 516,373 active member, 190,427 borrowers with Rs 10,660 mn (USD 93 mn) as outstanding loan balance (OLB) in 2009.

SBSs: They serve a total of 2.3 mn members and another 227,000 non-member clients. The industry report of Sri Lanka mentions that there are 1,038 Samurdhi Bank societies and reported 5.8 mn deposit and savings accounts and 0.6 mn active borrowers. They had Rs 7.8 mn as OLB and Rs 20.8 mn in savings in 2006.

CRBs and other Cooperatives: Data on the number of clients reached is not available but Central Bank data indicates 1.5 mn loan accounts and 6.5 mn savings accounts across 1,608 CRBs in 2007. Even allowing for multiple accounts, it is likely that CRB's has over 3 mn members. They had Rs 14.6 mn as OLB and Rs 25.3 mn in savings in 2006.

Sanasa/TCCSs: The outreach of the Sanasa TCCSs in 2007 is Members: 464,632, Borrowers: 55,898, OLB: Rs 523 mn (USD 4.5 mn) and Savings: Rs 522 mn (USD 4.5 mn)

Largest MFIs (among LMFPA members)	Number of members
Sarvodaya Economic Enterprise Development Services Ltd (SEEDS)	544,915
SANASA Development Bank Ltd	516,373
Sabaragamuwa Development Bank	265,501
BRAC Lanka Ltd	100,985
Lak Jaya Micro Finance Ltd	34,033

Other MFIs (NGOs/Limited liability companies/ companies limited by guarantee): The Lanka microfinance Practitioners' Association (LMFPA) Profile of members data for 2010 (unpublished) indicate that there are 961,850 members of 51 NGO-MFIs (including SANASA Bank). The largest NGO MFI is Sarvodaya Economic

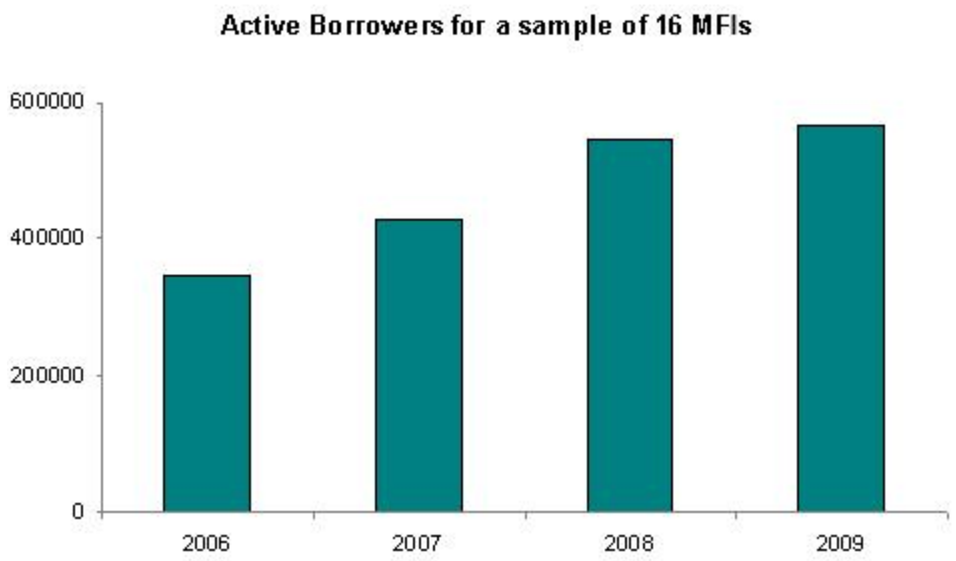
Enterprise Development Services (Gte) Ltd (SEEDS) have a member base of 544,915 members and active borrowers of 161,280 as of March 31st, 2010.

The total loan portfolio of all the 51 Institutions comes to Rs 25,432 mn (USD 221), with three institutions SANASA, Sabaragamuwa and SEEDS accounting for 80% of outstanding 80%. The average loan balance per borrower is 28,130 Rs.

When it comes to depth of outreach 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 (USD 26). For the NGO-MFIs, nearly 82% of their clients have a monthly household income of less than Rs 5,000 (USD 43.5). 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.

Growth

The historical growth tends for the sector as whole or for a large number of MFIs is not available.

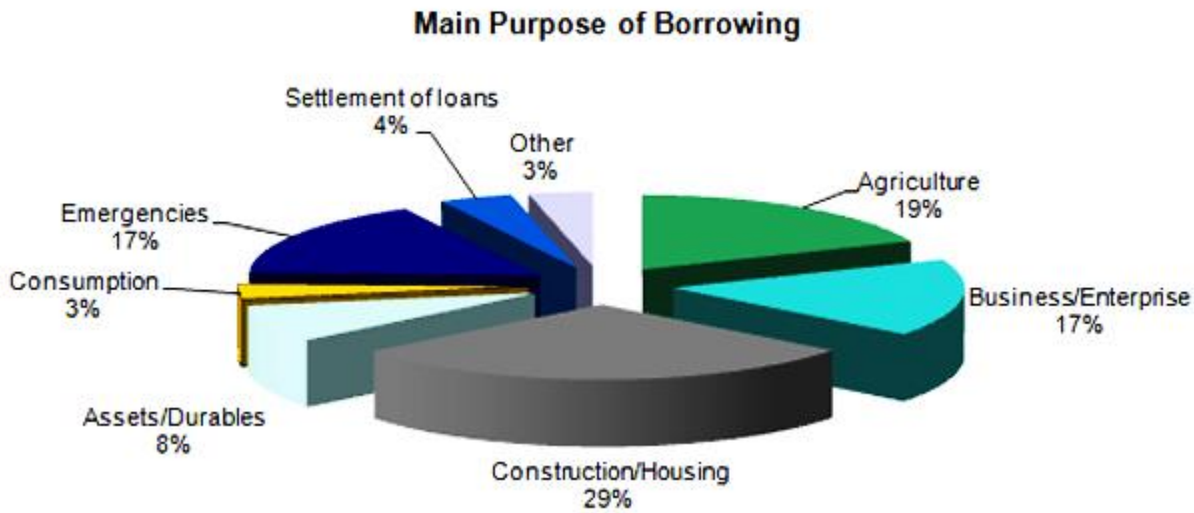


The State of Microfinance in Sri Lanka report prepared by Institute of Microfinance (InM) reveals that there are about 1,061,457 active borrowers in 2008, in 20 key MFIs compared to 981,724 in 2006. In terms of portfolio growth, the total outstanding loan balance (OLB) was around Rs 18 bn (USD 157 mn) in 2008 that is around a Rs 6 bn (USD 52 mn) increase from 2006.

Growth indicators for a sample of institutions (not including Samurdhi, CRBs and SBS), mainly comprising of key NGO-MFI players, show that the number of active clients are growing. The growth trend in members and clients will continue with the expansion of microfinance activities in the North and East.

Products and Services

Savings and loans are two main products that most of the MFIs are providing. Some institutions provide insurance products attached with the loans and regulated institutions such as RDBs offer pawning services to clients. The main outreach methodology is community based groups or societies.



Individual lending either directly or via CBOs or groups is the main lending mechanism, where bulk lending to CBOs, which was popular in late 80s and 90s, seems less prominent. It is noted that though institutions rely on "groups or CBOs" as means to mobilize clients, the predominant mode of lending is individual lending. The average loan balance per borrower is Rs 28,130 (USD 245) for 51 MFIs reporting to Lanka Microfinance Practitioner's Association (LMFPA) Member Profile 2010 (unpublished).

The RDBs and Sanasa Development Bank are permitted to mobilize deposits. Cooperative societies can also accept member deposit. In practice, many NGO MFIs also accept deposits on a limited scale.

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.

Micro-insurance reaches 1.46% of the population. The primary players in the market are HNB, Ceylinco Insurance and Sanasa Bank providing life, property, mortgage, loss of income and disability insurance. Currently, MFIs can only provide insurance as an agency of a licensed insurance provider. The high capital requirements which are a pre-condition for engaging in insurance business exclude MFIs from obtaining licenses for these activities.

The primary market for micro-leasing is purchase of trishaws, motorcycles and hand tractors. This is reasonably well provided for by both commercially minded microfinance providers and finance companies in the urban areas. Registration with CBSL under the Finance Leasing Act of 2000 is mandatory to carry out leasing activities. The leasing companies cannot mobilize savings or deposits. It can provide micro leasing, hire purchase and micro loans under a leasing license.

The most common lending rate is in between 15% to 25%, where flat or reducing balance methods are used for the calculations. The deposit interest rate is usually around the commercial bank interest rates and ranges from 5% to 10%.

<u>Sustainability</u>

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. Most government-led microfinance programmes have subsidized interest rates, weak repayment rate and high recurrent costs, and are far from sustainability. While Government supported or subsidized loans offer rates ranging from 8 to 18% sustainable rates are considered to start as high as 33%.

An important hindrance to the sector's sustainability is the low concern to the portfolio quality. Many microfinance providers are not familiar with Portfolio at Risk (PAR) and are unable to calculate it with their manual system. As a result, the average PAR > 30 days reported by RDBs ranges between 6% and 9% while MFIs report a PAR > 30 days between 5% and 25%, being closer to 25%. According to LMFPA, based on data from 51 member MFIs, these figures vary from 43% to 0% for these institutions and there are only 18 institutions that have PAR less than 5%. Approximate average of PAR > 30 days for the sector would be around 16%. As of Dec 2008, SEEDS reports 11%, SEWA 8%, Arthacharaya 15%, Samurdhi 12% and SANASA 12.5%.

There is no sector wide data available to track and analyse the sustainability figures for the various types of MFIs. According to InM Report 2009, which looked at various indicators of top 20 MFIs in Sri Lanka, only 10 MFIs reported Operational Self Sufficiency (OSS) and only 6 MFIs has OSS over 100%. According to the MIX data, and LMFPA member profile data many institutions (such as SEEDS, Arthacharya, Berendina, WDF-Hambanthota, etc) are operationally sustainable. However, there are a large number of regional small players still thriving to achieve the operational viability.

Meso level infrastructure

The meso level infrastructure for the microfinance sector is week though GTZ ProMiS has taken a number of initiatives to improve the meso level infrastructure in last few years.

The Centre for Banking Studies of the Central Bank of Sri Lanka, the Bankers Training Institute and the Distance Learning Centre, The University of Colombo offers various short training programmes and diploma courses in microfinance. The leading MFIs, such as SEEDS, SANASA, Cooperatives and Samurdhi have their own staff training centres. The private agencies for Technical Assistance (TA) are still rare, however, now there is an independent trainers' pool for CGAP training module developed by GTZ-ProMiS. An important feature of technical assistance in the country is that it is grant driven. During the last 5 years, Rural Finance Sector Development project funded by ADB worth USD 27.29 million and a GTZ program the Promotion of Microfinance Sector (ProMiS) equivalent to USD 5.6 million have provided Technical Assistance to MFIs for computerization, staff training, and developing TA providers for the sector.

The Lanka Microfinance Practitioners' Association (LMFPA) a network of MFIs represents the sector. The association has a membership of around 80-microfinance stakeholder, consisting primarily of NGO-MFIs and also some meso level service providers. The network has an objective to create a conducive environment for microfinance in Sri Lanka but as an institution, it is still at formative stages.

The Credit Information Bureau (CRIB) of Sri Lanka includes Commercial banks, Specialized banks, Leasing companies and Finance companies. Other than these four types, borrowers of the National Development Trust Fund (NDTF), Merchant bank and Export Credit board is using the CRIB. However, the CRIB for microfinance borrowers is not yet incorporated unless they are covered by existing institutions.

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 ConsorzioEtimos, a funding agency based in Italy.

Competition

According to InM Study, there is an increasing trend of commercial banks and finance companies going towards the lower end of the scale and moving to the more remote areas. This has created a certain degree of competition in deposit mobilization affecting the availability of deposit resources for micro credit providers to provide credit services to much needed microfinance clients.

Further while exact number are not available, many of the sample surveys on access to credit found that large percentage of families have multiple memberships and access to credit and savings institutions.

Risks

The main risk MFIs are facing now is the lack of funds to finance their portfolio. With only three apex funding institutions, and the state owned institution having an interest rate ceiling, MFIs - which are not regulated - do not have access to commercial investments and are unable to mobilise deposits, which aggravates the problem. It is important to note that none of the major players in micro credit market consider that competition is one of the major challenges for their growth and sustainability and more importantly many of them consider limited funding sources is the number one challenge for their growth.

In addition, many MFIs are spin-offs of NGO and the focus on sustainability is limited with many. As shown in the MIX market study on performance and transparency (2005) even basic data on outreach and profitability data are not available in certain MFIs, making it difficult to assess performance levels and sustainability of operations in the sector. Most institutions lack adequate management information systems (MIS) and are unable to track their loan portfolios and other performance measures. What little data are available rarely adhere to international standards and instead track cumulative indicators which do not accurately capture institutional performance. The Microfinance Practitioners Association does not collect performance data in regular intervals on member performance although initial survey and data base is established. Only very few institutions are familiar with international best practices reporting standards for micro finance. Another related issue is that the measures of portfolio quality often varies across organizations, some measuring PAR at one day and others tracking this indicator after 90 days which makes it difficult to compare the performance. Lack of information combined with the large number of competing microfinance provider's risks creating situations of over indebtedness among poor clients, who may take out multiple loans.

Regulations

The different categories of micro-finance institutions are registered under various laws but are not regulated or monitored through a specific regulatory and supervisory authority or arrangement. Some of the key laws applicable to microfinance institutions are as follows:

- **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.
- **Finance Companies Act No. 42 of 2011**: This law applies to all registered finance companies. License to carry on business is issued by the Monetary Board of CBSL.
- **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.
- Samurdhi Authority of Sri Lanka: Incorporated under parliamentary **Act No. 30 of 1995**. Vision was to creating a prosperous Sri Lanka when poverty is at a minimum.
- **DIvi Neguma Act No. 01 of 2013**: The Samurdhi Authority of Sri Lanka established under the Act No. 30 of 1995 amalgamated to this.

- The Co-operative Societies Law No. 5 of 1972 (as amended by Act No's. **5 of 1972, 37 of 1974, 11 of 1980, 32 of 1983 and 11 of 1992**) ("Co-operative Societies Law") was enacted to provide for the development of co-operative societies. They are entitled to make loans to members (or another registered co-operative society with the approval of the Registrar of Co-operative Societies) and accept deposits.

In addition, many institutions who conduct microfinance business are registered under The Companies Act No. 7 of 2007 ("Companies Act") and the Voluntary Social Service Organizations (Registration and Supervision) Act No. 31 of 1980 (as amended by Act No. 8 of 1988) ("the VSSO Act").

In August 2010 a proposed microfinance act was released to the public, which included setting up a Microfinance Regulatory and Supervisory Authority to license, register, regulate, supervise and strengthen companies, non-governmental organizations, societies and co-operative societies carrying on microfinance business. A board shall govern the Authority, consisting of officers from the Ministry of Finance, Central Bank and three members nominated by the Finance Minister. The LMFPA is lobbying the government to introduce regulations governing the microfinance sector and expects a positive outcome from such advocacy in the near future under the newly established government.

Financing

A sector wide detail data is not available for financing structure of MFIs in the country.

The main financing sources are donor grants, savings, soft loans and commercial loans, however, donor grants are declining now and they are mostly now available for Northern and Eastern parts of Sri Lanka.

Savings are mobilized from the members of MFIs. The regulated banks and Licensed Finance Companies mobilize savings from non-members too. However, savings mobilization by non-regulated MFIs even from their members is prohibited under the Finance Business Act No. 42 of 2011.

The State-owned apex lending institution NDTF provides bulk loans to finance loan portfolios. The NDTF lends to microfinance institutions for 9% (per annum on reducing basis) reducing balance, and has an interest rate ceiling of 15% reducing balance per annum. The institutions who apply for the credit services from NDTF needs to registered entities, with one year experience of microfinance, and should have a recovery rate above 90% with less than 10% non-performing loans. As per the Central Bank Annual report 2008, NDTF has lent Rs 1,402 million (USD 12 million) to 189 partner MFIs. 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.

The debt financing from commercial banks or financial institutions is very rare in the country. There are MFIs such as SEEDS who have obtained bulk loans from state bank to finance their loan portfolio, but the involvement of the commercial banks in lending to MFIs is limited to implementation of government programs such as Poverty Alleviation Microfinance Project (PAMP) under the Central bank supervision. The commercial banks get financing from the Central bank under PAMP at 4.5% interest rate which goes to end clients at 16%. The PAMP disbursed Rs 514 million (USD 4.5 million) in 2008.

Stromme Microfinance is another wholesale lending institute similar to NDTF which also provides technical assistance. The interest rate charged by Stromme Foundation is between 9 - 9.5% per annum (on reducing balance). It has 40 NGO partners. Stromme has disbursed Rs 1,193 million (USD 10 million) for the microfinance sector. Ecumenical Loan Fund (ECLOF) is another international source of funding for this sector. ECLOF has disbursed Rs 131 million (USD 1.5 million) during the year 2007 (ECLOF annual report 2007).

ETIMOS- the Italian agency having an office in Sri Lanka also provides whole sale loans to MFI.

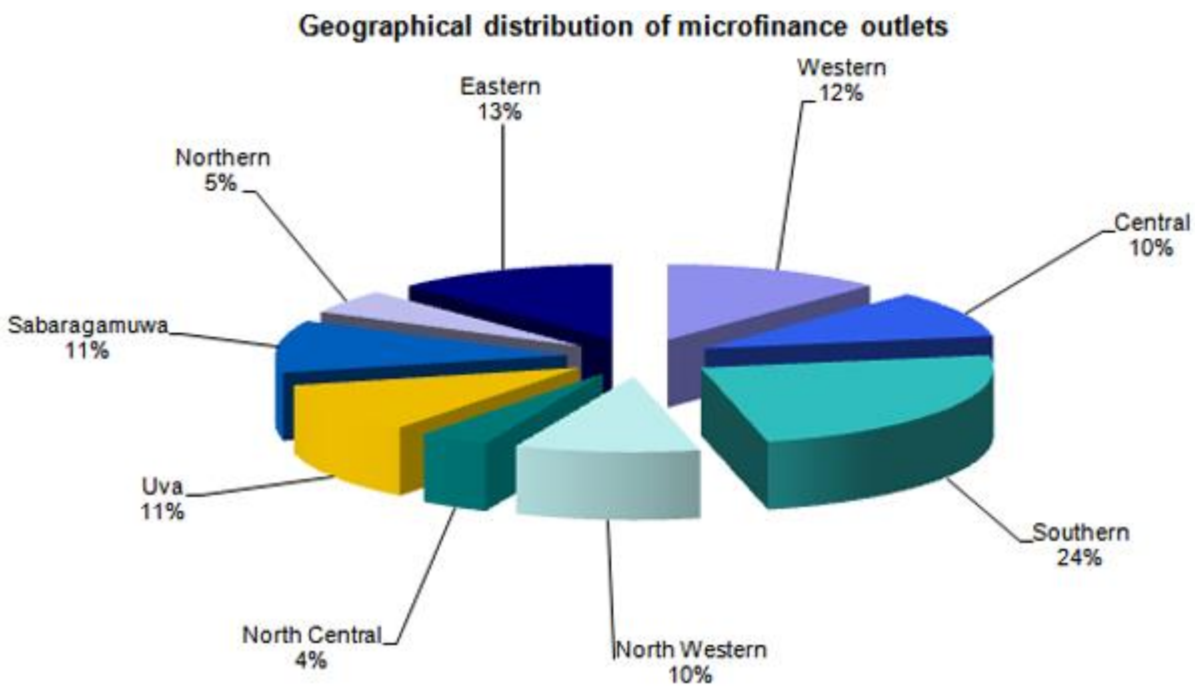
There is a positive trend of commercial borrowing from local and international sources in the last couple of years. As an example SEEDS has borrowed from NOVIB in the Netherlands and as well as from Peoples Bank, Hatton National Bank and Lankaputhra bank in Sri Lanka. However, local commercial funding institutions, which could play a role as wholesale lending agencies, are reluctant to get involved in the microfinance sector due to high risk perception associated with the sector. While a large number of off-shore microfinance funding agencies are available, 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. Against this background, funding becomes the key issue especially for MFIs (NGO/Companies) 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 restriction.

Tier II MFIs

According to the Sri Lankan context the majority of the MFIs fall into either Tier II or Tier III categories. The Tier one MFIs are very limited in number (mostly only Sanasa Development Bank - which belongs to top 50 MFIs according Forbes Magazine, as analysed through the MIX data). The emerging other MFIs who are improving their performance, (such as SEEDS, Women's Development Foundation, Berendina Microfinance, Sewa Finance, etc.) falls under the Tier II category. This is due to one or more reasons such as geographical coverage, near profitability, still achieving FSS, etc.

Market Gaps and Challenges

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



The above-mentioned study by GTZ also found that despite the presence of so many MFI's informal credit still remained an important source of credit and savings. Almost 32% of the households who were members of MFI's have borrowed from informal sources. The study also showed that informal credit as a % of credit received from MFI's was 15%. The average credit obtained from informal sources were smaller at Rs 10,862. In fact over 60% of households borrowed less than Rs 5,000 and 20% even less than Rs 1,000. The percentage of people using informal credit was highest in plantation sector. This shows that microfinance has not been able to offer products in the lower band. The Microfinance outlets are more widespread in Southern province (24% of total) while north and eastern area (3.9% of total) are very much underserved. Also 90% of microfinance outlets are concentrated in rural areas, approximately 10% in urban areas and 1% in the estate sector. This also points to the fact that there is unmet demand and market potential in those areas is still to be tapped. In light of the rebuilding of North and East, there is a huge scope for expanding microfinance services.

Approximately 50% of Sri Lankan households do not have access to credit and this unmet demand for microfinance in Sri Lanka is estimated at Rs 125 billion (USD 1.1 billion). A major gap from a demand side is the abundance of income generating loans and paucity of lending for other credit needs.

On challenges, certainly there is an inappropriate donor intervention and pervasive government presence. Following the fact that the microfinance sector is highly fragmented and diversified, sector data is largely unavailable. Indeed, the available performance data is often inconsistent across institutions and often does not comply with standards. "*Thus, while a number of MFIs are reported to be doing well, a large number of them have low recovery rates and several hundred of CRBs and TCCs are poor performing. The continuation of this over an extended period of time could result in collapse of institutions and loss of public confidence in these community-based institutions*".

Key Contacts

- **Central Bank of Sri Lanka (CBSL)**

  http://www.cbsl.gov.lk/

- **Lanka Microfinance Practitioners Association (LMFPA)**

  http://www.lankamicrofinance.com/

- **Ministry of Finance and Planning in Sri Lanka**

  http://www.treasury.gov.lk/

- **Promotion of the Microfinance Sector (ProMiS)**

  http://www.microfinance.lk/