

Micro Finance Institutions in Sri Lanka.

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Abstract

The formal rural financial sector in Sri Lanka comprises a large number of Micro financial institutions (MFIs). These MFIs, play an important role in meeting the rural credit needs in rural sector in Sri Lanka. MFIs have gained an increasing share of financial assets, which has been particularly helpful for satisfying the growing demand for loans and advances in poor people in the country. However, performance of MFIs in Sri Lanka is less than satisfactory and highly criticized today. Poor performance has been attributed to poor management of assets and consequently, the sustainability of these institutions is uncertain. Moreover, an attention to the efficiency of MFIs in Sri Lanka is more concern to the general public given collapses of several formal and informal MFIs. So, Microfinance is increasingly being considered as one of the most effective tools of reducing poverty. Microfinance has a significant role in bridging the gap between the formal financial institutions and the rural poor. The Micro Finance Institutions (MFIs) accesses financial resources from the Banks and other mainstream Financial Institutions and provide financial and support services to the poor. This article reveals which is the Micro Finance Institutions and its role in Sri Lankan economy.

Key words: Micro Financial Institutions, Rural Financial Sector, Micro credit

Introduction

A microfinance institution is an organization that offers financial services to low income populations. Almost all give loans to their members, and many offer insurance, deposit and other services. A great scale of organizations is regarded as microfinance institutes. They are those that offer credits and other financial services to the representatives of mainly poor strata of population. Microfinance is increasingly being considered as one of the most effective tools of reducing poverty. Microfinance has a significant role in bridging the gap between the formal financial institutions and the rural poor. The Micro Finance Institutions (MFIs) accesses financial resources from the Banks and other mainstream Financial Institutions and provide financial and support services to the poor. MFIs are the pivotal overseas organizations in each

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country that make individual microcredit loans directly to villagers, micro entrepreneurs, impoverished women and poor families. An overseas MFI is like a small bank with the same challenges and capital needs confronting any expanding small venture but with the added responsibility of serving economically-marginalized populations. Many MFIs are creditworthy and well-run with proven records of success; many are operationally self-sufficient. Various types of institutions offer microfinance: credit unions, commercial banks, NGOs (Non-governmental Organizations), cooperatives, and sectors of government banks. The emergence of “for-profit” MFIs is growing. In India, these ‘for-profit’ MFIs are referred to as Non-Banking Financial Companies (NBFC). NGOs mainly work in remote rural areas thereby providing financial services to the persons with no access to banking services.

The term “transformation,” or commercialization, of a microfinance institution (MFI) refers to a change in legal status from an unregulated nonprofit or non-governmental organization (NGO) into a regulated, for-profit institution. Regulated, transformed organizations differ from nonprofits in that they are held to performance and capital adequacy standards and are supervised by a financial authority, typically the central bank of the country where they are registered. A transformed MFI also attracts equity investors. The equity investors want to ensure that the values of their investments are maintained or enhanced and elect Board members who share a common vision for the new for-profit institution. Among transformed MFIs, varying classifications of regulated institutions exist, the strictest being banks — rural banks and thrift banks — followed by non-bank financial institutions. Different countries have varied names for these regulated MFIs.

The microfinance sector consistently focuses on understanding the needs of the poor and on devising better ways of delivering services in line with their requirements, developing the most efficient and effective mechanisms to deliver finance to the poor. Continuous efforts towards automation of operations is steady improving in efficiency. The automated systems have also helped accelerate the growth rate of the microfinance sector.

History of Micro Finance Institutions

The history of microfinancing can be traced back as long to the middle of the 1800s when the theorist Lysander Spooner was writing over the benefits from small credits to entrepreneurs and farmers as a way getting the people out of poverty. But it was at the end of World War II with the Marshall plan the concept had a big impact.

The today use of the expression microfinancing has its roots in the 1970s when organizations, such as Grameen Bank of Bangladesh with the microfinance pioneer Mohammad Yunus, were starting and shaping the modern industry of microfinancing. Another pioneer in this sector is Akhtar Hameed Khan. At that time a new wave of microfinance initiatives introduced many new innovations into the sector. Many pioneering enterprises began experimenting with loaning to the underserved people. The main reason why microfinance is dated to the 1970s is that the programs could show that people can be relied on to repay their loans and that it's possible to provide financial services to poor people through market based enterprises without subsidy. Shore bank was the first microfinance and community development bank founded 1974 in Chicago.

An economical historian at Yale named Timothy Guinnane has been doing some research on Friedrich Wilhelm Raiffeisen's village bank movement in Germany which started in 1864 by the year 1901 the bank had reached 2million rural farmers. Timothy Guinnane means that already then it was proved that microcredit could pass the two tests concerning peoples' payback moral and the possibility to provide the financial service to poor people.

Another organization, the caisse populaire movement grounded by Alphone and Dorimène Desjardins in Quebec, was also concerned about the poverty, and passed those two tests. Between 1900 to 1906 when they founded the first caisse, they passed a law governing them in the Quebec assembly, they risked their private assets and must have been very sure about the idea about microcredit.

Today the World Bank estimates that more than 16 million people are served by some 7000 microfinance institutions all over the world. CGAP experts means that about 500 million families benefits from these small loans making new business possible. In a gathering at a Microcredit Summit in Washington DC the goal was reaching 100 million of the world's poorest people by credits from the world leaders and major financial institutions.

The year 2005 was proclaimed as the International year of Microcredit by The Economic and Social Council of the United Nations in a call for the financial and building sector to "fuel" the strong entrepreneurial spirit of the poor people around the world.

Micro Finance Institutions in Sri Lanka

In Sri Lanka, there are many models being practiced by MFIs. Historically credit Co-operatives, Village Societies also called Community Based Organization (CBOs) and Village Revolving Funds were the most popular till 1990's. Credit co-operatives were introduced in early part of the century but were largely confined to middle class salaried employees till it was taken to rural masses in 1980's. Village society model was adopted by SEEDS in 1986 and majority of NGOs followed suit with this model, whilst government with its Samurdhi banks also followed a modified village society model. In the 1980's and even in 1990's many INGOs such as CARE International commenced village revolving funds and this is still popular in conflict areas where UNHCR is also supporting such autonomous village funds.

Micro Finance Models:

Village Banking

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

Sarvodaya- (they mobilize the community members for sharing labor and self-help work and then form a formal village society called Sarvodya society.)

Janashakthi and Samurdhi - (Janashkathi and Samurdi make informal village societies with 30 -50 members for each traditional village with the main intention of microfinance interventions and village banks are made as a federation of 10 -12 such societies)

SEEDS- (the Sarvodaya promoted body to provide bulk loans to such societies)

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

Gemidiriya- (Gemidiriya mobilize the community for multifaceted holistic development and Village Savings and Credit Organization (VSCO) is a functional part of the people's company, which is the legal entity in the community.)

Grameen Type Group Collateral Lending

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

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

There are many agencies that follow Grameen modified approaches in Sri Lanka but the agency in Sri Lanka which follows closest to Grameen model is Ceylinco Grameen Credit Co. Ltd a private for profit initiative commenced by Ceylinco Consolidated Group one of the largest private sector groups in the island. Recently the name of this MFI was changed to 'Grameen Credit Company'. HNB Assurance recently partnered with Prime Grameen by introducing a competitive life insurance scheme to cover the Prime Grameen loan clientele. Prime Grameen established in year 2000, is the flagship micro finance operator in Sri Lanka and a subsidiary of the HNB PLC consequent to it acquiring 51% of the controlling stake of the company.

Individual lending using group as a focal point

This is an adaptation from ASA model where individual lending is practiced using a group of 25 to 30 as a point of contact. Here group is not used as a form of collateral but used only for efficiency of loan collection and providing other services. Lak Jaya and Berendina Microfinance are two institutions, which follow this model with some modifications. Lak Jaya follows the ASA model very closely with women only and weekly recovery resulting from the technical assistance they receive from ASA.

BRAC Sri Lanka has a different group model similar to BRAC model in Bangladesh. Only women are permitted to borrow and they form small groups as well as larger village organizations though they are not registered legal societies as described in the village banking or village revolving fund models.

Individual lending

This is a straight forward lending model where micro loans are given directly to the borrower. It does not include the formation of groups, or generating peer pressures to ensure repayment. In Sri Lanka this model is followed mainly by both commercial and regional development banks. Instead of group pressure they either ask for collateral or for letters from guarantors. Original agriculture credit given by commercial banks both state and private from 1960's was of this type and even today it is the most significant way for commercial banks to give small loans.

Self Help Groups (SHG's)

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

Credit Unions /Cooperatives

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

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

There is another segment of cooperative banks formed under Multipurpose Co-operative Societies being the most popular in the country. They are called Cooperative Rural Banks (CRB). These are totally member savings based organizations and savings is the more relevant service and credit much less.

ROSCA's (Seettu)

Rotating Savings and Credit Associations (ROSCAs) also known as “Seettu” are essentially a group of individuals who come together and make regular cyclical contributions to a common fund, which is then given as a lump sum to one member in each cycle.

Principles of microfinance:

Microfinance is a relatively new segment of the market economy that is why institutions created in this segment have short experience in their activities, and their personnel is not sufficiently experienced and qualified. Taking this into consideration, staff of these institutes is recommended to follow the internationally recognized principles of microfinance:

Thorough examination of potential clients of the microfinance institution;
Thorough estimation of business viability and also factors which can positively or negatively affect the results of work in specific conditions;

Thorough registration of documents and contracts related to loan issuance and microfinance services providing;

Keep in touch with client in combination with monitoring of the terms of paying a credit, interests payments and with the aim to find out potential and real problems;

Setting of interest rates for microfinance services compatible with market ones;

Quick reaction to any problems which can complicate the perspectives of getting of issued credit payed back.

Conclusion

The Micro Finance Institutions should keep their goals to improve the quality of life of the poor by providing access to financial and support services; To be a viable financial institution developing sustainable communities; To mobilize resources in order to provide financial and support services to the poor, particularly women, for viable productive income generation enterprises enabling them to reduce their poverty; Learn and evaluate what helps people to move out of poverty faster; To create opportunities for self-employment for the underprivileged; To train rural poor in simple skills and enable them to utilize the available resources and contribute to employment and income generation in rural areas. If Micro Finance Institutions follow those it will cause to decrease the poverty in rural sector in Sri Lanka.

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