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Banking With The Poor Network

The BWTP Bulletin focuses on:

- Assessing the ability and performance of *Financial Inclusion* of Asian MFIs
- Evaluating the productivity and sustainability of Asian MFIs
- Identifying challenges and constraints, and recommending measures for improved performance of MFIs
- Promoting alliances among those working in international cooperation and development
- Informing external stakeholders of the outcomes of the Banking with the Poor Network and its members

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❖ China: Comparing NGO-Type MFIs in Shaanxi, China, with Grameen Bank, Bangladesh

M. Wakilur Rahman* and Jianchao Luo#

Abstract

This paper examines the sustainability of nongovernmental organisation-type microfinance institutions in Shaanxi province, China in comparison with Grameen Bank, Bangladesh. The findings show that despite geographical restrictions, the selected microfinance service providers have successfully expanded their services to isolated mountainous regions where formal financial institutions were non-existent earlier. They have built a strong financial and informational network with Plan China (country office of Plan International), China Association of Microfinance and women federation (Shaanxi province). However, the lack of funds, limited service provisions and restrictive policy environment shackles the industry from further expansion; necessitating urgent remedial steps for resolving existing barriers and allowing these institutes to participate in China's growth. The undertaking of similar research in other provinces is suggested for a better understanding of the Chinese microfinance sector.

Key words: Microfinance institutions, Shaanxi; China Association of Microfinance; Grameen Bank, Bangladesh

1. Introduction

Interestingly, microfinance sector is growing fast in terms of outreach, coverage, loan amounts and micro-savings, with services reaching over 150 million clients across the globe, and growing at around 25-30% annually (Pacheco et al, 2010), defying all conventional wisdom of financing poor, while maintaining financial viability (Morduch 1999, CGAP, 2006). The sector has developed and improved several unique and creative methodologies for their financial inclusion goals, and is considered to be one of the key instruments for poverty alleviation and economic growth in developing countries. Like many developing Asian countries, both Bangladesh and China have adopted microfinance to reach out and integrate their poor into the economic mainstream. Bangladesh adopted microfinance early on and has made tremendous progress in developing innovative micro-credit models, diversifying services, expanding outreach, and achieving sustainability (Ahmed, 2010; Rahman and Luo 2010; MRA, 2009); with the Grameen Bank's group lending methodology proving to

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be one of the most successful models, serving over 8 million clients in Bangladesh.

China adopted the Grameen Bank (GB) micro-credit model on an experimental basis in 1993. And consequently a number of different types of microfinance service providers (MSPs) were established within the Chinese financial market - including NGO-type institutions, formal financial institutes (state owned commercial banks), international donor agencies in collaboration with the Government and Government agencies (focused on poverty alleviation). These MSPs developed and adopted diverse credit models and innovative approaches (taking into consideration the country's policy environment) for their objectives.

Though there is great prospect, and a huge demand for microcredit service in China - large rural population with high levels of unemployed workers, numerous Small and Medium Enterprises (SMEs), limited outreach in rural areas, and high loan/deposit ratio in the formal financial institutions (He, 2008) - the Chinese MSPs, particularly the NGO-type microfinance institutions (MFIs), have been unable to make much progress over the years. This has been attributed to a lack of supportive policy environment and the absence of a dedicated regulatory authority for the sector.

The present study is an in-depth investigation into three NGO-type MFIs in Shaanxi province, for better understanding of China's MFIs performance, especially in comparison with the successful Grameen model.

2. Objective of Study

Previous research findings (Park and Changwing, 2001; Cheng and Abdullahi, 2009) established the effectiveness of GB model in China with respect to reaching poor clients; and the superior performance of NGO-MFIs, compared to the formal financial institutions. However, they also emphasised the need for further methodological innovations. Sun, R (2002) drew attention to other globally practiced micro-credit models alongside the GB model, while Lau (2008) focused on NGO-type MFI sustainability, with emphasis on poverty alleviation targets, especially in a liberalised China. Two distinct arguments have emerged from these studies on the issue of MFI sustainability and regulation - one view holding that regulation might hinder the microfinance development process from attaining of sustainability, supported by Christen and Rosenberg (2000), Mersland and Øystein (2009a), and Dichter (1997); while the others agree on a limited, soft regulatory regime towards sustainability[1].

Keeping previous reviews in mind, the present study focuses on the sustainability of NGO-type MFIs in China, taking Grameen Bank as the peer model - something never carried out before. This study critically evaluates the overall performance of three NGO-type MFIs in China (Shaanxi province) and compares them with Grameen Bank. More specifically, the paper is focused on outreach, credit performance, financial sustainability and regulatory situation of the selected MFIs.

3. Methodology

The study employs both primary and secondary source of information. Primary data was collected by adopting qualitative and quantitative approach.

[1] *Including Bagyenda (2010) and Okumu (2007) from Uganda; Vada (2010) from Cambodia; Diaz (2010) from Mexico; Vento (2010) from England; Kereta (2007) Ethiopia; Chiymya (2006, 2010) from Zambia; Mohanty (2010) from India; He (2009), Du (2005) and Sun (2008) from China; Rashid et al, (2010) and Haq et al (2008) from Bangladesh*

Shaanxi province was selected for the field investigation based on three criteria:

a) China's most successful province in microfinance services

b) Higher concentration of NGO-type MFIs and

c) Sample counties are state designated poor counties

A total of three NGO-type MFIs were selected out of six (only six NGO-type MFIs have membership status with China Association of Microfinance [CAM] in Shaanxi province) by applying random and purposive sampling technique. The Xixian Women's Development Association was chosen as the organisation received the first national welfare award in 2009. Pucheng Women's Sustainable Development Association and Chunhua Women Development Association were selected randomly from the remaining five CAM members. A detailed field survey was carried out with the selected MFIs during July-August, 2010. In addition, telephone interview/conversation was carried out with MFI staff whenever information discrepancy appeared.

Meanwhile, Focused Group Discussion (FGD), Financial Resource Mapping (FRM) and Problem Tree (PT) tools were adopted to gather information from clients. A total of six FGDs were conducted - three with credit beneficiaries and three involving non-credit beneficiaries in the three selected villages, of the three counties. After gathering information, applying bottom-up approach, in-depth institutional survey data were analysed and presented in a meaningful way. Finally, collaborative relationship approach was applied to determine the relationships among stockholders.

4. Results and Discussions

Performance of the selected MSPs

The overall performance of the selected MSPs has been measured in relation to outreach, operational mechanism, financial sustainability and regulatory status.

4.1.1 Outreach

Microcredit outreach refers to the ability of MSPs to provide financial access to a large numbers of borrowers who had previously been denied such access. It is notable that micro-credit outreach has expanded tremendously in most Asian countries, including China, over the last few years.

For example, Dongbu village of Chunhua county, and BaYi village of Xixiang county are remote communities encircled by mountains, and underdeveloped in terms of transport, communication and market infrastructure, with the area lacking livelihoods opportunities. They had no access to any financial services and largely depend on informal sources for their financial needs. Formal financial institutes were reluctant to extend their services to these remote areas, and were sceptical of their ability to repay, preferring instead to lend only to larger SMEs (Small and Medium Enterprises). Further, the complex application procedures and collateral requirements made it difficult for such communities to access their services.

It is in areas like these that the selected MSPs - Xixiang Women Development Association (XWDA), Pucheng Women's Sustainable Development Association (PWSDA) and Chunhua Women Development Association (CWDA) - have successfully extended their services, bringing micro-credit to these remote communities for the first time. The three MSPs have expanded their micro-credit services to 5633, 6555 and 2620 clients, and increased their services from 3, 4 and 3 townships to 8, 6 and 4 townships respectively (cumulative no. end of July, 2010

- Figures 1 & 2), despite the geographic limitations (remote and isolated communities) and policy restrictions (permit to operate within the county). It should be noted that GB, which has no such geographical or policy restrictions, cover 83458 villages, with 2562 branch offices spread across the whole country, serving 8.28 million borrowers (cumulative no. end of July 2010; Figure-3).

They also have, like most other Chinese MSPs, adopted the group guaranty system over traditional form of collaterals.

The percentage of active women borrowers for the three institutes, XWDA, PWSDA and CWDA, are 97, 97 and 95 respectively, which is similar to GB figures (97% women clients).

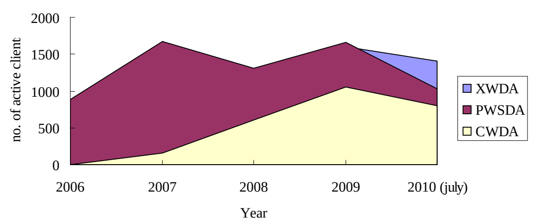

Figure 1 Outreach by each MSPs during 2006-2010

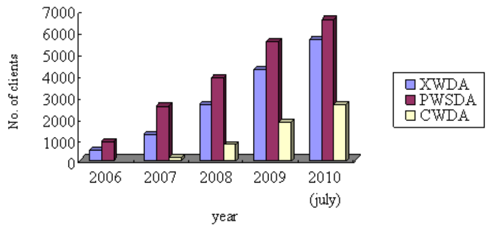

Figure 2 Cumulative outreach by each MSPs over time 2006-2010

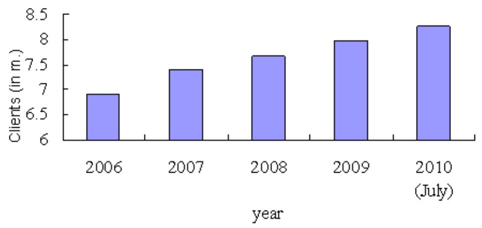

Figure 3 Cumulative outreach of GB over time 2006-2010

- The FGDs yielded some interesting information - clients gratefully acknowledged their ability to access financial services, but claimed an insufficiency of funds. They informed that the service charge on MSP loans were lower than informal sources, but higher than formal institutions (state owned banks). Generally, Rural Credit Cooperatives (RCCs), as a formal financial institute, offer loans at around 8 percent service charge, whereas the selected MSPs offer it at around 11 percent. Clients revealed that though they mostly don't pay interest when borrowing from friends and relatives (informal sources), there were instances where they had to pay a higher interest (15-20 percent) on such borrowings. However, their dependency on friends and relatives has decreased after the micro-credit services reached their village through the initiative of these MSPs. They also advised that the application and approval procedure for MSP loans were reasonably simple.

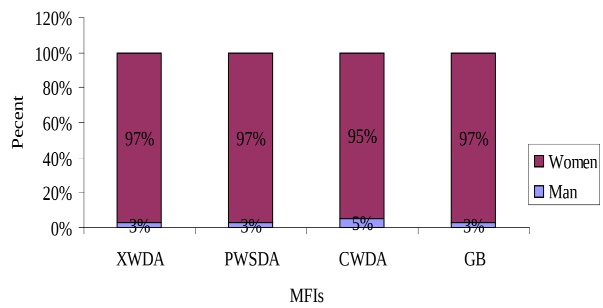

Figure 4 Percentages of active clients for women and men in 2010

4.1.2 Operational Mechanism

The selected MSPs follow a modified GB model for their micro-credit services (Plan China, 2009). Generally, they adopt the following lending procedure - selecting village, motivating villagers, group formation, household investigation, group training and awareness building, and electing group leaders. This is followed by application for loans, loan disbursement and, finally, repayment through quarterly instalments.

But, like all other Chinese MSPs, they too are restricted from deposit collection.

As per regulations, the manager or loan officer is required to make weekly visits to the villages for monitoring credit function, and developing a friendly relationship with the clients. But the researcher's field investigation found no such monitoring or rapport building exercise. In fact, the borrower is responsible for paying back loans at the MSPs' offices, rather than the loan officers collecting instalment from the villages. This causes lower interaction between borrowers and loan officers, and can lead to alienation. Further, group training for these MSPs does not involve training for entrepreneurship or enterprise management, and is limited to creation of group awareness and group responsibility only.

Though GB too lacks supervised or productive credit services in Bangladesh, the differences are apparent - weekly versus quarterly instalments, loan officers collecting instalment from clients against clients visiting MSP offices, non-requirement of formal application for lending versus formal application requirement, which are completely different from the GB model. Further, GB can collect deposits and also offer micro-insurance, remittance, pension, training, education and social awareness programs, which is not practiced by the studied MSPs. However, XWDA, PWSDA and CWDA have followed similar approach of GB in respect to increased lending amount considering previous lending successes.

4.1.3 Financial Sustainability

Sustainability may be defined as earnings (from micro-credit services) that cover operational and funding costs, and can take care of bad loans, while allowing for further expansion of services. It may be further delineated as Operational Self-Sufficiency (OSS) and Financial Self-Sufficiency (FSS), where OSS refer to the ability of the institution to generate enough revenue to cover its operating costs, and FSS refer to the institution's dependence (or lack of it) on subsidies for successful operation (Murdoch Dec 1999).

However, financial sustainability of the Chinese MFIs is slightly different due to the restrictive fund sources, funding options and limited service provisions. In fact, financial sustainability is considered as one of the major constraints of China's microfinance service providers. NGO type MFIs are not allowed to collect deposit from members, or funds from commercial banks and other sources, and they are neither allowed to receive grants from foreign donors. Financial assistance by Plan China is the only source of funds for these MSPs and the only means towards achieving financial sustainability. Plan China provided seed grants to the three selected MSPs - XWDA (24.12 thousand USD), PWSDA (22.06 thousand USD) and CWDA (22.35 thousand USD) for working in underprivileged villages, particularly with women (see Annex-2), and may be considered as a milestone in allowing them to gradually accomplish success in respect to loan quality, profitability, management efficiency and independent operation. Thus, the present study follows alternative measures for determining financial sustainability.

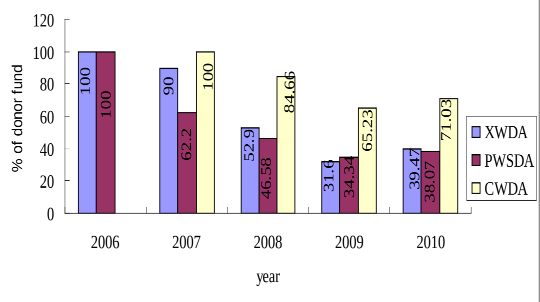

Figure 5 Donor dependencey of the selected MSPs

The Bangladeshi MSPs, (the most self-sufficient in Asia, particularly the larger ones) on the other hand are financially more sustainable since they can collect fund from various sources, including commercial banks, Polli Kormo Shyakak Foundation (PKSF), international donor grants, savings/deposit of members, interest and service charges (Bedson, 2009; Ahmed, 2010). GB has been enjoying financial self-sufficiency without receiving donor and government grants since 1998 and has disbursed 100 percent credits from bank deposits. In fact, PKSF has been playing a greater role in making MSPs financially self-sufficient, particularly the small and medium MSPs. As an apex institution, PKSF has played the role of both financial intermediary and market developer and continues to be an institution central to the Bangladeshi microfinance landscape (Bedson, 2009). Unfortunately, China has not established any such apex institution, though CAM has great potential in playing such a leading role.

4.1.3.1 Trends of annual earnings

The study found that within a short period of time XWDA, PWSDA and CWDA had accomplished a positive trend of annual earnings (Figure 6). CWDA's earning increased to US $29421 from US $2941 (2007 - 2009), XWDA's increased to US $7290 from US $ 2967 (2006 - 2009), and PWSDA's earnings increased to US $ 60887 from US $ 55397 (2006 - 2009). The increase in the annual rate of earning was 4.66%, 2% and 3.33% for XWDA, PWSDA and CWDA, respectively. Undoubtedly, such performance acts as an incentive and enhances the confidence of the MSPs toward reaching their financial sustainability target.

Similarly, GB too has made profit each year, except 1983, 1991, and 1992. GB earned the highest amount of profit in 2006 (US$20 million), while profits have declined in the following years - US$1.56 million (2007), US$18.99 million (2008) and US$ 5.38 million (2009). This profit reduction may be attributed to greater social responsibility undertaken by GB during natural calamities, investment on innovative and non-profitable schemes (beggar loans, student loans), and dividend sharing.

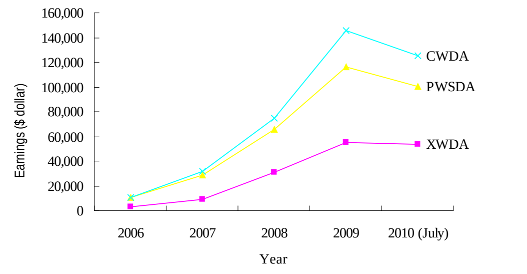

Figure 6 Annual earnings of the selected MSPs overtime

4.1.3.2 Correlation between borrowers and profit performance

Figure 7 (below) shows the correlation between the number of active clients and profit performance. It was measured using data from three MSPs (with the exception of 2006, for which year CWDA data is not available). There was concern in certain areas that it may not be feasible for the MSPs to reach out to poor clients for lower loan amounts, but the selected MSPs have actually made profit by servicing such small loans for the poor clients. The number of active clients and earning are strongly linked as observed, and implies that the MSPs have done well.

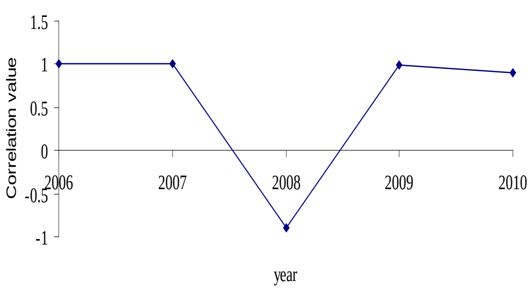

Figure 7 Correlation result between active clients and profit performance of the selected MSPs overtime

4.1.4 Financial resource relationships network

At the institutional level, interviews were carried out with MSP staff, their clients and partners (i.e. Plan China and CAM) in order to determine the degree of interaction, and the level of financial flow. Figure 8 depicts the complete set of association and highlights the more intense relationships. Plan China is at the centre of this network and interacts with the three key partners - XWDA, PWSDA and CWDA, who have their own association with women federations and CAM. All three MSPs have membership status with CAM, and are registered with the local government offices at county level. They have approvals from the women federations of Shaanxi province and have also received grants from Plan China's sustainable livelihood program.

Figure 9 (Annex 1) represents the core network, showing the intensity of relationship that exists among MSPs, village and township beneficiaries, Plan China, and CAM. Plan China can be considered as the backbone of this financial network, from where financial aid flows to the MSPs, and then, on to the target clients. Plan China not only provides financial resources but also provides other services, i.e. training (MFI staff and micro-credit clients) and information. Meanwhile, the selected MSPs have also raised funds from commercial sources though it is not 'legal'. Women's Federation of Shaanxi province and CAM provide technical and capacity building support for a smooth and healthy business environment.

With regard to the GB model, at the initial stage, Grameen Bank's financial network was built with charity funds (mostly from International Fund for Agricultural Development, soft loans from the central bank of Bangladesh, commercial banks and borrower savings). The donor agencies provided the bulk of capital money at a cheap rate of interest - with the government banks availing funds at a mere two percent annual interest rate, which GB then lent to their clients at 10-15 percent flat rate, helping GB to become financially self-sustained within a short period of time. However, the structure of the financial networks have shifted over time and at present borrowers of Grameen Bank own 95 percent (GB share) of the total equity of the bank; the remaining 5 per cent being owned by the government (GB, 2010). Today, GB's growing amount of deposits is more than enough to run and expand its credit program, and repay all its existing loans. Certainly, client's deposits are a major contributor to the GB success story, playing a vital role in the financial resource network. For instance, GB finances 100 per cent of its outstanding loan from its deposits and over 54 per cent of its deposits come from the bank's own borrowers.

4.1.5 Regulatory Status

Beside financial sustainability, policy regulation of microfinance is considered a crucial factor for the overall development of the microfinance sector. Policy regulation for sustainable microfinance has been prioritised at the national and international level since 1990s (Haq et al. 2008; Villacorta et al. 2009; Mohanty, 2010). The importance of policy regulation is recognised by stakeholders (Government, NGO-MFIs and borrowers), but attaining consensus remains problematic . In a recent speech Prof. Muhammad Yunus, founder of Grameen Bank, states that, "…there should be a separate regulatory authority for MFIs as distinguished in character from that for the commercial banks. The regulatory authority for MFIs should evolve guidelines keeping in view the objectives of socio-economic development of the poor". Bangladesh (like many other countries) established Micro-credit Regulatory Authority (MRA) in 2006 to ensure transparency and accountability of the microfinance sector. Meanwhile, GB followed self-regulatory mechanism and internal audit system for better financial and staff management. In addition, it is audited by two internationally reputed audit firms of the country. The financial report is published every year and is available on the GB website.

On the other hand, China Banking Regulatory Commission (CBRC) is the prime authorised institute for framing rules and regulations for, and maintaining the banking and microfinance sector in China. The policies governing microfinance remains vague and do not have a comprehensive framework that can promote smooth growth of the sector. Further, NGO-MFIs are not adequately regulated under this national policy, and come under the aegis of local administrations and departments, resulting in inconsistency, and consequently, insecure legal structure that undermine investor confidence (Bedson, 2009). For instance, the selected MSPs are registered with provincial government (civil affairs of their respective counties), and since there is a lack of regulation, the MSPs have adopted self-regulatory approach with the collaboration of Plan China, CAM and women's federation. MSPs produce financial report and it is certified by Plan China, after investigation. It must be noted that the MSPs do not have an internal audit system.

5. Problems addressed by MFIs and their clients

a. Shortage of Fund: Fund shortage was a major issue raised by both MSPs and the clients. MSPs claim that they could not expand their services due to limited funds. There was a lack of wholesale fund, while commercial funding is forbidden (MSPs accumulate fund from commercial sources illegally). Meanwhile, farmers/clients ask for larger loans as the current level of grants is insufficient for their enterprise. Interestingly, BaYi Village of Xixiang County's clients were satisfied with the present amount of loans as previously they were totally lacking financial access.

b. Lack of educative/supervised loan: From focused group discussion it was observed that there was a lack of supervised credit - farmers visit the MSP office to receive credit, and few cases are investigated by the MSPs' field officers.

c. Lack of Motivation: MSPs along with Plan China have been motivating farmers/clients about group lending methods but have had limited success so far.

d. Geographic location: The investigated villages were surrounded by mountains and lack transport and communication facilities. Hence, MSP field officers, along with other development workers, only occasionally visit these villages, which tend to alienate clients from development benefits. In addition, clients complained about low price for their products.

e. Service provision: Selected MSPs mostly provides micro-credit, rather than supplementary services like savings, insurance, education, medical, remittance and social awareness. In fact, they are restricted from offering additional services, particularly saving and insurance, which was reported during the institutional survey.

f. Lack of Training: Both MSP staff and clients have limited training. Plan China offers some basic training for MSP staffs and clients; however, Plan China's programs mostly cover awareness building rather than enterprise skill development.

g. Instalment duration: Selected MSPs have been practicing quarterly instalment for credit repayment. This seems good when compared to Grameen Bank's requirement of weekly repayments, particularly for farming enterprise. However, farmers suggested a half yearly instalment plan.

h. Regulatory environment: Like others, China's MSPs have also faced lack of regulatory structure for their services. They mostly seek legal status from provincial or local government as the central government does not have distinct microfinance regulation. Hence, they are deprived from government collaborative programs for regional development on a partnership basis.

6. Conclusions

The research found that as China moves towards a more liberalised and commercialised economic environment, the Chinese microfinance sector finds itself at a crossroad. Meanwhile, the MSPs and Plan China have been motivating group lending method that can be considered as an instrument towards increased popularity of microfinance among masses. The market access of microfinance service providers have significantly increased, contributing to capital mobilisation in rural areas. The selected MSP services have reached poor clients, particularly women living in isolated and mountainous villages. The collateral free micro-credit program that has been adopted has further broadened the micro-credit base, and their adoption of small amount of loans with quarterly repayment is highly suitable for farming enterprises, especially when compared to Grameen Bank's weekly repayment mode. The service charge is quite reasonable at around 11 percent, and lower than Grameen Bank's usual interest rates (expect education, housing and beggar loan). There is lower complexity in loan application and approval system (takes only a few days), and can serve as a lesson for formal financial institutions. Noticeably, the selected MSPs have accomplished about 100 percent repayment rate.

Regarding the financial status, the studied MSPs are in a better position as they have received seed grants from Plan China; it is an uncommon case with China's microfinance service providers. Hence, the selected MSPs were able to build a good service network (Plan China, CAM, and Women's Federation) which definitely improved their business capacity. Consequently, they have gradually achieved success with respect to loan quality, profitability, management efficiency, independent operation, and sustainable growth. However, they have also been facing some challenges due to restrictions on geographic expansion, funding from commercial and donor sources, limited service provisions and lack of supportive policy environment.

Other findings:

- It is observed that selected MSPs performed well in all three areas. Given the remote location and focus on agricultural farming in China's poor areas, it is suggested they should have greater flexibility in loan contract terms, increase monitoring mechanism, and ensure productive uses of credit
- It is clear that micro-credit alone cannot bring significant changes of poor livelihoods and a credit plus-plus approach is needed. Studied MSPs have had limited supplementary services which may not be sufficient for an overall, comprehensive development. MSPs should be innovative and offer new products suited to regional environment, and the government authorities should legalise such innovative services.

- Despite group lending motivation by Plan China, MSPs and other similar platforms, government should take more initiatives to increase awareness.
- Financial sustainability has been a major issue of concern for the Chinese microfinance sector. It is regarded that the restriction on fund collection is a major constraint toward attaining financial sustainability, as proven by the sample MSPs, whose success is dependent on Plan China's seed grants. Thus, it is suggested that the authorities allow MSPs to raise fund from commercial sources or external donor.
- It is proven globally that successful and sustainable microfinance programs can improve lives and play an important role in improving the rural economy, and possibly reduce the inequality between rural and urban areas. The government should come forward and take the opportunities offered by the microfinance sector and extend market access and policy supports toward a balanced development of this industry.
- Government-MSP partnerships tend to bring better results, as proven by international experience (Bangladesh government has several partnership programs with GB, BRAC, ASA etc.). In fact, the selected MSPs have good orientation within their service areas, and it is suggested that that potentiality should not be undermined by legal compulsions, and China too should include these MSPs in the local developmental process.
- China's MSPs are still regulated by the China Banking Regulatory Commission (CBRC). It is recommended that the authorities institute a separate regulatory body to better utilise the enormous potential that exists for microfinance sector in China.

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Annex-1 Figures 9 and 10

Figure 9

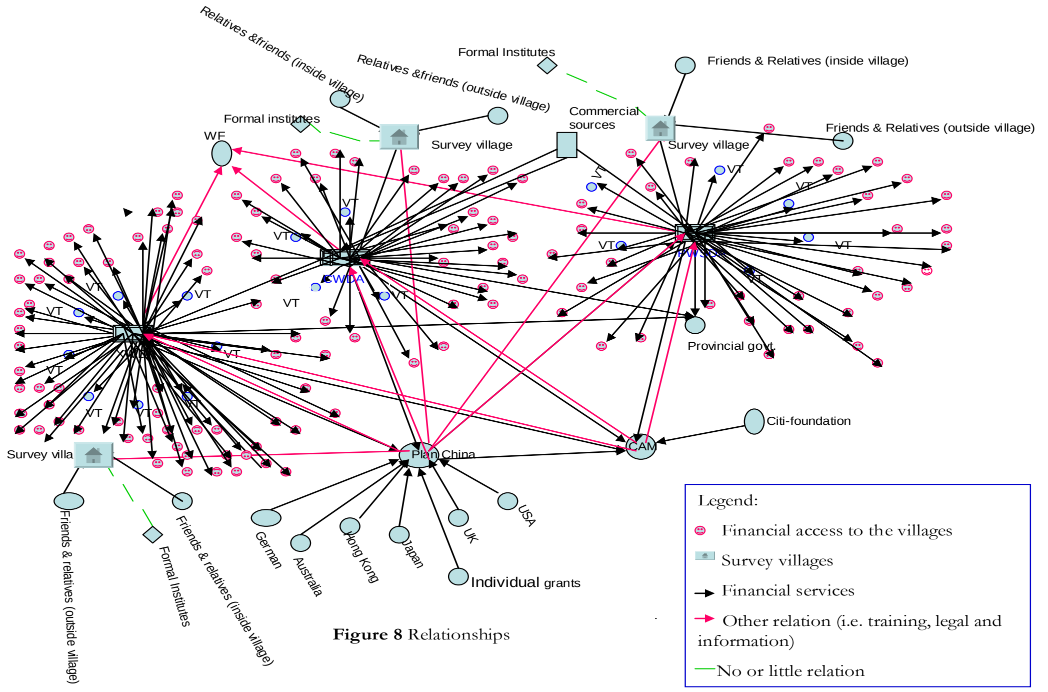

Figure 8 Relationships

Figure 10

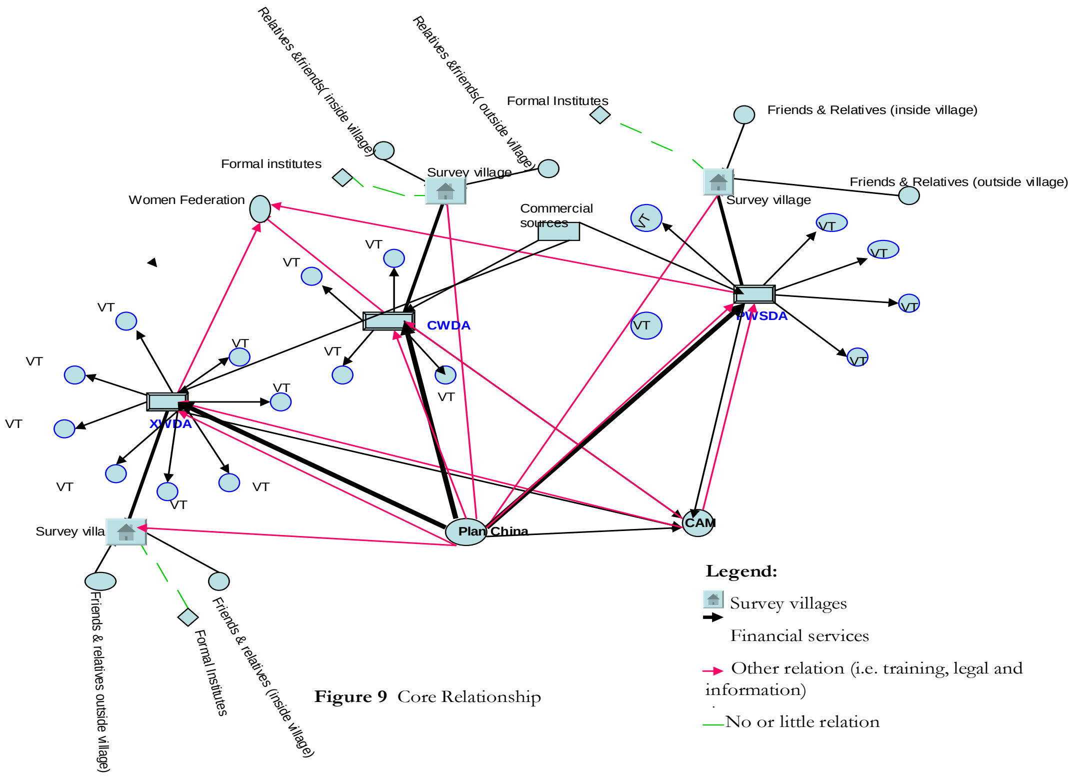

Figure 9 Core Relationship

Annex-2 Overall information of the studied MSPs and Grameen Bank

Elements	XWDA	PWSDA	CWDA	GB
Year of establishment	2005	2005	2006	1983
Area coverage (end of July, 2010)	8 townships (60 villages)	6 (35 Villages)	4 townships (30 villages)	Whole country (83458 villages)
No. of clients (cumulative up to July, 2010)	5253	6525	2657	8.28 million
No. active clients (end of July 2010)	1940	1856	1264	6.43 million
% of women clients among active borrowers	96.65	97	95.1	97
Service provision				
microcredit	√	√	√	√
Savings	☒	☒		√
Training/education	√	√	√	√
Insurance provision	☒	☒	☒	√
Others (remittance, social awareness)	☒	☒	☒	√
Group lending	√	√	√	√
Collateral/mortgage	☒	☒	☒	☒
Required formal application	√	√	√	☒
Days require to receive credit after application	3-7	7	3-7	7
Applicant received same amount as applied for	☒	☒	☒	√
Lending range ($)	147-1176	294-588	147-588	varies
Average loan size ($)				
Lending duration	1 year	1 year	1 year	1 year
Supervised/educative credit	√	√	√	√
Installment duration	quarterly	quarterly	quarterly	weekly
Installment collection	Clients pay to office	Clients pay to office	Clients pay to office	Loan officer collect
Interest rate (%)	10.8	10.8	10.8	8-15
Staff management				
Total employees (No.)	12	14	8	23,997
No. of loan officers	6	9	4	13,262
% of women staff	50	67	38	
Satisfactory remuneration for staff	√	√	√	√
Overtime benefit	☒	☒	☒	√
Insurance for staff	☒	☒	√	√
Training for staff	√	√	√	√
Participation on decision making	√	√	√	√

Annex-3 Financial features of the selected microfinance service providers

Elements	XWDA	PWSDA	CWDA	GB
Sourced of fund	Donor grants	Donor grants	Donor grants	Clients savings, borrowing from govt.
Source of wholesale fund	Plan china	Plan china	Plan china	Stop to receive donor grants since 1998
Amount received( ) as initial investment	$241176	$220588	$223529	$3.4 million loan from Central Bank and IFAD
Whole sale fund service charge (%)	☒	☒	☒	2
Precautionary amount (%)	1	1	1	-
Institutional ability to meet credit demand	☒	☒	☒	√
Operational cost US $ (personal +non personal) in 2009	25838	55348		204.42 million
Bad loan (%)	☒	☒	☒	3
Credit disbursed ($) end of 2009	5184000	4368000	3980000	9.43 billion
Outstanding amount ($) end of July, 2010	3939247	60887	30588	887 million
Repayment rate (%)	100	100	100	97
Income US$ (end of 2009)	55398	414031	208000	209.80 million
Operational self-sufficiency (OSS)	214	120	118	102.63
Return on equity	-	-	-	5.64
Financial self-sufficiency	-	-	-	99.3
Loan officer productivity	-	-	-	509

❖ Sri Lanka: Community-Based Organisations – Achieving a Double Bottom Line?

Imran Nafeer* & R.M. Nadeera Ranabahu#

Abstract

The purpose of this paper is to analyse the operational sustainability, and financial inclusiveness of the community based organisation model of microfinance institution in Sri Lanka. The findings indicate that although the spread and depth of outreach is limited within the studied CBOs, financial performance is promising. The CBOs are able to extend their services to the lower end of the market, but not to the lowest segment. Incorporation of this market segment during the CBO mobilisation and formation stage thus becomes vital. There's also a hint of 'trade-off' - where either profit or social good often takes the backseat.

Key words: Community based organisations, Sri Lanka; Double bottom line; Financial inclusion; Asia.

Introduction

In Sri Lanka and internationally, "financial inclusion" and "social bottom line" have become buzzwords for today's rapidly expanding microfinance industry - lending institution that is 'for-profit', along with 'for-social good'. And as it widens, and deepens, financial inclusion and social bottom line become central to the industry's success, and impact. The ability of microfinance institutions (MFIs) to cater to a marginal market space, and still remain commercially viable is an enormous challenge for the industry.

Community based organisations (CBOs) are one such group-based lending institution that caters to the under-privileged section of society in Sri Lanka. And over the years CBOs have become an integral part of the Sri Lankan microfinance landscape, remaining as one of the predominant group-lending model, though other forms of lending also exists. This present paper analyses six CBOs to assess whether the balance sheet and income statements of these institutions match their "mission statement", and whether they are effective institutions for achieving the double bottom line of financial performance, and socially beneficial outcomes.

Community Based Organisations (CBOs)

Community based organisations (CBOs) are associations of socio-economically homogeneous groups of men and women, based within a close geographic location. Formed with extensive help from NGOs and other organisations, who also train the members in various financial activities of community banking (Atapattu, 2009), a typical CBO has about 30 to 40 members (records of some institutions show there are about 500 members), who themselves perform a significant proportion of the functions and transactions; establishing their own by-laws, electing functionaries, distributing loans (backed by social

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collaterals and not with goods or property - Atapattu, 2009), and collecting payments and savings. A key feature of the Sri Lankan CBO is their strong focus on social development, and in spite of their substantial financial transactions, they are not exclusive microfinance entities, treating income generation assistance as just a part of their overall goal.

State of CBOs in Sri Lanka

CBOs are promoted within the country mostly by NGOs, who have their own microfinance business units. The SANASA Development Bank, SEEDS, Sewa Finance and Arthacharya Microfinance Institution are a few such entities.

Gemidiriya, a World Bank funded project implemented by the government, also promotes a village banking model called 'Village Savings and Credit Organisation' (VSCO) and Samurdhi (Samurdhi Banking Societies), which is the main poverty alleviation program of the government, with the CBO serving as the ground level mechanism. However, in the 1990's new players entered the market (Lakjaya, Ceylinco Grameen and Berendina Microfinance Institutions), who have adopted methods of direct lending to clients, where they use the community as collection mechanisms (Atapattu, 2009).

Though exact numbers are difficult to obtain, data available at various source provide only a rough idea. According to the Annual Report 2009 of SANASA Development Bank, there are 4,050 societies spread across the island; while figures of SEEDS (September 2009) indicate that there are 3,987 Shramadana Societies catering to 525,150 members. The Annual Report (2009) of Gemidiriya states that there are 1,043 VSCOs, while the Microfinance Industry report of Sri Lanka mentions 1,038 Samurdhi societies. The publication "Profiles of Members-2010" of the Lanka Microfinance Practitioners' Association (LMFPA) notes that there are 3,263 CBOs in their regionally based member organisations. But though the numbers seem encouraging, statistics indicate that a significant proportion of these CBOs are inactive. According to the Sri Lanka Industry Report, though SANASA has an official list of around 8,500 CBOs, only half of them are actually functional. The SEEDS statistics indicate that the number of inactive Societies range around 1,646.

CBOs are often criticised for having bad portfolios, high loan write-offs (which ultimately affect the functionality of these units), and poor quality of services. There are arguments that a significant proportion of the portfolio caters to the relatively better-off clients within the CBO where the poor have to co-guarantee with their marginal asset base; and that the poor and the marginalised merely play a passive role, or are mostly left out of the main operations of the CBO. In fact, the Sewa Finance states that due to certain ineffectiveness associated with the CBO model their lending methodologies were altered. The World Bank study "Microfinance in South Asia" (2006), reports that CBOs with microfinance portfolios, suffer from operational problems due to their excessive focus on social objectives which ultimately hinder them from functioning more effectively. This necessitates the need to explore the financial and social performance of CBOs, with an emphasis on the above arguments.

The Objectives of the Study

The overall objective of the study is to assess whether CBOs are effective modalities in achieving the double bottom line. The specific objectives are:

Exhibit 1

	CATEGORY	KEY VARIABLES
01	Outreach (Breadth)	Number of members (male & female), number of active borrowers (male & female), coverage of CBOs within GND
02	Outreach (depth)	Poverty rate of CBOs
03	Portfolio	Amount of outstanding portfolio, male/female distribution of portfolio, average loan balance per borrower, average loan balance per GNP per capita
04	Loan utilization	Purpose wise disbursements, amount of portfolio for poor
05	Portfolio Quality	Portfolio at risk (30 days), recovery rate, write-off ratio
06	Member participation	Attendance rate, participation of poor, exit rate,
07	Financial position	Total assets, liabilities and equity, total income and expenditure of CBOs
08	Cash flow management	Total cash balance of CBOs
09	Productivity	Administrative cost ratio, operating efficiency
10	Sustainability	Operational sustainability, financial sustainability
11	Profitability	Yield on portfolio, adjusted return on assets, adjusted return on equity

- To assess the financial performance, by analysing the portfolio quality, financial position, cash flow, productivity, sustainability and profitability of CBOs

- To analyse whether the social objective of MFI mission is achieved, with a special emphasis on the depth and scale of outreach

- To identify the challenges and constraints of CBOs in achieving the double bottom line and recommend measures to improve financial and social performance

Research Methodology

For this paper, the "case study" methodology was used for an in-depth study of the CBOs. The CBOs were selected with care, so as to understand the diversity of these organisations. The unit of analysis is the CBO, though individual client level information is also assessed to investigate different patterns within the entities.

The research focuses on two main aspects: financial and social performance at the CBO level. The CGAP guideline for financial analysis was used in calculating the financial performance, while ground level achievement of "Mission Statement" was assessed for social performance. However, the study gave a higher focus on inclusion of the poor and has considered this as the core theme under the social performance parameter. The key variables analysed in the CBOs are summarised in Exhibit 1.

Spread of outreach is measured using the number of members and borrowers who are currently accessing the financial services; i.e. borrowers, savers and shareholders.

This is different from the usage of "active borrowers" where borrowers with outstanding loans are only considered. A single borrower can have multiple loans but only borrower number is considered.

The depth of poverty is measured using poverty rate against progress out of poverty index (PPI) developed by Mark Schreiner (http://www.microfinance.com/#Sri_Lanka), an index that includes 10 simple indicators which highly correlates with poverty (Annex B). The likelihood of each client being poor is tested and scores are used to derive the poverty rate against national and international benchmarks. In this research poverty rate is checked against three bench marks - below national poverty line, below $2.5/per day and below $3.75/per day.

The portfolio is measured using the amount of loans outstanding, which include all current, delinquent and restructured loans, but excludes the written-off loans. In certain instances the disbursed loan amount, which is the total amount of loans issued, is considered.

Average loan outstanding, which is the gross amount of loans divided by the number of borrowers, is used to compare the loan amounts for each CBO. This is also used as a proxy for poverty after dividing the Gross National Product per capita (average loan outstanding per borrower/GNP per capita).

The quality of the portfolio is measured with the portfolio-at-risk (PAR) and repayment rate. Though PAR (Outstanding principal balance of all loans due more than 30 days/ Outstanding principal balance of all loans) 30 days is the most common figure, this research assessed the PAR one day figures as well. Repayment rate (current and past due loan amount received/ total amount due during study period + amount due from previous periods) and the write-off ratio (Value of loans written off during the same period/average gross loan portfolio during period) is also calculated to supplement the above.

Member participation in CBO work is reflected by the attendance rate (total number of meetings attended/ total number of meetings held) of members. And the success of a group is reflected by the retention rate (number of members at the end of the year - enrolments during the year/number of members at the start of the year) of members; where, higher rate of retention indicates higher levels of member satisfaction.

Productivity is manifested by the operating efficiency and administrative cost ratio; where operating efficiency reflects the total operating expenses against the average net portfolio, and administrative efficiency indicates the total administrative expenses against the average net portfolio. Taken together, these indicate the cost efficiency of the CBO operation.

The sustainability of the operation is measured with the Operational Self Sufficiency (OSS) and Financial Self Sufficiency (FSS), where OSS is derived by dividing operating income by operating expenses, and FSS is derived by adjusting inflation, in-kind donations and subsidies against operating expenses, with operating income then divided by adjusted operating expenses.

In addition, similar adjustments are done to calculate return on assets (adjusted operating profit/average total assets) and return on equity (adjusted operating profit/average total equity). The yield on portfolio (interest and fee income from loans/ average net portfolio) is calculated for a comprehensive picture on profitability.

The Study Setting - Sewa Finance and CBOs

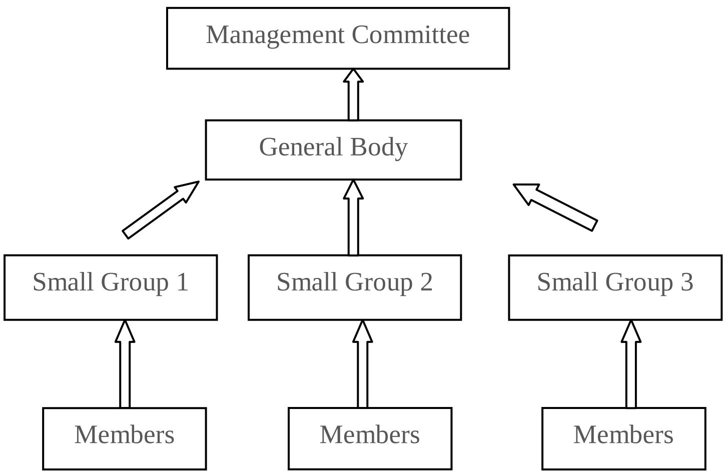
The researchers selected the MFI Sewa Finance (Guarantee) Limited since it follows the CBO model as its predominant lending mechanism; and limited the research area to Galle District.

Sewa Finance, the microfinance arm of Sewa Lanka Foundation, was established in 2005. The MFI envisions eradication of poverty through sustainable delivery of microfinance as its mission - providing financial services to the poor men and women of Sri Lanka, empowering them economically, enabling them to create income and employment-generating opportunities (especially self employment), increase their savings, eliminate their indebtedness to money lenders, and arrest distress sale of commodities and assets. The main financial products of the MFI are designed to achieve this vision, and include wholesale lending through CBOs: short term agriculture loans and enterprise loans.

Currently Sewa Finance has 495 CBOs (March 31st, 2010), and each small group (Exhibit 2) has a separate financial services unit – mainly for loans and savings. There is a management committee with a chairman, secretary, treasurer and committee members. All lending decisions are taken by this management committee. The general body meets once a month, where loans are issued.

Galle District is an area with a very competitive market, and with numerous microfinance players, especially after the huge influx of grants attached with tsunami relief services. The district currently has around 12.5 million rupees (31st March 2010) of loan outstanding with a 30 day portfolio risk of 1.57 %. This is also one of Sewa Finance's chief areas of operation (32 CBOs).

Exhibit 2: The CBO structure



Source: LMFPA profile of members

The researchers used the non-random sampling technique to categorise the CBOs as 'Good', 'Average' and 'Below Average' performers. The main criteria used for this categorisation are the maintenance of books of account, leadership, financial handling and other village development initiatives undertaken. However, a qualitative assessment of Sewa Lanka Foundation on institutional strength was also considered (Exhibit 3).

For better understanding, the research findings are presented according to this categorisation. But this does not imply that the researchers believe that this is the performance level of the CBO. After analysis, the categories have been re-arranged according to performance on different variables, and checked against MFI records to determine

Exhibit 3: The CBO development levels

Category	Name of CBOs
Good performers	Shakthi Samagi
Average performers	Liyasaviya Janashakthi
Below average performers	Isuru Sahana

Source: Secondary information

Data Collection and Analysis

Both primary and secondary data were collected to analyse the current financial and social status and trends. For quantitative data, two separate data collection techniques were employed. Financial data were collected from the books of account of the CBOs and MFI to derive income statements, balance sheets, cash flow statement and portfolio analysis. This was done as a desk review with extensive inputs from the CBO leaders, with MFI data used to corroborate CBO figures. In supplementing the primary quantitative data, discussions with key CBO leaders and field staff of the MFI was held, and CBO meetings were observed. Both quantitative and qualitative findings were then used to arrive at conclusions.

The research team visited 89% of the households of existing clients, and around 10% of exit clients in calculating the PPI score and determining the poverty rate for each CBO. The researchers categorised the clientele into four groups based on the poverty likelihood, considering the <$3.75 per day benchmark for this purposes (Exhibit 4). However, poverty rates of CBOs have also been compared with the national poverty line, and other international benchmarks for a better understanding. Using these poverty categories, and certain institutional and financial indicators (such as attendance, loan disbursements, portfolio quality) the figures have been re-calculated to identify the existence of differences.

Exhibit 4: Poverty categories

PPI score	Poverty category (as defined in this research)
0 to 34	Extreme poor
35 to 54	Relatively poor
55 to 74	Moderate poor
75 to 99	Non poor

Source: secondary data - http://www.microfinance.com/#Sri_Lanka

Limitations in the research

The main limitation the researchers faced was in deriving the financial statements and portfolio reports since the books of account at the CBOs are incomprehensive. The trial balance was prepared at only one CBO, while others simply maintained accounts; and only one CBO had been audited for the period of 2009. Therefore the financial statements were derived by the researchers themselves, using available data and by verifying numbers with other sources - such as bank statements and MFI figures.

Additionally, when assessing the social bottom line, the researchers only assessed the achievement in relation to inclusion of the poor. Ideally the main sections of the mission statement of Sewa Finance: 'economic empowerment, income generation opportunities, increased savings and elimination of indebtedness to money lenders', should be studied alongside inclusion of poor; but due to the wider focus on social performance, the research was limited to one aspect.

In gathering social performance data, where the PPI tool was used, the research had to stay focused on clients' family, rather than the household - where they live together, but maintain assets separately. This was done mainly due to the client targeting strategy of MFIs, which is the family unit. In PPI administration (focused on the household), the attributes attached with the household condition has the same marks, and this can be misleading. In this study, when the PPI tool was administered, there were 3% clients living in the same house out of the total sample.

Research findings and analysis

The majority of CBOs studied are promoted by Sewa Lanka Foundation, the parent organisation of Sewa Finance. All are registered with the Divisional Secretariat's office, and the chief microfinance services offered are loans, savings and shares.

These CBOs, except Isuru and Liyasaviya, were established in 2005 immediately after the tsunami disaster. Liyasaviya CBO was established before the tsunami, but was reorganised in 2005 to extend immediate relief services to its members, and demonstrate the perfect example of group bond amongst neighbours, especially in the face of challenge.

Exhibit 5: Membership

Name of the CBO	Good Performers		Average Performers		Below Average Performers	
	Shakthi	Samagi	Liyasaviya	Janashakthi	Isuru	Sahana
No. of Management committee members	9	7	11	8	5	7
No. of small groups	6	2	5	4	3	1
No. of members	38	18	30	29	21	12

Source: Primary data collection-2010

The common bond and the driving need of these CBOs (excluding Isuru) was the relief services being extended by the NGOs in the aftermath of the disaster, and even families who were only marginally affected, became members. CBO Isuru is unique since it was established as an effort of the CBO promotion of a NGO from an existing agriculture society. The objective of establishing Isuru, as revealed by the CBO leaders, is not financial services, but rather, social development and benefits attached with the NGO, Sewa Lanka Foundation.

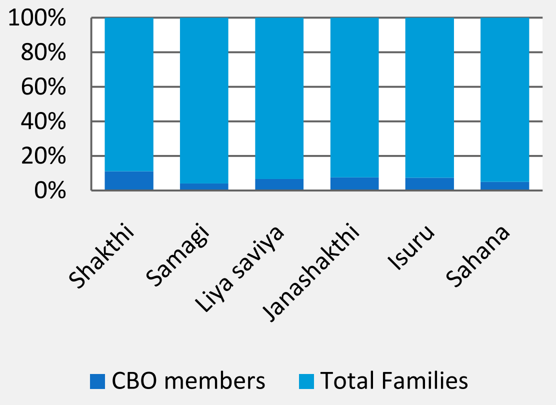
Spread and depth of outreach

The six CBOs studied, cater to 148 members of whom, 97% are females. The CBO Shakthi has the highest number of members (Exhibit 5).

The active member percentage of the CBOs is close to 45%. In this analysis the year 2005 was taken as base year, except for Isuru, which was formed much later. It is interesting to note that the CBOs Shakthi and Liyasaviya which had over 100 households (HHs), just after the tsunami, now have only around 30 members. Most member clients left the group voluntary, (distance of meeting place, higher opportunity cost, not having any grants or conflicts with CBO leaders, etc), while others were asked to leave due to their irregular attendance or poor credit culture.

The main purpose of these groups is to provide a platform for member transactions, for which the general body meets once a month. But though there is a client transaction cost associated with these meetings, small group weekly meetings provide for more opportunity to save and borrow, as small group members generally consist of neighbouring HHs. Small groups can ease management challenge in larger CBOs (like Shakthi and Liyasaviya), works better, and contributes to more effective functioning. However, in the case of Sahana CBO,where there is only one small group and the entire membership form the general body, conducting separate general and group meetings only increases the costs. While in

Exhibit 6: Coverage of CBOs



the case of Janshakthi and Samagi, where certain small groups are non-functional, it deprives small group leaders from participating in regular financial transactions.

According to secondary data, the village level coverage of Sewa Finance CBOs is only around 8%, while for Shakthi it is around 13% (Exhibit 6). But this doesn't imply that the remaining community is deprived of access to financial services as several institutions work in the same community - such as SEEDS, Arthacharya, Alternative Development Initiative, etc. Usually (up to 57% for Sewa Finance) clients have multiple memberships with at least one other village based entity, and the number can increase with the number of such institutions that the client has access to, with Shakthi having the highest percentage of members involved in other village based financial intermediaries.

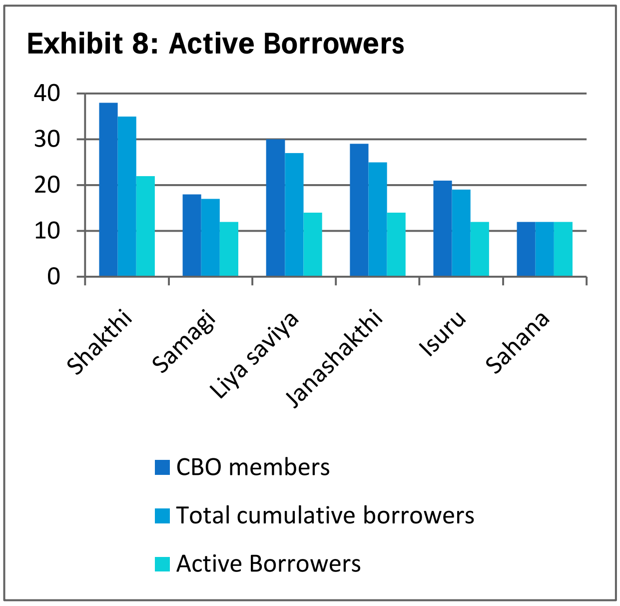
Active Borrowers

As of 31st March, 2010, the number of active members is 148. When the active borrowers are considered, about 43% of the members have an outstanding loan, and about 30% are waiting for the next cycle. The high number of waiting clients, at the point of data collection, is mainly due to the coinciding of loan repayment cycle. April being the main festive season, for which clients obtain loans, March is the time to clear all outstanding dues. However, around 9% of the clientele haven't used the credit facility, though they haven't withdrawn their membership either. In addition, CBO leaders, who perceive management of the CBO as an honorary role, have never availed the loan facilities.

Exhibit 7: Membership in other CBOs

Name of the CBO		Percentage of members who has joined other CBOs
Good Performers	Shakthi	68.18%
	Samagi	47.62%
Average Performers	Liyasaviya	57.50%
	Janashakthi	54.29%
Below Average Performers	Isuru	50%
	Sahana	62.50%

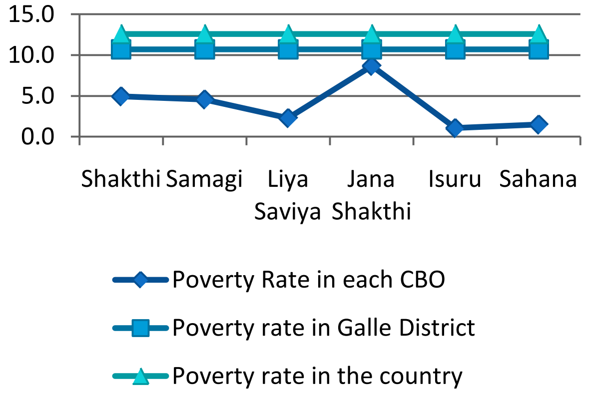
Source: Primary data collection-2010



Inclusion of poor

The depth of outreach is measured using the PPI, and the data have been collected from 131 of the 148 HHs. According to the findings, poverty rate of all CBOs, when compared with the national poverty line, is 4.38%, indicating that only around 6 clients of all CBOs fall under the national poverty line. Compared to the international poverty bench mark of less than $2.5 per day, it is 22.93%. The extreme poor, who live on less than $1.25 per day, is minute (1.59%) among this sample of CBOs.

Exhibit 9: Poverty Rate



The poverty rate for each CBO indicates that Janashakthi has the highest poverty rate among clients, (8.65% according to the national poverty line), while CBOs Isuru and Sahana have the lowest poverty rate. Shakthi and Samagi have a moderate poverty rate. When the poverty rate of CBO leaders is included, the overall figure drops to 2.3%, which is actually lower than the national average.

These findings were analysed against the district and national poverty rates and assessed based on the empirical data to confirm the overall poverty scenario within CBOs. The overall poverty rate in the Galle district is 10.7% which is also below the national poverty rate (12.6%). Therefore, the probability of having poor is relatively low compared to other districts - Nuwara Eliya, Monaragala and Badulla. The following Exhibit illustrates the number of people in each poverty group (according to the international bench mark of below $3.75 per day).

When analysing the general empirical evidence and points for individual PPI indicator, it becomes apparent that apart from certain indicators (number of government/semi-government employees, ownership of motorcars) the client HHs' score is usually high, with the PPI score for indicators relating to education level of female HH heads, ownership of assets and the housing characteristics have scores towards the higher end. And this high score is ultimately reflected in the poverty rate.

Livelihood in the area is predominately industry based - coir, fisheries, carpentry (Shakthi CBO), garment (Samagi CBO) and tourism related (Liyasaviya CBO). The labour force survey suggests that 51.9% are in the non-agricultural, informal sector; while 27.9% are self employed. The percentage of government/semi government sector employees is extremely low in the area and therefore the PPI score for this indicator was relatively low.

In terms of assets, more than 50% of the sample HHs possessed refrigerators, TVs, gas cookers, fans etc. But the figures are quite low for motor vehicles, though most HHs possessed motorbikes or bicycles. Studied HHs are situated close to the main highway and railway stations, and this might be the reason for HHs not owning motor vehicles.

Where house related indicators are considered - the studied sample had permanent structures with cement floor, and more than two bed rooms. Discussions with key stakeholders indicated that these were built under the tsunami relief schemes extended by various organisations.

Attendance

The participation in CBO activities is measured by the attendance rate of members, which is low across all CBOs at about 63%, although the required percentage is 80 for loan approval. Attendance rate is best at Liyasaviya, even though they have two meetings per month.

Exhibit 10: Categorisation - members according to poverty groups (N=131)

PPI score	Poverty Likelihood (<3.75 $ per day)	Poverty group	Good Performers		Average Performers		Below Average Performers	
			Shakthi	Samagi	Liyasaviya	Janashakthi	Isuru	Sahana
0 -34	100 to 81.4%	Extreme poor	8	4	4	9	1	1
35 – 54	71 to 46%	Relatively poor	13	6	8	11	5	5
55 – 74	36.1 to 10.2%	Moderate poor	10	3	10	6	8	5
75 -99	8.9 to 0%	Non poor	2	1	7	0	3	1
Total			**33**	**14**	**29**	**26**	**17**	**12**

Source: Primary data collection-2010

Exhibit 11: the attendance rate

CBO Name	Good Performers		Average Performers		Below Average Performers	
	Shakthi	Samagi	Liyasaviya	Janashakthi	Isuru	Sahana
Overall attendance rate	67%	74%	84%	74%	63%	76%
% of members above 80% attendance	36%	47%	59%	46%	37%	58%

Source: Primary data collection-2010

The attendance rate when further analysed according to poverty group, the predominant trend noticed was the gradual decline in attendance (Shakthi, Janashakthi and Liyasaviya). This phenomenon may be attributed to the fact that the non-poor group have other options to cover their financial needs without attending these CBOs. For example, a majority of Liyasaviya members are engaged in selling handicrafts and handlooms to tourist at the Unawatuna beach, and attending CBO meetings equates to loss of business hours.

Member Retention & Exit

Retention rate is the reduction in membership for the preceding year. The overall retention rate of the studied CBOs is around 89%, with the highest member exit rate in Isuru (a common phenomenon for immature CBOs).

Exhibit 12: Retention rate

Name of the CBO		Retention rate
Good Performers	Shakthi	86%
	Samagi	95%
Average Performers	Liyasaviya	94%
	Janashakthi	93%
Below Average Performers	Isuru	71%
	Sahana	92%

Source: Primary data collection-2010

Analysing the poverty rate of sample exit clients from all the CBOs, the poverty rate according to the $3.75/day, is 47.28% (just a 0.3% change; according to the national poverty line this is just 3.3%). According to the demarcations of the poverty levels in this research, the exit clients are either relatively or moderately poor. The argument about the poor leaving CBOs, is invalid.

The Portfolio & its quality

CBOs have different loan products for their client's various needs, the main types being emergency and productive loans (agricultural & entrepreneurship). In addition, various innovative loan products are also available: i.e. Housing (Shakthi), and New Year (Liyasaviya).

Exhibit 13: Poor among exit clients

Poverty category	Number
Extreme poor	6
Relatively poor	17
Moderate poor	12
Non poor	3

Source: Primary data collection-2010

The portfolio outstanding of all the CBOs is around 1.8 million rupees, where the highest amount is with Isuru CBO, mainly because Isuru had recently obtained a loan from the MFI. All CBOs, on average, have loan outstanding of more than 200,000 rupees (as of 31st March, 2010); with only about 133,875 rupees of internal funds to finance these. In Sahana CBO 100% of the loan portfolio is from MFI loan, while Shakthi CBO has 79,900 rupees of internal funds invested in their loan portfolio. Over the years, the loan absorption capacity of the CBOs has increased, where they are now capable of higher loan amounts. The average loan balance is close to 20,000 rupees, with Janashakthi and Isuru having the highest, and Sahana and Liyasaviya the lowest. Compared to the GNP per capita, the ratio is around 13%, which also indicates a certain degree of depth.

External loan portfolio (From Sewa Finance)

Sewa Finance has disbursed around 5.23 million rupees to the CBOs during the past two years. Samagi and Shakthi, which have a significant savings base, have reduced external borrowings, but other CBOs continue with external loans. Some CBOs have obtained fresh loans within a very short period, suggesting that they either paid off their earlier loan, or obtained an additional loan while the previous loan was still active.

Loan utilisation figures (all CBOs) of the poor families clearly indicate that the average loan amount of the poverty group has increased, with the extreme poverty group obtaining 30,000 rupees, and the non-poor, around 50,000 rupees.

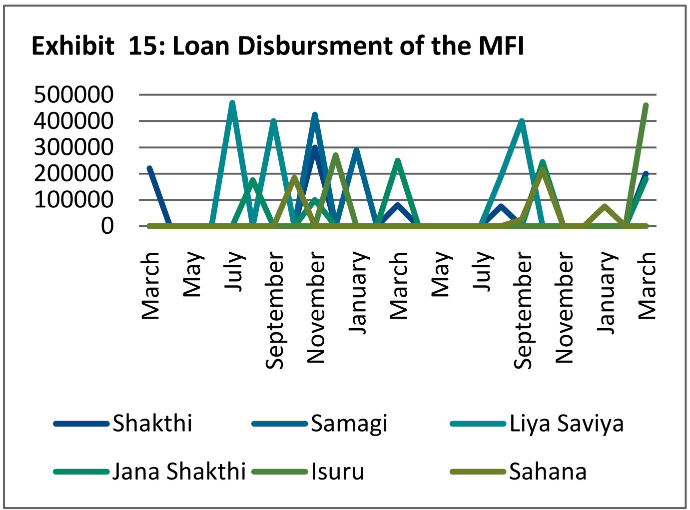
Exhibit 14: Average Loan Balance

Name of the CBO		Average Loan outstanding	Average loan balance per borrower	Loan balance as % of GNP per capita
Good Performers	Shakthi	392,111.04	17,823.23	8%
	Samagi	310,889.91	25,907.49	12%
Average Performers	Liyasaviya	217,179.13	15,512.79	7%
	Janashakthi	394,598.96	28,185.64	13%
Below Average Performers	Isuru	342,589.24	28,549.10	13%
	Sahana	180,184.86	15,015.41	7%

Source: Primary data collection-2010

Portfolio Quality

The average one day PAR for all CBOs is less than 30 days, with Isuru having a one day PAR of 11%; the write-off ratio is 0%, where all the loans disbursed is recovered. Recovery rate is



100%, except Isuru, where it is only 88%.

Further analysis of these PAR figures by the researchers, to identify the success factors for these numbers, revealed that the figures mask certain credit behaviours of members which need to be paid attention to. The PAR one day figure is zero mainly due to the point of time (March 31st) which the researchers had selected for the analysis. This is the period prior to the main cultural festival - Sinhala and Tamil New Year. Clients generally tend to clear all their outstanding loans and obtain a fresh loan during this time in the belief that the New Year needs a fresh beginning; which is also a moral incentive to pay off all dues.

The specified loan repayment procedure within CBOs is to pay back loans in equal instalments, but it was observed that clients repay loans in differing amounts. Certain members only pay the interest instalment each time and pay back the full loan amount as a bullet payment at the end, while some

Exhibit 16: Average loan amount according to poverty group

Poverty category	Average Loan Amount
Extreme poor	30,000.00
Relatively poor	35,666.67
Moderate poor	42,812.50
Non poor	47,777.80

Source: Primary data collection-2010

others pay the whole amount at the end of the loan term, without ever paying the specified instalments. This can disturb the cash flow of the CBO, and also affect the availability of loans for other members.

A unique behaviour the researchers noted was members paying the loan amount, with interest, at the beginning of the monthly meeting, and then obtaining the same amount as a new loan at the end of the meeting. This is equivalent to just paying the loan interest, while retaining the loan amount. And when a CBO charges a fine for late payment, this is a perfectly expedient method of loan renewal for these types of members. However, such quick disbursements were only observed in Isuru and Janashakthi CBOs. The findings at Janashakthi indicate that details of irregular loan payments, and defaulters in the small groups within the CBO, do not get reflected in the overall CBO books of account.

The major factor contributing to this loan discipline may be attributed to leadership - if the leaders demonstrate zero tolerance to loan defaults, and take interest in the small groups' activities, loan repayment is always prompt. Also, the 'promise' of a repeat loan keeps the members paying regularly, even though the instalment size may vary.

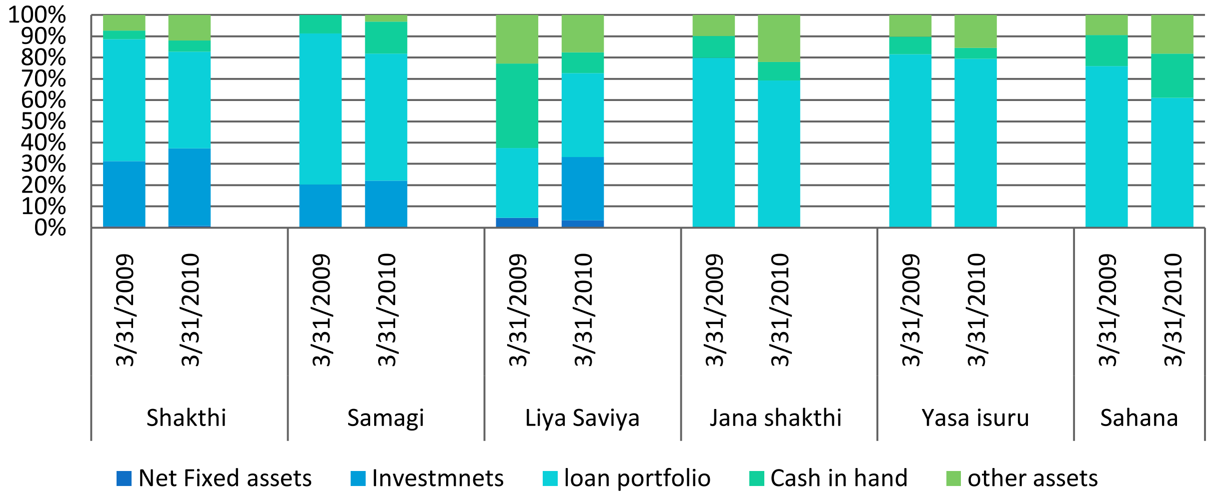
Client Graduation

Exhibit 17: Financial position

CBO Name	Good Performers		Average Performers		Below average performers	
	Shakthi	Samagi	Liyasaviya	Janashakthi	Isuru	Sahana
Assets	687,518.51	454,031.66	672345.52	530,947.21	590.579.46	347,504.58
Liabilities	464,189.98	305,038.36	448,192.37	508,345.31	567728.05	308,795.28
Equity	223,328.53	148,993.30	224,153.15	22,601.90	22851.41	38,708.30

Source: Primary data collection-2010

Exhibit 18: Assets of CBOs



According to the method of loan disbursements of Sewa Finance, a separate client graduation is not visible. MFI loans are generally for enterprise, while other loans for emergency and consumption purpose are also available. Clients, who obtain MFI loans, can also obtain consumption and/or emergency loans from CBOs. There were no instances noted where the client used the CBO as a means of linking with the MFI, and continuing without being a member of the CBO.

Financial Performance

The financial position of the CBOs indicates their financial strength, with all six CBOs together having assets worth around 2.7 million rupees. Shakthi and Liyasaviya have more than 650,000 rupees, while Isuru (which started 2 years after the others) has close to 600,000 rupees of assets.

The main asset category is the loan portfolio, with a significant percentage of fixed deposits in commercial banks, and some fixed assets (tables, chairs and filing cabinets donated by Sewa Lanka Foundation). The main component in the other asset category is the loan security fund of the CBOs with the MFI.

The main liabilities are member savings and MFI loans. The main equity components are the member shares.

Analysing the financial position of the CBOs, over the past two years, show that Shakthi and Samagi have reduced their percentage of portfolio, while increasing their investments. Liyasaviya has opened fixed deposit accounts in a commercial bank with their excess cash in hand. However, the main earning asset of the CBOs remains their loan portfolio.

While analysing the income statements of the 3 CBOs with investments, the effectiveness of fixed deposits needs a rethink. For example,

Exhibit 19: Savings in CBOs

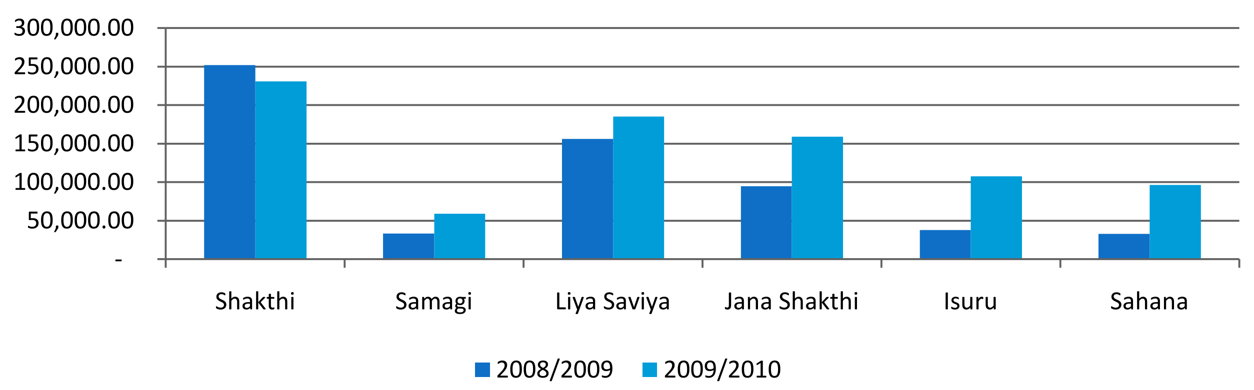


Exhibit 20: Cash Balance

	Shakthi	Samagi	Liyasaviya	Janashakthi	Isuru	Sahana
Beginning of year cash balance	33,094.65	42,516.68	204,892.05	53,771.29	21,919.11	28,261.26
Year-end cash balance	36,194.27	68,023.30	65,914.59	46,715.73	30,179.46	72,130.40

Source: Primary data collection-2010

except Shakthi CBO, where they have a higher income (mainly the interest from fixed accounts) over expenditure (10,526.48 rupees); both Samagi and Liyasaviya CBOs have higher financial expenses than income. It is -29,719 rupees in Samagi, and -57,763 rupees in Liyasaviya. If they were to invest this money in their loan portfolio there would be much higher return, and in turn would lower their external borrowings from MFIs.

Member savings

The member savings includes both compulsory and voluntary components, and indicate the asset base of the clients. Shakthi CBO has the highest amount of savings, which is followed by Liyasaviya. However, in Shakthi CBO, the member savings has reduced due to the overall reduction of membership.

Cash flow management

The cash balance of CBOs, (March 31st, 2010), is positive in 4 CBOs. The reason for a negative cash balance in Liyasaviya is the change in their fixed deposits. For Janashakthi, it is due to their changed loan portfolio.

The CBOs have never faced liquidity shortages since they have an established cash inflow of member savings, and the MFI loan facility.

The application process for external loans take around 2 weeks to a month; though, if proper documents are absent the period can be longer.

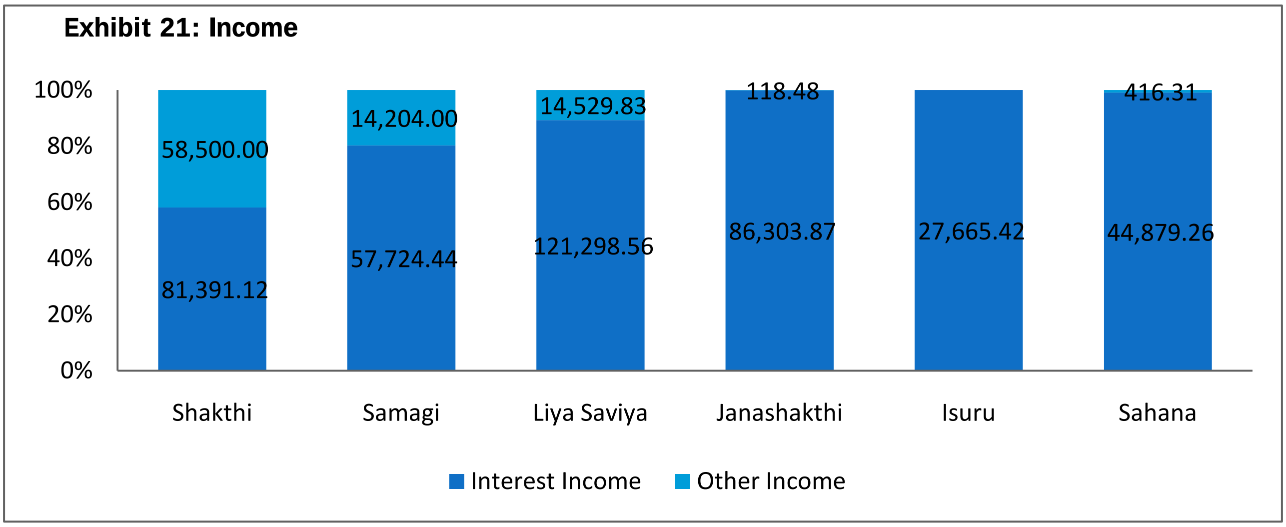


Exhibit 22: Expenses

CBO Name	Good Performers		Average Performers		Below Average Performers	
	Shakthi	Samagi	Liyasaviyai	Janashakthi	Yasa isuru	Sahana
Financial expenses	47,974	43,924	72,293	64,627	20,912	35,903
HR expenses	1,000					
Administrative Expenses	26,138	10,672	29,513	12,915	2,830	4,446

Source: Primary data collection-2010

Cash outflow constitutes a fixed monthly instalment, and interest, towards the MFI loans. To ensure timely repayment, credit officers schedule loan repayment dates two or three days prior to their payment date so as to maintain repayment schedule of the MFI. This is another reason for not having a PAR value.

Income & Expenditure

The main source of income for the CBOs is interest from loans. CBOs Shakthi, Samagi and Liyasaviya also have investment income. In Shakthi CBO 40% of their income comes from these investments, while in Samagi and Liyasaviya it is just 20% and 10% respectively. These three CBOs use part of this investment income for social activities. For example, Samagi uses the interest from fixed deposits in commercial banks for their New Year gift packages.

The main expenditure of the CBOs is the MFI loan interest payment. Administrative and HR expenses are negligible (where maintenance of books and accounts is considered a voluntary task), with only Shakthi paying for a manager (Rs.1000.00), for maintaining the books and accounts. The net surplus has an increasing trend in all the CBOs, which is a very good indication.

Productivity

The administrative cost ratio for all CBOs is less than 35%, indicating that the administrative cost is very limited (mainly rent, as office maintenance costs are nonexistent for most CBOs). But for CBOs such as Shakthi, which recently established a village bank, it may increase as operations expand.

Sustainability

All CBOs are operationally viable and able to cover their entire operational costs from their earnings, making them capable of functioning as independent units.

Exhibit 23: Productivity

CBO Name		Administrative cost ratio	Operating Efficiency
Good Performers	Shakthi	35%	19%
	Samagi	20%	18%
Average Performers	Liyasaviya	29%	46%
	Janashakthi	17%	20%
Below Average Performers	Isuru	12%	7%
	Sahana	11%	22%

Source: Primary data collection-2010

Exhibit 24: OSS & FSS

CBO name		Operating self sufficiency	Financial self sufficiency
Good Performers	Shakthi	186%	140%
	Samagi	132%	91%
Average Performers	Liyasaviya	133%	107%
	Janashakthi	111%	89%
Below Average Performers	Isuru	116%	63%
	Sahana	112%	74%

Source: Primary data collection-2010

To calculate sustainability, the researchers adjusted operating cost with inflation, in-kind, and cost of funds. The in-kind contribution from the committee members were calculated taking 200 rupees per meeting per month and valuing it at 2,400 rupees annually. The time of the book keeper/manager was valued as 1000 rupees per month (where it is around 2 hours work per week with 125 rupees per hour), the total being Rs. 12,000 per year. In addition, audit, also considered as an in-kind function, was included in these calculations. The inflation figure taken for calculations is 3.5%, where the costs are adjusted accordingly. The cost of funds adjustment was not performed since the market rate of loans is usually lower than the Sewa Finance loans, and since these CBOs are unable to obtain loans from those kinds of commercial sources.

Even after adjustments, two CBOs - Shakthi and Liyasaviya, are financially sustainable. Samagi and Janashakthi CBOs are close to financial sustainability, indicating that these CBOs are able to absorb macro changes well and survive.

Profitability

The average yield on portfolio is above 8% in all six CBOs. Liyasaviya has the highest yield of 56%. All others have figures of around 20%.

However, when both AROA and AROE figures are considered, apart from Shakthi and Liyasaviya all CBOs have negative figures, indicating that they are dependent on in-kind support. Though subsidised costs of funds are non-existent, the CBOs have a higher amount of office bearers' time, and inflation adjustments.

Conclusion

When the overall performance status of the six CBOs is considered, Shakthi and Liyasaviya are the best performers, while Samagi and Janashakthi fall under the average category, unlike the categorisation of the MFI. Isuru and Sahana fall under the below average category.

Where achieving the double bottom line is concerned, the CBO performance indicate that achieving financial sustainability is possible if the CBOs maintain just the basic savings and credit functions in a methodical manner. However, accumulated fund within the CBO need to be frequently intermediated to achieve greater income.

As indicated through the case studies, CBOs have their strengths and their weaknesses, especially when it comes to financial inclusion. The findings indicate that CBOs are effective means for achieving financial bottom lines, but do not seem to have a strong potential for financial inclusion, or catering to the poorest segment of the community, thus failing as an effective means for achieving the social bottom line. They mostly cater to the moderately poor, having a very limited spread amongst the more poor. There is also a certain degree of trade-off when it comes to financial sustainability and depth of outreach, since CBOs in areas with a high poverty rate (Janashakthi) aren't the best financial performers. While the better financial performers (Shakthi and Liyasaviya), cater to a larger market for achieving their financial returns.

Analysing the CBO membership reveals that most members belong to moderately poor HHs, with the very poor barely represented. Enrolling poor HHs at a mature stage of the CBO can prove to be problematic, especially with the established members, and the norms, rules and procedures. Mature CBOs may have significant accumulated savings per member, which a newcomer may be required to deposit at the time of enrolment. For someone from a poor HH, this can be a major deterrent. Further, existing CBO members may insist on checking the credit worthiness of a newcomer before incorporating him/her into the group. Therefore, the poor need to be included in the CBO at the mobilisation and formation stage itself.

For mature CBOs, MFIs can promote establishment of new small groups for such poor members, supervised by the CBO and MFI. These groups can then function on a trial basis before being incorporated into the CBO, when both parties are comfortable with each other - existing members about the credit worthiness of the poor, and the newcomers about the rules and procedures.

When the management structure of the CBOs is assessed, it indicates that the entities are run by non-poor leaders, where their role is that of service to others, and who are in search of community acceptance. Consequently, the activities and objectives of the poor and the general CBOs might be mismatched. For example, CBOs have higher social objectives, where they focus on village development activities that need additional time and money, and this may not be the main objective of the poor. This could be a major reason for the poor not joining CBOs. Therefore, matching objectives of poor clients is essential.

The CBO model seems to work well with small entrepreneurs and agricultural communities, where quick cash is needed at the smallest opportunity cost. For private and semi-government employees, the need for CBOs as a financial intermediary is relatively low, since these HHs have an assured income, and possible accessibility to other means of financial services. Therefore it is recommended that some background information on employment and means of livelihood be performed prior to establishing CBOs in an area.

CBOs function well if members reside on close proximity. With distance of meeting place, and the time allocated for meetings increasing, it leads to higher opportunity cost; and with social concerns like safety of children and other familial responsibilities, members tend to select other low cost options. It is visible that if the meeting time, venue and duration are made convenient, continuous participation is a higher possibility.

It is observed that CBOs with more than 100 members are not very effective since the management functions become difficult for community leaders. Maintaining membership figures to around 40 per CBO seems ideal, as smaller size also eases monitoring and account maintenance.

The group concept within the CBO was introduced as part of overcoming geographical difficulties, but this has often resulted in certain small groups becoming inactive due to lack of proper supervision and/or management skills. Leaders with managerial and financial skills are often leaders of larger CBOs, while small group leaders lack these skills and leadership qualities. The attention paid by the overall members and leaders on the functionality of these small groups are minimal. Hence, it is essential that monitoring and supervision be extended to small groups, and training and capacity building skills imparted to small group leaders.

When inactive CBOs are assessed, it is often a case of lack of transparency and accountability, and misuse of common funds. This happens when the community funds are significantly high and is difficult for the CBOs to handle. Letting the CBO assets to grow exponentially without a limit can affect transparency. It is recommended to let CBO funds to grow to a maximum manageable ceiling, and have the MFI promote the options of low risk investments or dividend sharing.

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Annex A: PPI Tool

Name	……………………………… …………	Age	……………
CBO Name	……………………………… …………	Member Since	……………
Male/Female	……………………………… …………	Membership status	

Existing member	
Exist member	

	Indicator	Value
i	How many members does the HH have?	**A.** Six or more **B.** Five **C.** Four **D.** Three **E.** One or two
ii	How many household members are employees of govt. or semi-govt. entities?	**A.** None **B.** One or more
iii	What is the highest educational level that the female head/spouse has passed?	**A.** Grade 1 or less **B.** Grade 2 to 7 **C.** Grade 8 or 9 **D.** Grade 10 **E.** No female head/spouse **F.** G.C.E. (O/L) or equivalent, Grade 12 or higher
iv	What is the principal construction material of the floors?	**A.** Mud or other **B.** Cement **C.** Terrazzo/tile
v	How many bedrooms does the household have?	**A.** None **B.** One **C.** Two **D.** Three or more
vi	Does the household own an electric fan?	**A.** No **B.** Yes
vii	Does the household own a television and a VCD/DVD player?	**A.** No television **B.** Television but no VCD/DVD **C.** Television and VCD/DVD

vii i	Does the household own a cooker (gas, kerosene, or electric)?	A. No B. Yes
ix	Does the household own a refrigerator	**A.** No **B.** Yes
x	Does the household own a bicycle; motorcycle, scooter, or three-wheeler; or motor car, van, bus, lorry, 2-wheel, or 4-wheel tractor?	**A.** None **B.** Bicycle only **C.** Motorcycle etc. but no motor car etc. (regardless of bicycle) **D.** Motor car etc. (regardless of bicycle or motor car etc.)

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