

Linkage Banking and Microfinance Development in Sri Lanka

by Sharmini Serasinghe



The Asia Pacific Rural and Agricultural Credit Association (APRACA), together with the German Agency for Technical Co-operation (GTZ) and the Hatton National Bank (HNB) co-sponsored a National Consultation Workshop on ‘Linkage Banking and Microfinance Development in Sri Lanka’.

The core issue addressed at this workshop was how best the rural financial system in Sri Lanka could be enhanced with sustainable financial services for all segments of the population including small farmers, small entrepreneurs, women and the poor.

Sri Lankan village life has a strong tradition of self-help. Many economic activities particularly those relating to agricultural operations and even social and cultural activities are undertaken on the basis of mutual cooperation and self-help. This has largely influenced Sri Lankan initiatives in microfinance. Although microfinance activity abound in Sri Lanka, their implementation and achievements vary. In a number of instances the concept of self-help has been corrupted by the advent of individualism and commercialization, while others have evolved into simple microfinance structures.

Against this background, the National Consultation Workshop was proposed to bring to the fore these microfinance activities, examine their operations, integrate their activities where necessary and identify measures of promoting the best practices from their operations. “In Sri Lanka, it is not surprising to find a barefoot banker roaming around the villages providing banking services. Nor is it abnormal to find an informal moneylender with a direct credit line from a bank. It is equally normal to find banks acting as pawn shops, and private. moneylenders, with rural youth. and retired government personnel acting as change agents, following up on loans and assisting in bank recovery”, says the Chairman of APRACA Moh’d Rosli Abd. Aziz.

APRACA was established in 1977 with the initiation of the Food & Agricultural Association and the World Conference on Credit for farmers in developing countries. It is an association of governmental and non-governmental institutions in Asia and the Pacific Region, which are directly or indirectly involved in rural and agricultural credit through a formal system. APRACA has 54 members in 21 countries in the Asia and Pacific Region. It has seven member institutions in Sri Lanka, namely, The Central Bank of Sri Lanka, Bank of Ceylon, People’s Bank, Hatton National Bank, Seylan Bank, National Savings Bank and the Thrift and Credit Cooperative Societies.

APRACA’s mission is to promote efficiency and effectiveness of rural finance and access to sustainable financial services, in order to broaden the formal rural financing mechanism.

The strategy of APRACA is to achieve its mission through mutual participation and commitment among its member institutions, mutual co-operation with local and

international agencies in promoting financial innovations and sustainable financial services policy dialogue on financial re form, etc.

In Sri Lanka, credit institutions engaged in microfinance fall into three categories: formal, semi-formal and informal. Formal institutions consist of the two state banks- Bank of Ceylon and the People's Bank, the Regional Rural Development Banks and few of the private domestic banks, the most important being the Hatton National Bank. The semi-formal institutions and programmes are wide and varied. They include: Cooperative Rural Banks, Thrift and Credit Cooperative Societies, Government programmes initiated under the National Youth Services Council, Integrated Rural Development Programmes, Change Agents Programme and the Small Farmers and Landless Credit Project and the NGO programmes. The informal sector consists of money lenders, traders and family members.

Commenting on APRACA's mission in Sri Lanka, Chairman, Aziz says, "these sectors have been operating independant of each other. So we want to integrate these sectors by having the best system in order to deliver rural credit to the rural farmer.

Formal institutions are primarily designed to cater to large customers in a range of sectors in the economy. Their credit systems, procedure and style of delivery are more appropriate to the needs of such customers than to those engaged in micro projects. Therefore, these institutions suffer from high administrative costs, inflexible standards of credit analysis, emphasis on physical collateral and a banking culture more appropriate to large enterprises.



In this context, the semi-formal institutions show some special features, strengths and potential for future development of sustainable microfinance programmes.

About 60% of the credit needs in the rural sector are met by informal sources, "in

many countries we find, that the informal sector is more acceptable to the rural population", says Aziz. The chief strength of informal credit structures in rural financial markets is the close contact lending sources maintain with borrowers, which leads to simplification of procedures and reduction of transaction costs.

The definition of microfinancing varies from country to country. Where Sri Lanka is concerned, it is basically a small loan for financing small projects aimed at self-employment, in the rural and semi-urbanized areas. The Deputy General Manager Development Banking of HNB D Wijesundera says, "according to the standard set by the World Bank the cut-off point for a loan for microfinancing is about US8 5000 which is approximately Rs 2,75,000. HNB assists microfinancing with small loans which can go up to about Rs 250,000."

HNB commenced its rural development activities way back in 1972. Since then, the Bank has expanded its spectrum of development banking covering rural and agricultural financing, lending for plantations, and small and medium industries, financing of large investment proposals and microenterprise financing.

In 1982, HNB became a member of APRACA with the primary objective of enhancing and improving the outreach and the quality of rural development, "after joining APRACA as a member, there was remarkable assistance from this association in upgrading skills, particularly of the people who are involved in rural credit, by sharing country experiences as to how other countries implemented their rural development projects. So in that sense I think we have gained substantially by being a member of APRACA", says D Wijesundera.

In May 1989, HNB introduced its own microfinance scheme called 'Gami Pubuduwa', targeting the upliftment of the rural poor by creating self-employment opportunities, emphasizing on unemployed rural youth and rural women. Over the last seven years, more than 20,000 small loans have been granted exceeding Rs 350 million, while maintaining an impressive collection ratio of 97.8%. Through this scheme the bank has also been able to mobilize rural depos its amounting to Rs 415 million.

With the aggressive expansion of development banking, particularly rural financing, HNB looked for the assistance of various governmental and non-governmental organizations, both national and international in reaching its objectives.

Commenting on the theme of the workshop Linkage Banking' Wijesundera says,

“over the years we have been trying to find ways of taking the banking sector to the rural poor. Even today, there is a large number of people who are away from the banking system. Although there is rural development, rural banking, microenter prises, self-employmen whatever you call it, yet there is at large segment of people without banking assistance. So one reason attributed for this gap was the Linkage. There’s no proper linkage to function as a conduit in taking banking to the poor. So, in that context, we have to find out what the best methodologies are through which banking can be brought to the rural sector.”

The Central Bank of Sri Lanka is the apex institution of the formal financial system in the country. Commenting on the Central Bank’s contribution to rural financial services, the Deputy Governor of the Central Bank of Sri Lanka P Amerasinghe says, “the government of Sri Lanka has announced that it will launch two self-employment projects with an allocation of Rs 500 million each. One scheme is for Samurdhi beneficiaries where the implementation is being done by the Ministry of Youth Affairs, Sports & Rural Development in collaboration with the People’s Bank and the Bank of Ceylon. The second scheme is for self-employment promotion for microenter-prises where the beneficiaries will be non-Samurdhi groups. This scheme is implemented by the Central Bank in collaboration with the People’s Bank, Bank of Ceylon and the Hatton National Bank.. These two programmes are specially designed for the unemployed poor and unemployed youth, “and the Linkage Bank will support them through this microenterprise system by providing loans of about Rs 50,000 with an interest rate of about 108 which is a subsidised interest rate”, he added. The administrative function of implementing these two programmes will be carried out through the Rural Credit Department of the Central Bank.



The GTZ extends a variety of technical assistance in developing countries including Sri Lanka for microfinancing and other self-employment projects. GTZ has been involved with APRACA for about ten years, providing technical assistance to the association in promoting Linkage Banking and grassroots financial systems

development within the Asia and Pacific Region. Commenting on the outcome of the National Consultation Workshop, Banking & Financial Systems Consultant for GTZ, Klaus Maurer says, “after three days of intensive consultation and discussions with various institutions involved in rural financing in Sri Lanka, we hope that we will have a platform of co-operation among different institutions in Sri Lanka. We would also like to define what kind of support would be necessary to promote the systems even further in Sri Lanka”. Maurer went on to say that he had observed many initiatives going on in this area, “since few years there have been financial reforms in this. country which have created a suitable environment for competition, and the banks-the commercial banks and State banks-are getting more active, getting more pressurized by the competitive situation to do. something about the rural sector, because as in many Asian countries, the majority. of the rural population does not have access to financial services, at least not to the extent that would be expected. So I think that various initiatives are going on that are quite successful and its a matter of sharing experiences and possibly some matter of networking among the various initiatives”. According to his observations, Maurer believes that Sri Lanka has excelled particularly in the field of savings mobilisation when compared with other countries in the region.

Against this setting, the work-shop on Linkage Banking and. Microfinance Development in Sri Lanka’ is envisioned to become a platform for an exchange of experiences and approaches in implementing microfinance projects. among local formal and non-formal institutions in Sri Lanka. The ultimate view is to formulate a workable APRACA country support programme for Sri Lanka, to address the problem of effectively delivering financial services to the country’s marginalized sector.