Democratic Socialist Republic of Sri Lanka

FY2017 Ex-Post Evaluation of Japanese ODA Loan

"Poverty Alleviation Micro Finance Project II"

External Evaluator: Yumiko Onishi, IC Net Limited

0. Summary

Microfinance was considered an important tool for attaining Sri Lanka's poverty alleviation policy goal. The project's objective was to increase the income of people living in poverty by providing credit, targeting the north-eastern region, where there were long years of civil war, as well as adjacent poor areas, and by improving the capacity of Participating Finance Institutions (PFIs) and beneficiaries, thereby contributing to the poverty alleviation. At the time of the ex-post evaluation, the poverty ratio of Sri Lanka had achieved its policy target, which was set during the project appraisal. In the northeast, however, the poverty rate continues to be higher than the national average, and microfinance remains important. Development policy, development needs, and Japan's ODA policy at the time of the appraisal are consistent with the project, and the relevance of the project is high. Considering the high demand for funds, the credit component was increased by 1.8 times the planned amount through fund reallocation. Nevertheless, the total project cost was more or less the expected amount. On the other hand, because the credit component was increased and the loan scheme was operated beyond the planned duration, the project period was prolonged. As a result, the efficiency of the project is fair. The operation and effect indicators set to measure effectiveness have mostly indicated that the target was achieved and that several positive impacts have been seen for people living in poverty. Therefore, effectiveness and impacts are high. The operation of the project's revolving fund was completed in June 2018. No issues have been observed with regard to the institutional, technical, or financial aspects of the operation and maintenance of the executing agency and PFIs, and no delays have occurred in the debt recovery of the revolving fund. Therefore, the project's sustainability is also high.

In light of the above, the project is evaluated to be highly satisfactory.

1. Project Description

Project Locations

A Business Activity Funded by Microfinance

1.1 Background

In 2006, Sri Lanka's human development indexes for items such as literacy rate and access to basic health and basic education were better than those of countries in a similar economic situation and significantly above the South Asian average. While this indicated that Sri Lanka had a potential capacity for development, development was delayed in the country as a whole because of severe poverty in such areas as the north-eastern region, which was politically unstable, plantation (tea estate) areas, and arid rural areas.

One of the factors that was considered to be hampering efforts to tackle poverty in Sri Lanka was the severely worsening economic environment in the northern and eastern regions due to 20 years of civil conflict. Of the 119 high-poverty villages listed by the Government of Sri Lanka in 2006, the top 20 were concentrated in Puttalam District, bordering the Northern Province; Badulla and Monaragala Districts, bordering the Eastern Province; and Ratnapura District, next to Monaragala. Although the list did not include the Northern and Eastern Provinces because statistics were not available, the poorest area has spread across the Northern and Eastern regions and surrounding areas.

The Government of Sri Lanka has long considered microfinance an important tool for poverty alleviation and has been practicing it through a number of institutions[1]. However, there were several issues in the microfinance sector:

- Although outreach had been made to people living in poverty, financial sustainability had not been sufficiently secured.
- A policy environment that strengthens the sector as a whole had not been sufficiently developed.
- Capacity development among institutions and beneficiaries was needed.

[1] In addition to the Central Bank of Sri Lanka and Samurdhi Bank implementing government schemes, commercial banks in both the public and private sectors, semi-governmental regional development banks, and cooperatives provided microfinance. (Source: materials provided by JICA)

- Monitoring of microfinance projects needed to be strengthened
- Fund supply and access to financial services were insufficient in the northern and eastern regions, and there were no medium-term credit programs.

The history of microfinance in Sri Lanka is long, and various kinds of institutions have been implementing it. However, the microfinance market at the time of the appraisal lacked legal regulations and competition and was still at an immature stage. Particularly in the northern and eastern regions, insufficient fund supply and access to financial services were issues. Alleviating poverty by providing credit to the poor in the northeast and surrounding areas required support for microfinance that struck a balance between responding to the above issues and providing social welfare, while ensuring the long-term sustainability of the microfinance project.

1.2 Project Outline

The objective of the project is to increase the income of people living in poverty by providing credit to the poor in the northeast and surrounding regions, where the poverty rate is high, and carrying out training for participating financial organizations, microfinance organizations, and beneficiaries, thereby contributing to both poverty alleviation and social and economic stabilization in the regions.

Loan Approved Amount/ Disbursed Amount	2,575 million yen / 2,561 million yen	
Exchange of Notes Date/ Loan Agreement Signing Date	June 2008 / July 2008	
Terms and Conditions	Interest Rate Repayment Period (Grace Period Conditions for Procurement	0.65% (0.01% for consulting services) 40 years 10 years) General Untied
Borrower / Executing Agency	The Government of Democratic Socialist Republic of Sri Lanka / Central Bank of Sri Lanka	
Project Completion	November 2015	
Main Contractor(s) (Over 1 billion yen)	None	
Main Consultant(s) (Over 100 million yen)	-	
Related Studies (Feasibility Studies, etc.)	Project formulation study for the Poverty Alleviation Micro Finance Project II (JICA, September 2007)	
Related Projects	<Japanese ODA Loan> Poverty Alleviation Micro Finance Project (August	

	1999), Pro-Poor Economic Advancement and Community Enhancement Project (March 2003) <Asian Development Bank> Rural Finance Sector Development (2001), LOLC Finance and LOLC Micro Credit (2015) <World Bank> Financial Sector Modernization Project (2017)

2. Outline of the Evaluation Study

2.1 External Evaluator

Yumiko Onishi, IC Net Limited

2.2 Duration of Evaluation Study

This ex-post evaluation study was conducted with the following schedule.

Duration of the Study: October 2017 – January 2019

Duration of the Field Study: March 7–28, 2018 and May 29–June 8, 2018

3. Results of the Evaluation (Overall Rating: A[2])

3.1 Relevance (Rating: ③[3])

3.1.1 Consistency with the Development Plan of Sri Lanka

At the time of the project appraisal, the *Mahinda Chintana Ten-Year Plan* (2006), the Sri Lankan policy document at that time, aimed to reduce poverty to 12% by 2015, at a time when 23% (as of 2002) of the Sri Lankan population was living in poverty. As it envisaged alleviating poverty and reducing regional disparities through regional and rural development, the Sri Lankan government was implementing and expanding a number of projects that targeted poverty alleviation and regional development. About the north and east, it said "if a peaceful environment where people are guaranteed of rights to a decent living is created, realization of rapid social and economic development of Sri Lanka can be expected," and regarded economic and social stability in the north and east as important for the development of the entire country. Furthermore, the *Mahinda Chintana Ten-Year Plan* recognized that economic development would not automatically benefit people living in poverty and outlined a new strategy focused on providing opportunities for the poor to participate in the process of economic growth. In this strategy, from the perspective of promoting micro and small industries which increase income for the poor, the microfinance was positioned as an effective tool for increasing income, and alleviating poverty.

As explained in section 3.1.2 Consistency with the Development Needs of Sri Lanka, poverty alleviation was still part of Sri Lanka's policy at the time of the ex-post evaluation. *Vision 2025*,

[2] A: Highly satisfactory, B: Satisfactory, C: Partially satisfactory, D: Unsatisfactory
[3] ③: High, ②: Fair, ①: Low

prepared in 2017, points out that there is a significant regional inequality in the nation's economic development. Poverty rate in the Northern and Eastern Provinces, Monaragala District adjacent to the Eastern Province, and plantation areas is still high. To make a breakthrough, the Sri Lankan government aims to continue to improve access to finance and strengthen financial literacy in an effort to improve access to finance for small and medium enterprises. It plans to establish a development bank using existing financial institutions. As can be seen in the enactment of the Microfinance Act in 2016, microfinance is considered important in Sri Lanka.

As can be seen from the development policy at the time of the appraisal and ex-post evaluation, poverty alleviation and microfinance are both in line with the project.

3.1.2 Consistency with the Development Needs of Sri Lanka

At the time of the appraisal (2007), 15% of the Sri Lankan population was considered to be in poverty as of 2006. The Gini coefficient[4] at that time was 0.49. Although the poverty rate and the disparity between urban and rural areas in the country have slowly reduced in the past 20 years, poverty continued to be an issue for development of Sri Lanka. This was particularly true for the north and east, which have been affected by long years of civil conflict. Under such circumstances, microfinance was considered an effective tool for increasing income for people living in poverty and for poverty alleviation. According to a 2002 report[5] of the Asian Development Bank (ADB), demand for microfinance funds across Sri Lanka was estimated to be SLR 20 billion annually, and the supply–demand gap was SLR 10 billion. Particularly in the north and east the issues were a) an insufficient supply of funds; b) lack of access to financial services; and c) an absence of medium-term credit programs. To provide credit to the poor in insecure areas like the north, east, and surrounding areas and alleviate poverty, support was needed which balanced tackling various issues and considering social welfare issues, while promoting competition and introducing market principles in the microfinance sector.

Table 1 shows changes in poverty rates in the project's target areas as confirmed at the time of the ex-post evaluation. The share of people living in poverty has been slowly declining in the country since 2002. However, as seen in the poverty rate of the target areas in 2016, out of the 14 target districts, eight are above the national average of 4.1%, indicating that poverty remains an issue.

---

[4] Indicates disparity of incomes. A figure closer to 0 indicates a society with less income disparity while one closer to 1 means there is inequality.

[5] Charitonenk, Stephanie and Dulan deSilva (2002). *Commercialization of Microfinance: Sri Lanka*. Asian Development Bank.

Table 1: Poverty Rate in the Target Districts

Unit: %

District	FY 2006	FY 2009	FY 2012	2016
Jaffna	N/A	16.1	8.3	7.7
Kilinochchi	N/A	N/A	12.7	18.2
Mullaitivu	N/A	N/A	28.8	12.7
Mannar	N/A	N/A	20.1	1.0
Vavuniya	N/A	2.3	3.4	2.0
Trincomalee	N/A	11.7	9.0	10.0
Batticaloa	10.7	20.3	19.4	11.3
Ampara	10.9	11.8	5.4	2.6
Puttalam	13.1	10.5	5.1	2.1
Anuradhapura	14.9	5.7	7.6	3.8
Polonnaruwa	12.7	5.8	6.7	2.2
Badulla	23.7	13.3	12.3	6.8
Monaragala	33.2	14.5	20.8	5.8
Ratnapura	26.6	10.4	10.4	6.5
National	15.2	8.9	6.7	4.1

Source: Household Income and Expenditure Survey (HIES)

To find out the improvements in financial access attained by the project in the north and east, a banking density index[6] was obtained. Table 2 indicates changes in the index.

Table 2: Banking Density Index in the Target Districts

Unit: %

District	2005	2010	2016
Jaffna	17	15	24
Kilinochchi	7	4	15
Mullaitivu	6	3	20
Mannar	14	13	19
Vavuniya	11	12	20
Trincomalee	14	10	14
Batticaloa	10	12	17
Ampara	11	14	17
National	20	14	17

Source: CBSL

As can be seen in the changes in the banking density index, many financial institutions have entered the area since 2009, while others have increased their branch networks. This has resulted in a significant improvement in access to financial services. This was triggered by a

[6] Banking density index indicates penetration of banks against the population. Higher the number, it means there are better penetration of financial institutions. Here, it is calculated as (number of financial institution branches in the district) ÷ (total population of the district).

large demand for funds in the north and east for reconstruction and recovery of livelihood when the civil war ended in 2009. Some financial institutions popped up that provided loans without using microfinance practices such as forming beneficiary groups or saving for several months to serve people who preferred to obtain credit without using such procedures. These financial institutions are lending at high interest rates, and many are using malicious means to recover the loans. Because it is easy to obtain credit, some people have ended up taking multiple loans, and some have been driven to suicide. Interviews with PFIs and beneficiaries in the area revealed that malpractice in the microfinance sector is now a social problem. It appears that, even today, it is difficult to obtain credit for micro and small business activities in rural areas and among the poor in urban areas and that the demand for microfinance is high.

3.1.3 Consistency with Japan’s ODA Policy

In the *Country Assistance Program for the Democratic Socialist Republic of Sri Lanka* (April 2004), Japan’s official development assistance policy at the time of the appraisal, “assistance for poverty alleviation” was included as a direction for the next five years of assistance. In the JICA’s *Medium-Term Strategy for Overseas Economic Cooperation Operations* (2005–end of September 2008), “foundation for sustainable growth” was a priority area, while “assistance for economic growth for poverty alleviation” and “reducing disparity among ethnic groups and regions for peace building” were the priority areas for Sri Lanka, making them consistent with the project.

This project has been highly relevant to Sri Lanka’s development plan and development needs, as well as Japan’s ODA policy. Therefore, its relevance is high.

3.2 Efficiency (Rating: ②)

3.2.1 Project Outputs

a) Credit to People Living in Poverty

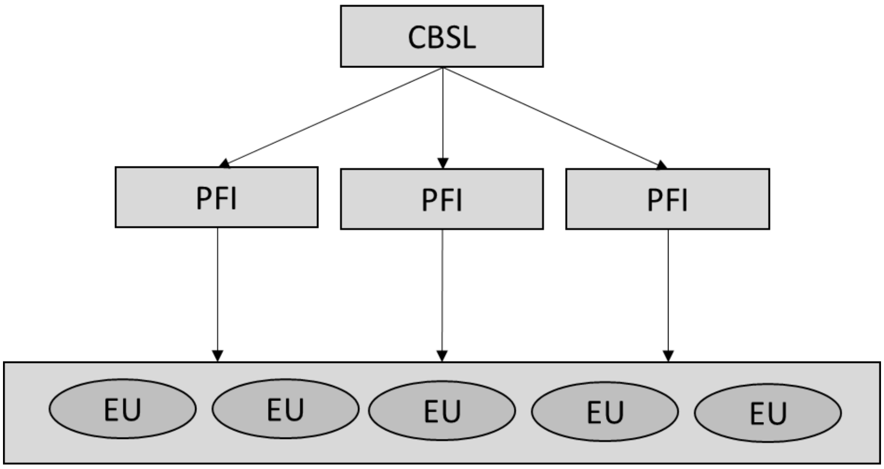
The target areas for the project are the 14 districts listed in Table 3. Of the credit component, at least 50% was supposed to be given to the Northern and Eastern Provinces, and 65% was actually provided to these areas. The higher share of credit to the Northern and Eastern Provinces is assumed to be due to the acceleration of reconstruction work in the area after the civil war ended in 2009 and because the project began with credit from Batticaloa district in the Eastern Province and was expanded to adjoining areas.

Table 3: Loans from the Project (at the time of final disbursement)

Province	District	No. of Loans	Loan Amount (SLR million)	%
Northern	Jaffna	7,553	466	15
	Kilinochchi	1,443	85	3
	Mullaitivu	1,470	103	3
	Mannar	1,417	80	2
	Vavuniya	595	39	1
Eastern	Trincomalee	6,772	360	11
	Batticaloa	11,600	585	18
	Ampara	7,497	386	12
Others	Puttalam	6,391	345	11
	Anuradhapura	4,218	230	7
	Polonnaruwa	1,993	90	3
	Badulla	2,207	124	4
	Monaragala	2,223	126	4
	Ratnapura	3,836	194	6
Total		59,215	3,213	100

Source: CBSL (questionnaire survey for the ex-post evaluation)
Note: The percentage refers to each district's share of loan amount.

The lending scheme, as seen in Figure 1, was designed so that PFIs were selected from those fulfilling the selection criteria set beforehand by the Central Bank of Sri Lanka (CBSL), the executing agency, and signed administrative agreement. Then the loan would be provided to the beneficiaries through PFIs.



Source: Prepared by the external evaluator.
Note: EU refers to end users, the beneficiaries of the project.

Figure 1: Lending Scheme

The PFIs were selected using criteria such as a) an annual recovery ratio of a minimum of 75%; b) a return on asset ratio of a minimum of 1%; c) a return on capital ratio of a minimum of

10%; d) a current asset ratio of a minimum of 20%; e) an on-time loan recovery ratio of a minimum of 70%; and f) a loan infection ratio of below 30%. Of the 12 PFIs that expressed interest, 11 participated in the project. Table 4 is a list of PFIs and portfolios.

Table 4: PFIs and Their Portfolios

PFI	No. of Loans	Amount of Loan (SLR million)
Bank of Ceylon (BOC)	24,987	1,368
People's Bank	13,259	734
Regional Development Bank (RDB)	11,830	673
Sanasa Development Bank (SDB)	5,342	265
LOLC	2,370	78
Hatton National Bank (HND)	787	58
Lankaputhra Development Bank	294	20
Sampath Bank	132	8
Union Bank	129	7
People's Leasing Company	73	1
Commercial Bank	12	1
Total	59,215	3,213

Source: CBSL

Originally, loans to the beneficiaries were considered through two channels: one is directly from PFIs to the beneficiaries and the other is from PFIs through Participating Agencies (PAs), which are microfinance institutions such as NGOs, to the beneficiaries. It was considered that using PAs would enable better outreach to and better care for the beneficiaries. However, reasons such as the higher risk of irrecoverable debt (because the PFIs would not recover the loans directly from the beneficiaries), the difficulty of monitoring PAs, and the smaller interest margin when PAs are used, would have made the project less attractive to the PFIs, none of the PFIs used PAs.

In the lending scheme, two modes were planned: a) lending to individuals who belonged to a group of about five beneficiaries and b) lending to individuals who were not in a group because they lived in remote areas where group formation was difficult. Nevertheless, groups were formed even in remote areas, and all of the credit was provided to individuals belonging to a group. Beneficiaries were required to meet the following conditions to obtain credit:

- Monthly household income of SLR 15,000 or less[7]
- At least three months of saving after group formation (the amount of saving to be decided among the members)
- Household was not a beneficiary of other microfinance schemes simultaneously

[7] Since November 2015, based on the revision of poverty line used in the project, the amount was increased to SLR 16,500.

- Household was not a defaulter of other financial institutions

Loans to the beneficiaries were provided at low interest as planned at the time of the appraisal. The interest rate was initially 12% and was reduced to 10% after it was revised in August 2015 by the Steering Committee set up for the project. Although there were slight differences among the geographical areas and the PFIs, the first loans with a maximum amount of SLR 50,000 and second and third loans up to SLR 100,000 and 150,000 were given after the group formation and regular saving for three months had occurred.

The target business activities included trade and services, livestock, agriculture, and small-scale industry, as was planned in the appraisal. Trade and services accounted for 39% of the total, and livestock and agriculture accounted for 20% each.

Photo 1: Dairy Husbandry

Photo 2: Brick Production

The project kept in mind the structure required to continue providing microfinance after the project was completed and thus established development societies by amalgamating several beneficiary groups. The activities of the development societies, their benefits, and their future prospects are summarized at the end of the report.

b) Procurement of Equipment for Project Management and Monitoring

Motorbikes and office equipment required for project monitoring were procured. Originally, the procurement of office furniture was also planned, but the furniture used in the previous Poverty Alleviation Micro Finance Project was used, and new furniture was not necessary.

c) Consulting Services and Capacity Development

Originally, the project planned to make use of staff from PFIs on deputation to fill the posts required to operate and manage the project. However, the required human resources were not secured, and individuals were recruited from the open market. A total of 93 people, including those in the Central Project Office at the CBSL headquarters; credit, training, and marketing experts at Project Regional Offices; and field officers for the PFIs were posted.

Training for field officers was conducted quarterly by the CBSL starting in 2010 when their recruitment commenced. Training for the beneficiaries was conducted by the CBSL, PFIs, and Sarvodaya Economic Enterprise Development Services[8] (SEEDS), an NGO hired for one year in 2014. Aside from group formation, entrepreneurship, and bookkeeping, the Project Regional Offices and PFIs assessed the needs of the beneficiaries, and technical training such as for agriculture and food processing was conducted. Table 5 provides a summary of the training conducted by SEEDS[9]. A total of 432 beneficiary training courses were conducted by the Central Project Office and Project Regional Offices of the CBSL, in which 14,135 beneficiaries participated.

Table 5: Capacity Development Training for the Beneficiaries Conducted by SEEDS

Training Course		No. of Programs	No. of Participants
Vocational Training	Agriculture	96	4,693
	Fisheries	21	1,146
	Livestock	71	3,802
	Small industries	50	2,613
Entrepreneurship Development		151	7,087
Society Development	Leadership	83	3,147
	Bookkeeping	80	2,922
	Exposure visit	20	588
Marketing Workshop	Value addition	14	675
	Value chain	14	664
	Market and new technologies	14	727
Information Technologies		5	106
Total		619	28,170

Source: SEEDS

3.2.2 Project Inputs

3.2.2.1 Project Cost

In the appraisal plan, the total project cost was JPY 2,759 million (the foreign currency portion was JPY 79 million, and the local currency portion was SLR 2,552 million), of which JPY 2,575 million was from a Japanese ODA loan. The actual total project cost was JPY 2,680 million (the foreign currency portion was JPY 71 million, and the local currency portion was SLR 3,858 million). The disbursement of the Japanese ODA loan was JPY 2,561 million. Table 6 shows that, as there was a high demand from the beneficiaries and there were unused funds in other components, the credit component amount was enhanced using the balance amount by reallocating the fund twice.

[8] Established as an NGO in 1986. The organization is registered as a private company now. It runs capacity development training mainly for micro enterprises.
[9] Table 5 does not include beneficiary training and workshops conducted separately by the CBSL and PFI.

Table 6: Planned and Actual Project Cost

Unit: JPY million

	Plan	Actual
a) Credit component	2,100	2,381
b) Procurement of equipment	25	35
c) Consulting service	368	75
d) Others	266	189
Total	2,759	2,680

Source: CBSL

Although there were increases and decreases in the costs for each component, the project was implemented without any issues. There was no problem with the funds provided by the Government of Sri Lanka, and the project cost was within the plan.

3.2.2.2 Project Period

At the time of the appraisal, the planned project period was 72 months beginning in May 2008, when the selection of consultants and the preparation of the operation manual were to start, and to be completed by April 2014, when the consulting services were to end. The project indeed started in May 2008. However, because the credit component was enhanced by fund reallocation, the lending scheme was operated beyond the original project period. The service of personnel was extended beyond the final disbursement date of June 2018 using the Sri Lankan government's own funds to operate a revolving fund. Therefore, the completion of the project has been designated as the final disbursement date of November 2015, when the project's consulting service was completed. As a result, the project period was 91 months and exceeded the planned period.

3.2.3 Results of Calculations for Internal Rates of Return (Reference only)

The internal rate of return for the project was not calculated at the time of the appraisal. Therefore, it was not recalculated at the time of the ex-post evaluation.

The project cost was within the plan, but the project period exceeded it. Therefore, the efficiency of the project is fair.

3.3 Effectiveness and Impacts[10] (Rating: ③)

3.3.1 Effectiveness

3.3.1.1 Quantitative Effects (Operation and Effect Indicators)

Table 7 shows the target and actual figures for the project's operation and effect indicators.

[10] Sub-rating for Effectiveness is to be put with consideration of Impacts.

Table 7: Operation and Effect Indicators

	Target	Actual	
	2015	2017	Remarks
	2 Years After Completion	2 Years After Completion	
a) Number of loans	75,000	150,535	Inclusive of loans given from the revolving fund of the project for the target and the actual.
b) Total amount of approved loans	SLR 2,000 million	SLR 3,213 million	Exclude revolving fund for the target and the actual.
c) Ratio of beneficiaries who apply for loans more than twice	90%	10%	Inclusive of loans given from the revolving fund for the actual.
d) Repayment rate by beneficiaries on time	90%	93%	—
e) Ratio of beneficiaries who have cross passed above the poverty line	50%	98%	Result obtained from the quantitative survey conducted in the ex-post evaluation for the actual.

Source: CBSL

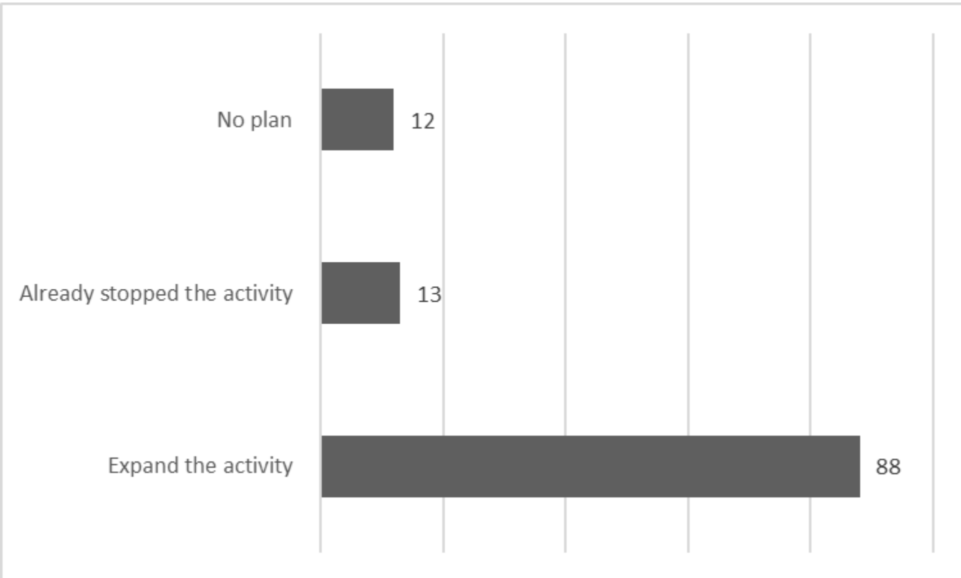
As seen in a) the number of loans and b) the total amount of approved loans, the demand for microfinance funds from the beneficiaries was high, the actual figures significantly exceeded the target figures because the unused balance of the Japanese ODA loan was allocated to the credit component. The total number of people who have taken loans, excluding those from the revolving fund, was 141,799. There are no comprehensive gender-wise data on the beneficiaries, but, according to the mid-term evaluation and quantitative survey[11]conducted in the ex-post evaluation, the share of male beneficiaries was 12 to 16% while the female share was 84 to 88%.

The figure on c) the ratio of beneficiaries who apply for loans more than twice includes those from the project and the revolving fund. It appears that the target was set based on the actual

[11] A quantitative survey was conducted to supplement the data on the effectiveness and impact of the project. Using multistage sampling, it covered 113 beneficiary households in six districts of the project target districts. The six districts were selected by ranking the target districts in the order of most number of loans. The top three districts were selected from the Northern and Eastern Provinces, and three more districts were chosen from other districts: Ampara, Jaffna, Batticaloa, Anuradhapura, Ratnapura, and Puttalam were selected. Only the beneficiaries from the top four lending PFIs were covered because of the way the databases on beneficiaries are organized by the PFIs and because many beneficiaries live in places where it is difficult to identify their addresses. In each district, one PFI branch was randomly selected from each of the BOC, People's Bank, RDB, and SDB branches with at least 20 loans from the project. From the beneficiary list of each PFI branch, six beneficiary households were selected from both the BOC and People's Bank, the PFI with larger number of loan cases, while four were selected from both the RDB and SDB using a randomized list. Using this method, a survey of 120 households was planned. However, some of the beneficiaries could not be traced, and others were absent. Ultimately, 113 households were surveyed.

ratio of the beneficiaries who applied for a loan more than twice in the earlier Poverty Alleviation Microfinance Project[12]. The project's achievement rate is much lower, and the target figure of 90% may have been ambitious. Moreover, the actual figure of 10% includes the beneficiaries who borrowed a second or more times only from the project fund. Some of the beneficiaries took subsequent loans from other credit schemes. According to the quantitative survey conducted at the time of the ex-post evaluation, the share of beneficiaries who took subsequent loans from the project was 12%, and the share of those who took subsequent loans from other schemes was 19%. Some of those (12 out of 22 respondents) who took loans from other schemes said that they did so because they needed loans above the project's credit limit. Similarly, according to the survey at the time of the ex-post evaluation, most of the respondents were continuing with the businesses for which they had taken credit. Eighty-eight respondents (78%) were planning to expand or thinking about expanding their businesses in the near future (see Figure 2).

Unit: People



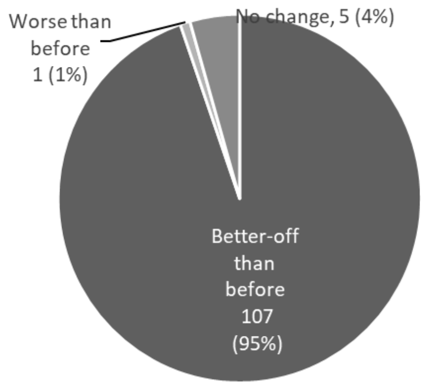
Source: Quantitative Survey

Figure 2: Future Plan for the Business for Which the Loan Was Taken

The actual figure of d) repayment rate by beneficiaries on time is almost the expected rate. And e) the ratio of beneficiaries who have cross passed above the poverty line exceeded the target. According to the survey conducted by CBSL in 2016, the figure was 91%. In the quantitative survey of the ex-post evaluation, when the monthly income of the 112 households who responded was compared with the poverty line determined by the Government of Sri Lanka

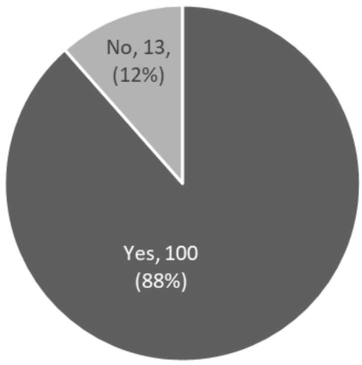
[12] Microfinance project implemented by Japanese ODA loan from 1999 in six districts of Kurunegala, Matale, Nuwara Eliya, Badulla, Kalutara and Hambantota.

in December 2017 (SLR 4,584 per capita), the average monthly income per person was SLR 11,753; 110 households (98%) had surpassed the poverty line. Similarly, in the quantitative survey, 107 out of 113 households (95%) felt economically better off, and 100 households (88%) felt financially better prepared for an emergency than they were 10 years before.



Source: Quantitative Survey

Figure 3: Current Economic Status Compared to 10 Years Ago



Source: Quantitative Survey

Figure 4: Whether Financially Prepared Now Compared to 10 Years Ago

3.3.1.2 Qualitative Effects (Other Effects)

The expected qualitative effect at the time of the appraisal was the capacity development of the PFIs. However, each PFI has its own human resource development and training programs, and no systematic PFI capacity development effort in the microfinance sector was made during the project. Training was limited to the field officers recruited for project implementation. On the other hand, a significant number of PFIs, which had no or limited experience in operating microfinance schemes before the project, gained experience and knowledge of microfinance by participating in the project. This was confirmed in interviews with PFIs in the ex-post evaluation. Moreover, some of the PFIs, taking advantage of the project experience, developed and are operating their own microfinance projects (see the column at the end of the report for more details).

3.3.2 Impacts

3.3.2.1 Intended Impacts

Poverty Alleviation and Other Impacts

The expected impacts of the project were poverty alleviation in the target areas and a contribution toward social and economic stabilization in the northeast. With regard to poverty alleviation, the impacts were as indicated in the effectiveness indicators. In addition, several positive impacts from the activities of beneficiary groups and development societies are observed. For example, group savings, a prerequisite for obtaining credit, gave beneficiaries a regular saving habit. When inquired about regular saving habit 10 years ago and now, as part of the quantitative survey, the saving habit has improved as seen below.

Table 8: Saving Habit of the Beneficiaries

	No.	%
10 years ago		
Was saving	50	44%
Was not saving	63	56%
Now		
Saving	81	72%
Not Saving	32	28%

Source: Quantitative Survey

Most of the beneficiaries are women, and many of them have taken executive positions in beneficiary groups or development societies. More women have been able to gain leadership skills through the activities of the beneficiary groups and development societies. In interviews with the beneficiaries, some women said that, earlier they had no skills to generate income or even they had the skills, they were unable to use them to contribute to the household income. Many said that, since participating in the project, they were able to contribute to the household budget by earning on their own and the group and development society activities gave them skills, such as in negotiation, that are useful in the society and that have given them confidence.

The site visits and interviews with beneficiaries and PFIs indicated that the continuity[13] and activity of the beneficiary groups and the formation of development societies are proportionate to the degree of involvement of the PFIs' ground-level staff such as field officers. In places where field officers or similar staff were posted after the project ended and where the officers are regularly visiting and supporting the activities of the beneficiary groups and development societies, internal lending and other social and welfare activities seemed to be actively taking place. The members clearly identified the objective of the development societies and charted out a path to future development.

Growth of Microfinance Market

At the time of the appraisal, the microfinance market in Sri Lanka was in a stage of infancy. Therefore, the project was expected to lead to the capacity development of institutions that would operate microfinance and thereby promote competition and the introduction of market principles. Moreover, considering that there was a high demand to improve financial access in the northeast at that time, the contribution of the project to the development of the sector was

[13] Reference is made here to the beneficiaries who have demand for microfinance even after the project and who recognize the need to continue belonging to beneficiary groups and development societies. Some of the beneficiaries graduated to small enterprises using the credit from the project, and some no longer needed to be part of a beneficiary group or development society because they ceased their business.

considered as an impact.

Although Sri Lanka has a long history of microfinance, no comprehensive statistical data on the sector in the country have been gathered. In its backdrop was the existence of various types of institutions which operated microfinance, and there was no microfinance act until 2016. The Lanka Microfinance Practitioners' Association (LMPA)[14], an association of microfinance practitioners, is developing data based on annual surveys; however, the target is its membership and will not comprehensively cover the microfinance schemes operated by the commercial banks. Changes in the loan portfolios in Sri Lanka's microfinance sector are presented below based on the available documents and information collected from the LMPA.

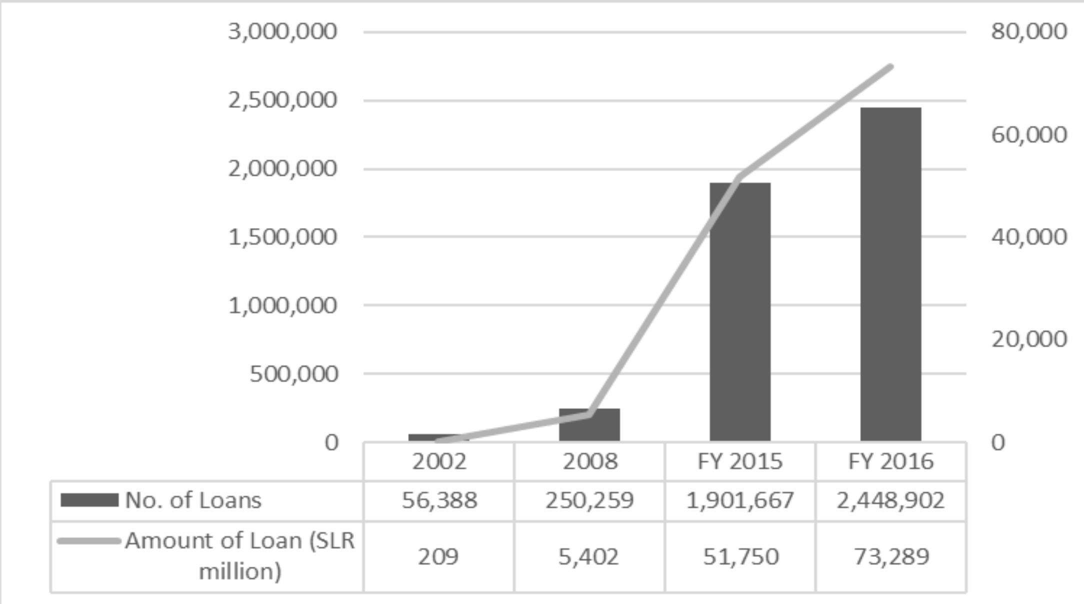


Figure 5: Changes in Performance of Microfinance[15]

The microfinance institutions shown in the above figure are selected using different methodologies and thus cannot be simply compared. However, the sector has grown dramatically, mostly over the last 10 years. Financial institutions and branch networks are expanding in several regions, and financial access has significantly improved. In addition, as regard to the fund demand and supply in microfinance sector, there is a sufficient number of players and the supply is ample. On the other hand, malpractice is becoming an issue in rural

[14] Non-profit organization established in 2007. Members are NGOs and various financial institutions that implement mainly microfinance. When it was established, networking of practitioners was the objective, but it now advocates for microfinance and became a coordinating body for microfinance in the country.

[15] Source for 2002 data: Gant, Richard et al. *National Microfinance Study of Sri Lanka: Practice and Policies* (2002). Co-sponsored by AusAID and GTZ. Source for 2008 data: Atapattu, Anura. *State of Microfinance in Sri Lanka* (2009). Prepared for Institute of Microfinance. Source for FY 2015 and FY 2016 data: Lanka Microfinance Practitioners' Association. Microfinance Review Sri Lanka: Performance and Analysis Report 2016 (2017).

areas and among the urban poor. As approximately 2,000 microfinance institutions are estimated to be operating, the LMPA is considering developing a code of conduct for the membership. From such point of view, the project employed fair practices in providing and collecting loans based on the operation manual while conducting awareness programs on financial literacy for the borrowers. The project prevented malpractice in the microfinance sector. As indicated in the interviews with PFIs, they improved their capacity to operate microfinance in a changing environment by participating in the project. However, because PAs were not involved, the project has not contributed to capacity development for organizations such as NGOs operating microfinance. In addition, the PFIs include public commercial banks, such as the BOC and People's Bank, that had strong branch networks in the country to start with, and the involvement of institutions such as the RDB and SDB, whose main clientele is in rural areas, was noteworthy. Therefore, it is fair to say that the benefit to private commercial banks was limited.

In the interviews, microfinance experts and practitioners in the country, said that the design of the project distorted the market because public commercial banks such as the BOC and People's Bank had a competitive edge over private institutions to start with, and the contribution of the project to promoting competition in the microfinance sector is thus considered to be limited.

3.3.2.2 Other Positive and Negative Impacts

Regarding impacts on the natural environment, the main targets of the project were services, agriculture, and livestock on micro and small scales. The surveys on the executing agency and PFIs and field visits did not reveal any activities that would cause negative impacts on the natural environment.

Livelihood-related activities to which the project provided credit were conducted in the homes and on the agricultural land of the beneficiaries and in rented place, and no resettlement took place. No land acquisition that could cause negative impacts was observed.

All the above indicates that the project has largely achieved its objectives. Therefore, the effectiveness and impacts of the project are high.

3.4 Sustainability (Rating: ③)

3.4.1 Institutional/Organizational Aspect of Operation and Maintenance

As was originally planned, the Regional Development Department (RDD) of the CBSL was in charge of the project and the operation and maintenance of the revolving fund. For project implementation, a Central Project Office was established at the CBSL headquarters, and five Project Regional Offices were established in 2011 in Jaffna, Kilinochchi, Anuradhapura, Batticaloa, and Monaragala. Debt recovery and re-lending of the project were implemented through the revolving fund. Details of the revolving fund are provided in 3.4.4 Current Status of

Revolving Fund. The field officers recruited for the project and PFI staff attended to debt recovery and the operation of the revolving fund. Some of the PFIs such as the BOC absorbed field officers as permanent employees, who were originally recruited for the project. Other PFIs allocated their own staff to perform debt recovery, and no manpower shortage occurred. Therefore, there is no issues with the institutional aspects of operation and maintenance.

3.4.2 Technical Aspect of Operation and Maintenance

The CBSL, the executing agency, was established in 1950 and has been playing a central role in stabilizing Sri Lanka's economy, price, and financial systems. From the time of the appraisal, the CBSL has had rich experience as a financial institution, and the RDD was implementing microfinance and two-step loans supported by donors such as ADB, the International Fund for Agriculture Development (IFAD), and the Canadian International Development Agency (CIDA).

For the project, consultants assigned to the RDD were recruited, mainly from among those who had experience of working in financial institutions and had knowledge of and experience in the finance sector. Financial institutions in Sri Lanka, including the PFIs, appear to have a strong technical capacity. Some of the PFIs had limited know-how and experience related to microfinance, but a certain amount of knowledge and experience were gained through the project. When the project started, an operation manual outlining the principles of loan appraisal and debt recovery was prepared. A format for loan appraisal was prepared, and the beneficiaries were appraised on its basis. In addition, PFIs have their own manuals related to loan appraisal and debt recovery, which are being used at the time of the ex-post evaluation. Although their technical capacity is not specific to microfinance, both the CBSL and PFIs offer regular training programs for their staff. Thus, the technical aspects of the operation and maintenance of the project are adequate.

3.4.3 Financial Aspect of Operation and Maintenance

Budget allocation such as the administrative costs required for project implementation was properly arranged by the Government of Sri Lanka, and there were no issues with regard to finance. Financial status of the CBSL and the PFIs for the last three years were checked and, budgetary allocation to the RDD of the CBSL had no issues. The PFIs' statuses varied, but most of the major financial indicators such as return on assets and return on equity are close to the average of the banking sector[16] in the country. Therefore, it is fair to say that the financial statuses of the RDD of the CBSL and the PFIs are not problematic at the time of the ex-post evaluation.

[16] The average in 2016 for return on assets is 1.9%, return on equity 17.3 % and capital adequacy ratio 15.6%.

Table 9: Financial Indicators of PFI (partial)

	BOC			People's Bank			RDB		
	2014	2015	2016	2014	2015	2016	2014	2015	2016
Total asset (SLR million)	1,329	1,568	1,669	1,026,769	1,176,595	1,302,048	92	106	130
Total equity (SLR million)	74	81	92	43,470	49,495	59,649	92	106	130
Return on assets (%)	1.6	1.7	1.9	1.8	1.8	1.7	1.3	1.5	1.8
Return on equity (%)	20.5	22.2	28.4	35.5	27. 1	27.5	9.5	9.8	11
Capital adequacy ratio (%)	13.6	13.1	12.3	14.3	12.6	12.1	6.9	7.6	6.5
Debt-equity ratio (%)	293.1	228.2	124.5	34.6	30.4	21	—	83.8	82.3
	SDB			HND			Lankaputhra Development Bank		
	2014	2015	2016	2014	2015	2016	2014	2015	2016
Total asset (SLR million)	40,572	60,289	66,032	576	752	858	7,914	8,426	8,671
Total equity (SLR million)	4,695	5,297	5,519	60	65	77	4,661	4,818	4,942
Return on assets (%)	2.1	2.2	1	2.2	2.3	2.5	2.4	2.9	3
Return on equity (%)	12.5	14.4	7.5	16	16.8	20.2	4	4.2	5.4
Capital adequacy ratio (%)	15.3	12.5	12.3	14.8	12.7	15.3	74.3	69.3	75.5
Debt-equity ratio (%)	7.4	10.1	10.8	54.6	100.6	119.8	69.8	74.9	75.4

Source: PFI

3.4.4 Current Status of Revolving Fund

At the time of the appraisal, the option of operating the project's revolving fund together with the revolving fund of the earlier Poverty Alleviation Micro Finance Project was considered; however, because the target areas are different, they were operated separately. At the time of the ex-post evaluation, a few of the consultants recruited for the project by the RDD were engaged in the operation of the revolving fund and recovering debts.

The status of the revolving fund as of end of December 2017 is shown below. Operation of the revolving fund which had been managed by the CBSL and PFIs ended in June 2018 following a decision of the Sri Lankan government.

Table 10: Operation Status of the Revolving Fund

No. of loans from the revolving fund	91,320
Amount of loans from the revolving fund	SLR 6,680 million

Source: CBSL

Debt recovery from the beneficiaries by PFIs was continued by field officers and PFI staff after the project ended, in line with each PFI's rules. As described earlier in 3.3.1 Effectiveness, on-time repayment from the beneficiaries of the project is high (93%), largely because the repayment schedules did not constrain the beneficiaries and because of the diligent services provided by the field officers and PFI staff. No problems such as delayed repayments from PFIs to the CBSL have occurred.

No major problems have been observed in the project's institutional, technical, or financial aspects; in the operation and maintenance system; or in the current status of the revolving fund. Therefore, the sustainability of the project's effects is high.

4. Conclusion, Lessons Learned and Recommendations

4.1 Conclusion

Sri Lanka considered microfinance as an important tool for poverty alleviation, one of the nation's policy goals. The project was implemented to increase the income of people living in poverty by providing credit, targeting the northeast, where there were long years of civil war, and adjacent poor areas, and by improving the capacity of PFIs and beneficiaries, thereby contributing to the poverty alleviation. At the time of the ex-post evaluation, the poverty rate of Sri Lanka had been reduced to the policy target set at the time of the project appraisal. In the northeast, however, the poverty rate continues to be higher than the national average, and microfinance is still important. The development policy, development needs, and Japan's ODA policy at the time of the appraisal are consistent with the project, and the relevance of the project is high. Considering the high demand for funds, the credit component was increased by 1.8 times the planned amount through fund reallocation. Nevertheless, the total project cost was more or less the expected amount. On the other hand, because the credit component was increased and the loan scheme was operated beyond the planned duration, the project period was prolonged. As a result, the efficiency of the project is fair. The operation and effect indicators set to measure effectiveness have mostly indicated that the target was achieved and that several positive impacts have been seen for people living in poverty. Therefore, effectiveness and impacts are high. The operation of the project's revolving fund was completed in June 2018. No issues have been observed in terms of the institutional, technical, or financial aspects of the operation or the maintenance of the executing agency and PFI, and no delays have occurred in the debt recovery of the revolving fund. Therefore, the project's sustainability is also high.

In light of the above, the project is evaluated to be highly satisfactory.

4.2 Recommendations

4.2.1 Recommendations to the Executing Agency

None.

4.2.2 Recommendations to JICA

None.

4.3 Lessons Learned

Implementing the Scheme Applying Credit Plus Concept and Assistance at the Field Level

The project has contributed to improving the skills of the beneficiaries through technical training, bookkeeping and entrepreneurship training, as well as the formation of beneficiary groups and development societies. In addition, through the activities of the groups and development societies, many women have acquired leadership skills, resulting in women's empowerment. This was largely a result of implementing a credit scheme with the value addition called "Credit Plus" instead of simply providing low-interest credit to the poor. Beneficiaries have been able to improve not only their technical skills but also their life skills through the training and activities of the groups and development societies. The involvement of PFI staff at the field level such as the field officers recruited for the project played a key role. In the places that saw greater involvement of field officers, the beneficiary groups and development societies continued to be active even after the project ended. Some societies have introduced social welfare activities for their members and envision the development society playing a larger role.

When operating credit schemes, as in the case of this project targeting the poor, incorporating programs designed to improve the beneficiaries' technical and life skills is recommended. Maximizing the effect of such programs requires the assistance for allocating human resources and establishing systems backed by the strong commitment of the institutions operating the scheme.

Comparison of the Original and Actual Scope of the Project

Item	Plan	Actual
1. Project Outputs	a) Credit for people living in poverty b) Procurement of equipment for project management and monitoring Vehicles for monitoring (motor bikes), office equipment, office furniture c) Consulting services Assistance for project implementation, capacity development and assistance at field level	As planned Vehicles for monitoring (motor bikes), office equipment As planned
2. Project Period	May 2008–April 2014 (72 months)	May 2008 –November 2015 (91 months)
3. Project Cost		
Amount Paid in Foreign Currency	79 million yen	71 million yen
Amount Paid in Local Currency	2,680 million yen (2,552 million Sri Lankan rupees)	2,609 million yen (3,858 million Sri Lankan rupees)
Total	2,759 million yen	2,680 million yen
ODA Loan Portion	2,575 million yen	2,561 million yen
Exchange Rate	1 Sri Lankan rupee = 1.05 yen (As of September 2007)	1 Sri Lankan rupee = 0.79 yen (Average between January 2008 and November 2015)
4. Final Disbursement	November 2015	

Ripple Effect: Future Path for the Development Societies and BOC's Mithuru Scheme

Two things that can be called byproducts of the project are described here. The first concerns the development societies, comprised of multiple beneficiary groups, and their future prospects. The second concerns the Bank of Ceylon's (BOC) microfinance product, the Mithuru scheme, which was developed based on the experience of the project.

<u>Development Societies</u>

In the project, development societies were established to continue offering microfinance after the project ended by amalgamating several beneficiary groups. One development society is made up of five to eight beneficiary groups, and the membership varies from small ones (e.g., 20–30 members) to ones with more than 100 members. Development societies are based on the beneficiary groups formed by each PFI; therefore, the members are the customers (beneficiary groups) of the same PFI. They are registered in accordance with the Societies Ordinance of Sri Lanka, and the members all hold shares. By the end of December 2017, 1,062 development societies had been formed.

The activities of the development societies established in the project vary. What is common among them is saving and internal lending within the society. As happened in the beneficiary groups, the development societies collect a certain amount of money from the members regularly, and, using the saving as capital, they lend to the members (and sometimes to non-members), setting interest rates, repayment periods, and ceiling amounts for the credit. For one particular development society, the ceiling amount for the first loan is SLR 5,000/month with a 4% monthly interest rate. For successive loans, the amount is gradually increased. Several development societies that have built a track record on saving and other activities have taken bulk loans, leveraging products such as the Mithuru scheme as described in subsequent section. A bulk loan is a form of credit financial institutions provide to organizations, like development societies, that have multiple customers, and on-lending to the customer is entrusted to the organization.

In the operation of bulk loans, development societies are serving as small development banks in the villages. In Sri Lanka, this type of village banking formation and success have a long history. The most famous model is perhaps the Women's Development Federation (WDF) in Hambantota. The WDF has amalgamated women's groups, which were formed by a poverty-eradication program (Janasaviya) implemented in the past, at the village level and established a bank outlet, the Janashakthi Bank Society, in each target village. Each bank society has a dozen to hundreds of customers as members. In the WDF model, as in the development societies of the project, the members hold shares in the WDF. Moreover, the

WDF provides not only financial services but also occupational training, awareness programs, and social welfare.

The maturity levels of the development societies vary, and they were established at different times. Thus, not all the development societies follow the WDF model. Some of the development societies of the project were established simultaneously with the beneficiary groups. Because the formation of the societies took place hurriedly, not all the members necessarily recognize their objectives, and some of the societies' activities have dwindled. On the other hand, the societies whose members understand their objectives and importance and have a strong track record have a clear vision to develop into village-level financial institutions, as the WDF did.

In addition, some of the development societies are providing services such as funeral funds and financial assistance for emergencies as social welfare to their members. To strengthen the members' cohesiveness and attract new membership, some of them are organizing cultural events in the village. Others are marketing agricultural produce. Members of a development society in Jaffna have taken up food processing and are using the interest income from internal lending to build a processing center.

The development societies are beneficial to not only the beneficiary members but also the PFIs. By providing bulk loans through the societies, PFIs can reduce the administrative procedures which would otherwise be required when they directly lend to a large number of individuals. They can also introduce new products through the development societies.

Mithuru Scheme

By participating in the project, the BOC (a PFI) saw great potential in microfinance. Considering that the project will end one day, the BOC has been operating a microfinance product called the Mithuru scheme since 2013 using its own funds. Mithuru has been lending to both the individual members of the Mithuru development society and the societies, basically using the same conditions as those of the project. As of March 2018, credit had been provided under the following conditions:

- Interest rate: 10%/annum
- Credit Limit

	Society members	Society
First loan	SLR 100,000	SLR 500,000
Second loan	SLR 200,000	SLR 750,000
Third loan	SLR 300,000	SLR 1,000,000
Fourth loan	SLR 500,000	-

- Repayment period: Up to 36 months for society members with loan amount less than

SLR 200,000. Up to 60 months for society members with loan amount SLR 200,000 and above and for the societies.

The project targeted 14 poor districts in the country, but the Mithuru scheme is targeting across the whole country. From the beginning of the scheme's operation to December 2017, 444 development societies were formed[1]. In 2017, credit of SLR 237 million was provided. Bulk loans to the development societies are given based on a performance assessment of the society. The assessment is based on the frequency of society meetings, saving amounts, the record keeping of various books, and an audit.

The Mithuru scheme is the BOC's corporate social responsibility. To provide low-interest credit, as was done in the project, when all the capital comes from the bank's own funds, a strong commitment from the institution is required. People who had worked as BOC field officers and at BOC branches and headquarters were interviewed. The interviews indicated that BOC management understood the potential of microfinance and had a strong commitment from the beginning of the project. The BOC had experience of microfinance before the project began, but, by taking part in the project and assisting in beneficiaries' capacity development and responding carefully to their needs, the importance of the "Credit Plus" concept has infiltrated in BOC. Therefore, like the project, Mithuru scheme provides occupational training and other leadership-related training.

As described in the main text of the evaluation report, the demand for microfinance in Sri Lanka remains high, and many of the project beneficiaries still require a similar scheme. The Mithuru scheme, an unexpected ripple effect of the project, is a good response to such demand.

[1] Includes the development societies established as BOC customers in the project.