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RURAL OUTREACH AND FINANCIAL COOPERATIVES:

SANASA, SRI LANKA

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
ALMAO	All Lanka Mutual Assurance Organization
CBOs	Community Based Organizations
CCA	Canadian Co-operative Association
CBSL	Central Bank of Sri Lanka
CEO	Chief Executive Officer
CICL	Ceylinco Insurance Company Ltd
CIDA	Canadian International Development Agency
CGAP	Consultative Group to Assist the Poor
CLEAR	Country-Level Effectiveness and Accountability Review
COICL	Co-operative Insurance Company Ltd
CRB	Cooperative Rural Bank
DID	Développement International Desjardins
EC	European Commission
GDP	Gross Domestic Product
GSL	Government of Sri Lanka
GTZ	Gesellschaft für Technische Zusammenarbeit
IBSL	Insurance Board of Sri Lanka
IFAD	International Fund for Agricultural Development
IFC	International Financial Corporation
IFI	International Finance Institution
IMF	International Monetary Fund
INGO	International NGO
IPS	Institute of Policy Studies
KfW	Kreditanstalt für Wiederaufbau
S Rupee	Sri Lankan Rupee
MFI	Microfinance Institution
MIS	Management Information System
MPCS	Multi-Purpose Cooperative Society
NGO	Non Governmental Organization
NICL	National Insurance Corporation Ltd
NPL	Non-Performing Loans
NSB	National Savings Bank
NTDF	National Development Trust Fund
PAR	Portfolio at Risk
PTCCs	Primary Thrift and Credit Cooperatives
RDB	Regional Development Banks
SAICL	SANASA Almao Insurance Company Ltd

SANEEPA	SANASA Producer Consumer Alliance
SEDCO	SANASA Engineering and Development Company
SDBL	SANASA Development Bank LTD.
TCCS	Thrift and Credit Cooperative Societies
WB	World Bank

1. INTRODUCTION

COUNTRY BACKGROUND

Sri Lanka is an island nation with a population of 19.4 million and an area of 65,610 sq km (25,332 sq miles). There are nine provinces, of which the Western province has the largest population 5.525 million and the highest population density 1,583. The Eastern, Uva, Northern and North Central provinces have the lowest average population density (141) due to their size, rural nature/lack of industry, lower population and the effects of the civil war.

The major languages are Sinhala, Tamil, and English. The major religions are Buddhism, Hinduism, Islam, and Christianity. Sri Lanka is primarily rural (72 percent), 21.5 percent is urban and 6.5 percent is estate. The GNI per capita is US $1,010. Nearly 18 percent of GDP is agricultural, 26.5 percent is industry and 55.7 percent is service based. Majority of the employment is in the agricultural sector at 32.8 percent. The main exports are clothing and textiles, tea, gems, rubber, and coconuts.

Sri Lanka is a low-income country with middle income human development. Its high literacy rate of 92.5 percent is on par with the Philippines and Thailand (India's rate is approximately 60 percent). The literacy rate for women 90.6 percent and that for men is rate 94.5 percent. Forty-one percent of the population has attended secondary school and 21.2 percent have tertiary education only.[1] The educational level in rural areas is significantly lower than in the capital and largest towns. Life expectancy of men is 71 years and that for women is 77 years.

FINANCIAL SECTOR

There is significant scope for financial deepening in Sri Lanka. Private sector credit is very low at about 35 percent of GDP in 2004. Insurance penetration in the country is low, at only six percent of the population for life insurance and eight percent for general insurance.[2] Penetration of life insurance is less than a third of levels found in China and India.

There are 22 commercial banks. Two government-owned banks, Ceylon Bank and Peoples Bank, have a majority of the banking sector assets. Hatton National Bank has the largest microfinance clientele of 125,500 borrowers as of June 2005. The majority of

[1] Consumer Finances and Scio-Economic Survey Series of the Central Bank of Sri Lanka.
[2] P. 1 ADB Technical Assistance Report Sri Lanka Microinsurance Sector Development.

commercial bank lending is short term and heavily focused on the Western Province where Colombo is located. In addition to the commercial banks, there are 14 licensed specialized development banks including SANASA Development Bank Ltd and six regional development banks, and 28 registered finance companies. Furthermore, there are 1,539 cooperative rural banks (CRB).

The overall performance of the commercial banking sector has improved in recent years. However, political interference in both the state bank sector and the cooperative sector excluding SANASA continues to be an issue. There are plans to restructure two government-owned commercial banks. While there bank branches and finance companies located in all of the large regional cities, their presence in rural areas is limited. The commercial banking sector has limited involvement in rural finance other then through deposit mobilization

The insurance sector in Sri Lanka includes two government insurance schemes (the Samurdhi Authority and the Agriculture and Agrarian Insurance Board) and 13 private insurance companies. As of 2004, the sector is dominated by the two companies, Ceylinco Insurance Company Ltd., Sri Lanka Insurance Corporation Ltd. and Eagle Insurance Company Ltd. The two companies have a life insurance market share of 58 percent and a general insurance market share of 64 percent.[3]

The Government offers subsidized mandatory and voluntary life insurance for those whose incomes are below the poverty line. It also offers death, disability, crop, and livestock insurance for low-income farmers. However, the government programs are not based on actuarial principles and are unsustainable without government refinancing. A few MFIs provide insurance services, but these programs also have premiums that are not actuarially calculated but are often subsidized with donor funding.

MICROFINANCE AND RURAL FINANCE

There are several providers of micro and rural finance. This sub-sector is characterized by large subsidies, government-owned institutions (Samurdhi), multipurpose cooperatives which are quasi government institutions, and government credit lines such as the National Trust. Recent influx of Tsunami aid has resulted in several new microfinance startups that lack adequate skills.

Banks commercial and developmental are registered and required to follow Central Bank regulations. Cooperatives are registered and supervised by the Ministry of Cooperatives. Outside of the banking sector supervision is very weak. There are organizations mobilizing savings which are not receiving any supervision.

Most Sri Lankan households have access to some form of savings account and short-term credit, but their access to a wider range of financial products is more restricted. Despite a

[3] Insurance Board of Sri Lanka. Annual Report.

growing and more diverse set of financial institutions, there is an uneven provision of services across regions and market segments.

A recent household survey interviewed 1,500 households from 50 Grama Niladhari divisions across 17 districts in Sri Lanka.[4] Of the total sample 1,480, 78 percent had access to credit and 75 percent had access to savings. Sixty-six percent had access to both. In addition to the presence of government's Samurdhi Credit and Savings Societies in all the divisions surveyed, the presence of other providers was also very impressive (Table 1). The number of providers in a division varied from one to eight; the majority had 3 to 6. Among the private providers, SANASA cooperatives had the largest outreach. SEEDS, which had a presence in 24 percent of the divisions, is Sri Lanka's largest MFI.

Table 1. Outreach of Major Microfinance Providers

MFIs	Coverage of divisions (number)	Coverage of divisions (percent)
Samurdhi Savings and Credit Programme	50	100
SANASA PTCCSs	28	56
MPCSs	20	40
Regional development banks (RDBs)	15	30
SEEDS	12	24
Peoples Bank	11	22
Farmers' organizations	5	10
Bank of Ceylon	4	8
Fishermen's organizations	4	8
Arthacharya Foundation	3	6
Ceylinco Grameen Bank	2	4

Source: Institute of Policy Studies. 2005.

[4] Microfinance Survey. 2004. The Institute of Policy Studies. 2005.

2. POLICY AND INSTITUTIONAL ENVIRONMENT

LEGAL FRAMEWORK, REGULATION AND SUPERVISION

All cooperatives in Sri Lanka, including the Primary Thrift and Credit Cooperative Societies (PTCCS) and their District Unions, are regulated under the the Cooperative Societies Law of 1972 and its two ensuing amendments (1983 and 1992). In order to operate, each PTCCS must register with the Registrar or Commissioner of Cooperative Development. PTCCSs can opt for a limited or an unlimited liability structure. PTCCSs are typically community-based and can serve individuals that live, work, or own real estate in the geographic area defined by the cooperative's bylaws. Individuals are eligible for full membership at age eighteen. PTCCSs are also legally permitted to provide savings services to minors and to adult non-members.[5] Government officials are prohibited from serving on the boards or credit committees of primary societies.

The PTCCSs, District Unions and the Federation are regulated by the Government of Sri Lanka's Ministry of Cooperatives and the Cooperative Development Department within the Ministry. PTCCS and DUs are registered and controlled at the District level Department while the Federation is registered and controlled at the national level. Key responsibilities of the Cooperative Department include: a) Carrying out yearly audits of registered cooperative societies; b) Replace the board of a troubled cooperative with an interim board and dissolve a cooperative under certain conditions; and, c) Approval of any requests to expand a cooperative's activities geographically and the authorization to merge. However these regulatory responsibilities of the Cooperative Department results in several weaknesses in the SANASA system.

The Cooperative Department perceives PTCCSs as village institutions that should not expand beyond the village boundaries. The requirement of approval for geographic expansion or consolidation of PTCCSs impedes the natural consolidation of cooperatives. Neither does the Cooperative Department have the skills to carry out proper audits for financial cooperatives. For example, Cooperative Department auditors have been reported to object to PTCCSs provisioning for and writing off bad loans. The weaknesses of the system of Cooperative Department audit results in financial weaknesses in PTCCSs and DUs that are not addressed in a timely manner. Absence of prudential rules applied on a national basis leads to a variety of different approaches to regulation from the Cooperative Department at the district level.

[5] P. 6. Research Monograph Services Number 19 Strengthening Credit Unions in Sri Lanka: Dispelling the Middle Class Myth WOCCU.

Competitive Position

Overall, SANASA faces competition from the formal banking sector, financial companies and from a growing number of MFIs operating at the district level. It faces less competition from the Cooperative Rural Banks because they primarily collect deposits and are less active in providing credit, particularly at the level of SANASA PTCCSs members. SANASA PTCCSs are particularly facing increased competition from NGOs and MFIs after the Tsunami. These institutions often do not have the same savings requirements and have easier conditions for loan access.

The network's competitive position is particularly strong in rural areas. As was previously mentioned, of all financial institutions outside of the government Samurdhi program, SANASA's PTCCSs have the largest market presence at the village level. PTCCSs' strong competitive position in rural areas can be attributed to their long presence, their ability to function as autonomous entities, and their low overheads.

SANASA's bank, SANASA Development Bank Limited, however, is a very small market player compared to the countries two largest banks, Ceylon Bank and Peoples Bank. In the majority of small cities, there are large numbers of bank branches and financial companies. For example, in Chilau where SDBL recently opened a branch office, it faces competition from 10 banks and 20 finance companies.

Role of Donors and TA Providers

The SANASA network has had number of long-term partners including the Canadian Co-operative Association (CCA), Développement International Desjardins (DID), Canada, Rabo Bank, Netherlands, and WOCCU. These institutions, amongst others, have been involved with SANASA for a long time and continued to be involved through various projects.

SANASA's model of a bank with members of cooperatives as shareholders is based on the Rabo Bank model. Rabo Bank Foundation is currently providing technical assistance (year long) to SDBL to improve their risk management system including policies and procedures, internal control and audit systems. DID and WOCCU will be providing assistance to PTCCS and SDBL to improve their use of Information Technology. WOCCU is currently implementing a pilot to introduce application of PEARL prudential standards and management of overdue loans. CCA along with the Canadian Red Cross is starting up a 10 year $100 million rehabilitation project in the North-East of Sri Lanka, which includes assistance for PTCCSs affected by the Tsunami.

SANASA's donors and TA partners have significantly contributed to its dramatic expansion from 1982 to 1996 (five times increase in the number of PTCCSs and members) and in helping the network create its own apex bank and insurance company, both of which are profitable. However, rapid growth has overwhelmed PTCCSs. Inadequate controls, very basic accounting system, and credit and risk management systems that have not evolved to meet changing needs are some of the key issues that threaten the sustainability of the cooperatives.

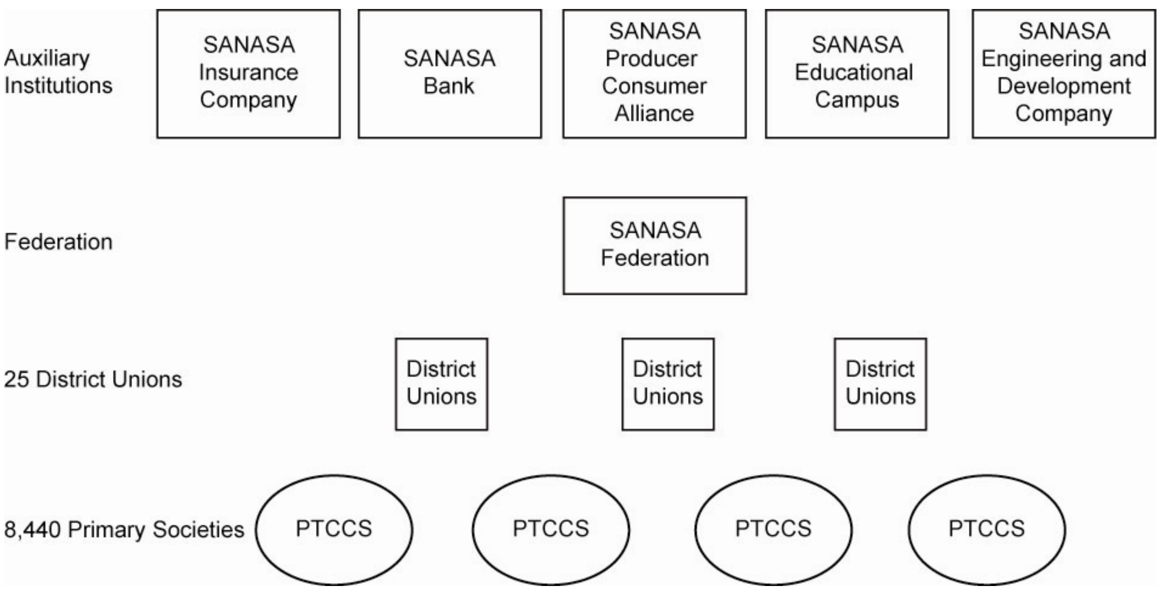
Focus on growth has also come at the cost of inadequate attention to sustainability and creating an appropriate regulatory environment. Donor funded capacity building projects that did not create programs that recovered full-costs made it difficult to SANASA to create such programs when these projects were completed. Donors and TA partners have also not been successful in improving the regulatory and supervisory environment for the PTCCSs.

Some directed credit programs funded by donors such as The Million House Program have also reinforced the dangers of directed credit. These credits undermine the PTCCS's social cohesion, threaten weak risk-management systems, and expose PTCCSs to the political interference, for instance in the form of debt forgiveness. During the period of the Million House Program, individuals created new PTCCSs simply to obtain program credits than to build their own self reliance. The majority of such PTCCSs that were created in this way no long exist.

3. SANASA NETWORK

The SANASA network includes PTCCSs at the village level, District Unions of the PTCCSs in a district, a national Federation, and several companies that are jointly owned by the PTCCSs, the DUs, and the Federation. Figure 1 gives the overall structure of the network.

Figure 1. Structure of SANASA



Source: Author.
Note: PTCCS = Primary Thrift and Credit Cooperative Societies.

SANASA PTCCSs are completely autonomous. The District Unions and the Federation have no authority (e.g. rights of supervision, audit or control) over the SANASA PTCCSs. Prior to a recent change, PTCCSs purchased shares in their DUs, and only DUs could purchase shares in the Federation. Now, PTCCSs can directly purchase shares in the Federation. PTCCSs, DUs and the Federation are all free to purchase shares in the SANASA companies.

Similarly, DUs also have no responsibilities to share annual audited reports or information on their investment or credit activities with each other or with the Federation. The boards of the DUs are made up of Chairmen selected from their member PTCCSs. Each of the 25 DUs has its own rules and criteria for lending. Collaboration between the DUs is limited to that at the Federation board level or through one of the SANASA companies.

SANASA Federation is registered with the Cooperative Department at the national level. The Federation has no mandate to control DUs or PTCCSs. Many of the responsibilities of the Federation (financial services, lobbying government) are similar to those of DUs, but are carried out at the national level. Areas where responsibilities overlapped include accessing funds and projects from donors, training and setting of policies for PTCCSs. Areas of differentiation include providing guidance and developing strategy for the Movement as a whole and producing newsletter and documents for PTCCSs and DUs.

The Federation Board is made up of representatives from DUs. With the advent of SDBL, the Federation has devolved its lending activities and its role in solicitation and channeling of funds to SDBL. The Federation is, however, SDBL's largest single share holder.

The Movement's companies are not under the supervision of the Cooperative Department. They are registered as limited liability companies and are supervised by their respective industry regulatory agencies. SDBL is registered as a Limited Liability company licensed and supervised by the Central Bank of Sri Lanka (CBSL) as a special Development Bank. SANASA Insurance Company Limited is a composite company licensed to conduct general insurance and is supervised through the Insurance Board of Sri Lanka (IBSL).

PRIMARY COOPERATIVES

Outreach and Financial Performance

In 2004, 8440 PTCCS in the SANASA network reported a total of 854,354 members. Based on this membership, SANASA estimates that reached a population of 3,285,942 out of a country wide population of 19,462,000 (based on a family size of just less than four).[6] This corresponds to 16.9 percent of the overall population. As the majority of SANASA PTCCS are in rural areas, the percentage of coverage in rural areas is much higher. SANASA members tend to come from the low and middle income families, but not generally from the poorest families. The majority of the PTCCSs visited were successful in expanding their membership using techniques such as door to door membership drives.

Table 2 presents consolidated data on some key financial indicators such as savings, loans, and fixed assets from 2002 to 2004. In 2004, the consolidated savings in the PTCCSs was nearly US$36 million (S Rupees 3,730.82 million) and the consolidated loan outstanding was over US$14 million (S Rupees 1,362.46 million). While estimates of actual loan losses are not available, the high percentage of past due loans suggests that this is likely to be significant. These data are from self reported information from PTCCSs that are consolidated by the Federation. Data on profits is not reported or collated on a systematic basis.

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[6] Assuming that there are no more than one member of a family in a PTCCS or that such cases are negligible.

This data however needs to be read with several caveats. There is no centralized system of periodic financial reporting, verification, analysis, and consolidation of financial performance of PTCCSs. Neither is there a common rating system for either PTCCSs or DUs. Most PTCCSs do not provision for or write off loan-losses or deposits that they may not recover from failed DUs. Hence, the loan amounts are overstated.

Table 2. Savings, Loans and Fixed Assets in PTCCS, in US$

Year	Number of PTCCSs	Total fixed assets, in millions	Average fixed assets per PTCCS	Total savings, in millions	Avg. savings per PTCCS	Total loan, in millions	Avg. loan portfolio per PTCCS	Loans delinquent for over 3 months %
2002	8,440	7.33	868	43.18	5,116	28.71	3,401	25.1
2003	8,440	7.46	883	39.55	4,686	29.09	3,447	22.7
2004	8,440	6.18	732	35.67	4,226	26.49	3,139	23.5

Source: SANASA Statistical Report 2003 and 2004.

Table 3 shows the trend in average savings and lending rates in PTCCSs and the rates offered by National Savings Bank and Commercial Banks. The table suggests a significant fall in interest rates on savings and a less marked fall in the loan interest rates. While this has allowed an increase in spread available for PTCCS, it is not clear whether this resulted in increased profits for the cooperatives. It is also notable that while the PTCCS loan rates did not decrease as significantly as their savings rates, they are still significantly lower than the upper end of rates in the range of commercial bank interest rates. Similarly, the savings rates offered by PTCCSs have been consistently higher than that offered by National Savings Bank (NSB) and close to the upper end in the range of rates offered by commercial banks.

Table 3. Average Savings and Loans Interest Rates in PTCCSs and Other Lenders, in %

Year	SANASA PTCCS savings**	NSB savings deposit rates	Commercial bank savings rates	Commercial bank lending rates*	SANASA PTCCS loans**
2000	11.5	8.4	2–11	14–28.5	17
2001	10.0	8.4	4–12	12–26.5	18
2002	8.5	6.0	3.5–11	12–25	16
2003	7.5	5.0	2.1–7.25	7–23	15
2004	6.5	5.0	3–7.5	9–23	15

Source: SANASA Statistical Reviews, CBSL 2005 Annual Report. * Secured by stock in trade. ** Average of those PTCCS responding to an annual survey.

Governance and Management

In most PTCCS which are small, the board tends to be also credit committee and internal control committee. PTCCS boards hold monthly meetings and have Annual General Meetings where the annual results are presented to the membership. The annual report to the general membership, however, is usually rather limited, presenting "cash in and out" and profits with very few if any details concerning the portfolios quality. Boards with members from the business community, teachers or other professionals are reported to function better. Most boards are voluntary and do not receive salaries. In a handful of PTCCSs, the Chairman receive a stipend or a performance bonus tied to results.

The majority of PTCCS board members and managers appear to have very limited knowledge of credit, financial and risk management, and internal controls. Only a handful of the PTCCS are reported to provision their loans and almost none are reported to write off loan losses. Controls carried out by boards and managers are typically rudimentary and involve primarily controls of receipt books and passbooks. Furthermore, in small PTCCSs it is difficult to carry out internal controls because board members who approve the loans are also often responsible for carrying out the control.

Turnover in board membership is reported to be low. Chairman of a rural PTCCS is a high profile role in the community, and several Chairmen are reported to be in position for several years irrespective of the cooperative's performance. Both adversely affect transparency of operations, and can lead to fraud.

Staffing

In 2004, PTCCSs reported a total of 3,155 staff and 56,934 volunteers. Over 63 percent of PTCCSs did not have paid staff. Their activities are carried out by volunteers. Twenty-five percent PTCCSs have from one to three staff, and about one percent PTCCSs have more then three staff. The largest cooperatives have eight to ten staff, including a manager.[7]

PTCCSs with less than 80 to 100 members, do not have any paid staff. As the PTCCSs increase their membership, they usually hire their first staff. The first staff person may be either a manager or an accounts clerk. As membership increases further the PTCCS generally add credit officers to help with collections. However, only about a third of PTCCSs have the resources to hire professional managers and book keepers.

Staff capacity at PTCCSs level is low. This continues to be a major challenge to SANASA despite the dramatic growth in overall number of cooperatives during the past twenty years. The less availability of qualified personnel in rural areas and the inability of most cooperatives to pay competitive salaries are causal factors.

There is a general unwillingness on the part of qualified young people to live and work in rural areas. They look for opportunities in the government sector and in major urban areas particularly the Western province in where Colombo is located. While some of

[7] SANASA Statistical Report 2004.

SANASA PTCCS's staff have basic book keeping or business training at the secondary level many have primary or secondary level education with no experience in book keeping, business or finance.

The majority of SANASA PTCCSs are not able to pay competitive salaries to attract and retain qualified personnel because of their small size and revenues. The regulatory restrictions on growth are structurally limit the ability of most cooperatives to grow to a size where they can afford to pay such salaries.[8]

Training and Capacity Building

PTCCS's staff or volunteers receive basic class room training in operating cash books, receipts, basic journal and cooperative principles from the DU or at the Educational Campus. Onsite training is extremely limited, which limits staff or management ability to apply what they had learned and solve problems. Some staff interviewed learned on the job from the manager or by looking at the books of the PTCCSs and teaching themselves. The majority of staff and volunteers do not receive any training in key financial/credit management areas such as portfolio management including aging, provisioning and write off, and risk management.

Despite the capacity building role of the DUs (some DUs have several training staff) and the presence of an exclusive training institution (the Educational Campus), capacity building available to the cooperatives is inadequate. The rapid growth of cooperatives in the past twenty years has exacerbated this problem. It has lead to a feeling, amongst interviewed PTCCS staff and board members that they are largely abandoned by the secondary and tertiary structures. It has also resulted in a great deal of unevenness in the capacity of staff, board members, and general membership.

Lack of Institutional Mechanisms to Expand on Pilot Projects: Pilot projects, such as the WOCCU project in 1998–2001, have had negligible impact on SANASA PTCCS due to the lack of institutional mechanisms to expand on the pilot project. The WOCCU project worked with 70 societies out of 8,440 in the areas of financial and credit management. No institutional mechanism was put into place by SANASA to disseminate the training materials and software developed by the project (primarily for loan and delinquency management) to other cooperatives. During the same period, the portfolio quality of both PTCCSs and DUs dropped significantly.

Weak Institutional Capacity to Develop Training materials that match needs of the PTCCSs: There is inadequate capacity at the DUs and at the Educational Campus level to develop appropriate hands-on training materials and to carry out practical training adapted to PTCCS current needs. SANASA training materials are primarily theoretical rather than practical exercises. The basic training materials are adequate for a very modest book keeping system that was appropriate for early stages of PTCCSs, when they have a small membership and limited product line. It does not match the needs of

[8] Mergers and geographic expansion requires approval by the Cooperative Department. The Department views SANASA PTCCSs as village organizations and are reluctant in allowing expansion.

PTCCSs, which have a wide variety of savings and loan products, and which act as de facto micro-banks since they can also provide savings facilities to non-members.

While PTCCS staff and members pay modest fees to attend training events, it is generally expected that training should be a free commodity. This makes it difficult for SANASA to develop a training program that recovers full-cost and hence is financially sustainable. Dependence on externally funded projects for capacity building often meant that qualified training staff were hired while funding was available and then let go when the funding ended.

Auditing

Internal audit: In medium to large PTCCSs, internal audits are the responsibility of an audit committee of the board. In the smaller PTCCSs, there are usually no audit committees and the board is responsible. However, as was discussed earlier, since the capacities of the boards are limited in most PTCCSs, their ability to carry out internal audits is also limited.

External audit: The Department of Cooperatives has the sole right to conduct external annual audits of the PTCCSs, DUs, and the Federation. It levies a 10 percent charge on profits to cover the cost of these annual audits. The Federation and the District Unions carry out a very small number of "informal" audits of PTCCS. However, neither has the authority to carry out formal audits. Absence of audit role for the DUs or the Federation is a serious weakness in the SANASA system.

The audit capacity of the Cooperative Department is reported to be extremely weak and the audits very cursory. The Cooperative Department tends to concentrate on PTCCSs that are easily accessible and PTCCSs in remote locations may not be audited at all or on a very irregular basis. Examples of PTCCSs that provided accounting documents to the Cooperative Department auditor over three years ago and not yet receiving an audit were reported.

The Department of Revenue and Taxation recently passed a regulation requiring cooperative societies with assets over S Rupee 5,000,000 (approx. US$50,000) to be audited by Certified Public Accountants. The proposed new Microfinance and Cooperative Laws may further modify the external audit requirements.

Products and Services

Savings products include savings accounts and time deposits for members and non-members. Savings products include a variety of savings accounts and time deposits for children, women, and men. The savings products are very well adapted to member's savings abilities and patterns. Time deposits with monthly installments are available for periods ranging from six months to three years. Some PTCCSs even have a retirement product that requires 10 years of monthly deposits and then guaranties the individual a monthly payment for life.

According to Sri Lankan Cooperative legislation PTCCSs can mobilize non-members savings up to 10 percent of total assets. Non members may join as full members after a six month probationary period but do not have access to credit until they become members. Non-members are drawn by relatively higher deposit rates.

Loans are provided for emergency, consumption, social, microfinance, equipment and rural infrastructure (Solar, biogas, sanitation, etc.). Table 4 gives the list of major PTCCS loan products and their key features. Types of loans vary according to the region and to the size of PTCCS. However, key characteristics of PTCCS loans are the following.

- *Monthly Payments No Formal Grace Periods:* While loans have different maturities and interest rates, depending on the product and the PTCCS, all have monthly repayment schedules and no grace period. It is expected that agricultural loan borrowers, where income from use of loan is seasonal, make payments from other revenue sources when there is no income from agriculture.
- *Diversified loan-portfolio:* While the major share of the portfolio is for microenterprises, the PTCCSs provide loans for several other activities listed in Table 4. In this way, PTCCSs maintain a diversified loan portfolio and serve a wide gamut member's credit requirements.
- *Wide Range of Loan Maturities:* PTCCS credits can varied from one month to seven or eight years. While the majority of loans are generally in the short to medium term, the medium and long-term nature of PTCCS's assets makes their financial management much more complex.

Table 4. PTCCS Loan Products

Loan types
Long-term loans 3–7.5 years
• Land purchase, Housing, Electric hook-ups, Solar, biogas & gas and sanitation, • Vehicles& Equipment Loans: For purchase of farm equipment and three wheelers • Loans to pay the cost of leaving the country to work elsewhere, • Business loans (coir export, animal husbandry, batiks, prawn farming)
Short-term loans: Up to a year
• Quick loan: Short-term emergency loans consumption and social purposes • Disaster Loans • Educational Loans: Study abroad or to pay for books • Travel loans • Pawn loans • Women's gold loans, Wedding loans: Jewelry for marriage • Festival Loans: Christmas & New Years • Agricultural Loans: Paddy, other crops, small animal husbandry, spices vegetables • Microenterprise loans: Business start-ups and expansion. Examples of activities include coir, sales of consumer products, sewing, etc. • Equipment loans • Youth Loans • Disabled persons loan • Consumption loans

Source: Author's compilation based on PTCCS interviews and PTCCS's documentation.

Insurance products are provided in cooperation with the SANASA Insurance Company. Products provided include loan and savings insurance, life insurance, property and theft insurance, personal accident insurance, Health insurance and motor vehicle insurance.

Table 5 shows the wide range of non-financial services provided by PTCCSs. The most common services are welfare services and children clubs. Additionally some PTCCSs also provide postal services and phone services (in rural areas). They also generally fund village religious festivals. The non-financial services provided by the PTCCSs are key in their having strong community connections.

Table 5. Non-Financial Services: Number of PTCCSs Providing Different Products

Service	2002	2003	2004
Transportation to ceremonies or other places	36	41	31
Input & output services agricultural inputs and marketing	98	101	106
Collect funds for members that are in need	93	95	88
Pre-schools	401	392	418
Insurance and other agent services	163	158	171
Welfare services	2,034	2,010	2,151
Children's clubs	1,351	1,340	1,334
Green children's clubs (Ecology clubs)	161	187	191
Other services	342	359	342

Source: SANASA Statistical Reports 2003 and 2004.

Lending Technology and Risk Management

Loan appraisal techniques vary across PTCCSs. Factors generally considered include savings history, guarantors, business requirements, and applicant's experience in the business. Loans are approved by either the full board, in the case of small PTCCS, or by a credit committee composed of board members in larger PTCCSs. Board members verify receipts and ledgers on a periodic basis, and also get involved in loan collections for past dues, particularly in the smaller societies. While some of the PTCCS staff and board members understand concepts such as maturity mismatches and linking interest rates to risk, these skills are not as well developed as they should be given the complexity of PTCCS's financial products. The predominantly manual accounting system makes it difficult to manage their overdue loans. Only a handful of PTCCSs provision for loan losses.

MIS and Other Systems

The vast majority of PTCCSs (8,380) use paper systems for their accounting and loan management. Only 60 PTCCSs use an Access® based loan management software. This software was created by the Federation and started a program of licensing the software and assisting PTCCSs with installation and trouble shooting for a fee. However, the Federation has since terminated this program since the costs of providing support and trouble shooting on a national basis was found to be prohibitive.

A private company of former SANASA employees is currently selling a similar software package to PTCCSs. This "outsourcing" approach may turn out to be viable although the market of PTCCS's that have large enough portfolios to justify use of the system is limited.

DISTRICT UNIONS

Products and Services

DUs provide loans and savings instruments (savings accounts and fixed deposits) to member PTCCSs, members in PTCCSs, and non-members. Savings products provided include savings deposits, time deposits, and children's deposits. PTCCSs are required to buy shares and have compulsory savings in DUs. They can also buy additional shares DUs. Credit products include loans for agriculture, animal husbandry, microenterprises, energy-saving devises such as solar gas and bio-gas, and housing. In addition to the financial products offered, DUs also provide training to PTCCSs and represent the cooperatives at the district level. Training is provided in cooperative principles, general and financial management, and basic accounting. Box 1 gives an overview of a DU.

Financial and Operating Performance

Box 1. A DU Case—Achievements and Challenges

Monragala is a remote, primarily agricultural, area with a population of 136,000. Monragala DU started operations in 1980 with five PTCCSs. Currently, Monragala DU has 10 zonal offices and a staff of 40. There are 400 PTCCSs that have registered with it but only 180 are reported to be functional.

As part of their strategy for sustainability, DUs invest in real-estate, and businesses. It owns several building including a guest house, an office building, and a training complex. Additionally, the DU runs a pawning center, and sells office supplies and equipment. Approximately 60 percent of the DU's revenues come from interest revenues and 40 percent from their business activities. While the DU is able to meet its current operating costs, it lacks funds for credit and training. The share of delinquent loans in credit portfolio is very high at 54 percent. Furthermore, the DU is losing its best client PTCCSs to SDBL (which has a branch in Monragala).

The DU management sees a role in providing credit and training to PTCCSs that need to be rehabilitated or can not meet the SDBL's prudential requirements. The DU itself needs a new strategy that will restructure its operations, downsize staff and write off bad loans.

Source: Author.

Consolidated data on performance of DUs is not available. The Federation does not collect, consolidate, and analyze DU financial performance. Of the 25 DUs, seven have ceased operations but have not yet been liquidated by the Department of Cooperatives. A few DUs have excellent boards, dynamic managers, and significant assets. However, DUs have a structural problem of a weak business model. Their primary sources of income (interest on loans, fees) are weak and not growing; there is less demand for their credit services after the establishment of SDBL; they have weak systems to collect loans and several have high levels of past due loans.

Governance and Management

DUs have boards made up of Chairmen/women from the District's PTCCSs. These board positions tend to be taken as a sinecure. This is reported to often result in inadequate due-diligence in approval of credits to PTCCSs. DUs are run by a General Manager with the assistance of deputy managers. Many DUs have several staff in their main and sub offices. The low salaries make it difficult for DUs to attract and retain qualified and dynamic managers and staff. DUs also appear to lack a system of incentives to encourage better performance from the management and staff. DUs are audited by the Cooperative Department which is not competent to carry out audits on what are complex financial institutions.

FEDERATION

SANASA Federation, also known as The Federation of Thrift and Credit Co-op Societies Ltd. of Sri Lanka, is the apex body of the SANASA movement. Federation acts as the initiator of SANASA's vision and mission. The SANASA Federation's primary role is to support its members through the provision of services, resources, advice and training. The Federation was very successful at mobilizing external resources during the major expansion of PTCCSs and DUs in the 1980s and early 1990s. The Federation is typically the largest investor in SANASA companies.

Governance and Management

The Federation Board is made up of Chairmen/women of DUs. The Federation's General Manager has recently become the Chairman of SDBL. The Federation staff is composed of a small core of administrative staff including accounting staff, an information technology staff, publication staff, and the general manager. The Federation staff is much leaner than that of the DUs. In the past when the Federation managed projects, it had projects staff. With the change in the role of the Federation, projects are being run out of the SDBL and training staff is at the Education Campus which is a separate company. A yearly external audit is carried out by the Department of Cooperatives

Services

There have been several changes in the Federation's role in the recent years. Historically, the Federation had the role of mobilizing and managing of national and international funds for lending and technical assistance, refinancing DUs, and capacity building. The first two roles have been transferred to SDBL. The SANASA Educational Campus has taken over most of the capacity building activities of the Federation. Service currently provided by the Federation are the following.

- *National and International Spokesperson:* The Federation is the national and international spokesperson for the SANASA network. At the national level, it liaises with other co-operatives, social entities, and the government of Sri Lanka on behalf of SANASA. It represents SANASA internationally through its affiliation with international cooperative organizations and other similar institutions.
- *Policy development and Conflict resolution:* The Federation serves as a forum to develop consensus on new strategies and resolve conflicts within the network. It plays a key role in formulating policies and procedures for PTCCS operations.
- *Governance of SANASA Companies: The* Federation plays a key role in the governance of SANASA Companies through its role as an investor. In some cases, it also does this through board positions. For example, the Federation's GM is the Chairman of SDBL
- *Publications and Statistics:* The Federation publishes the "SANASA" newsletter and produces and distributes PTCCS stationary and books. It also collects and collates key statistics on the PTCCSs. However, this is not done from a regulatory perspective since it does not perform this role.

Financial and Operating Performance

Table 6 shows that the Federation has consistently been making a net-loss although the loss in 2005 is very modest. The Federation's major sources of revenue are from interest on fixed deposits. In 2005 it had just over US$1 million in fixed deposits with SDBL. The larger loss in 2004 reflects a major one time financial adjustment due to loan losses. Its major investments in 2005 included about US$120,000 US$33,000 in the SANASA Insurance Company, US$500,000 in the SANASA Educational Campus, and US$30,000 in the SANASA Press.

Table 6. Federation Financial Performance (2002–2005)

	2002	2003	2004	2005
Operational revenues	0.224	0.209	0.074	0.078
Other revenues	0.320	0.232	0.225	0.150
Costs	0.782	0.531	1.172	0.230
Net profit / loss	(0.238)	(0.090)	(0.872)	(0.002)

Source: SANASA Federation Annual Reports
Note: 2002 and 2003 include Educational Campus's revenues and costs.

SANASA DEVELOPMENT BANK LIMITED

SDBL was started in 1997 and has a license from the Sri Lankan Central Bank as a Specialized Development Bank. As of December 31, 2005, SDBL share holders include: the SANASA Federation, 37 DUs, 3,771 SANASA PTCCSs, 13 multipurpose cooperatives, two other institutions, three nominated directors and 26 individuals. Microfinance accounts for about half of SDBL's business.

SDBL's clientele includes SANASA PTCCSs and their members, CBOs, NGOs, and the general public, including micro and small entrepreneurs. SDBL has nineteen branches, two extension centers, and an extension counter at its head office. It makes loans and mobilize savings including fixed deposits, but cannot offer current accounts and foreign exchange services. All branches are computerized and use Microbanker loan management system and accounting package, but does not have a real time network. SDBL has developed software to support management controls, strategic decision making. SDBL has implemented a new internal audit / risk management system for which the Rabo Bank Foundation is providing technical assistance.

SDBL faces competition from all commercial banks, particularly Peoples Bank and Ceylon Bank (which has established a Grameen type program in rural areas), finance and leasing companies, MFIs, and NGOs working in the area of microfinance. Commercial Banks and Finance companies are present in all of the mid-size towns in which SDBL has branches. Since SDBL cannot offer full banking services, all of the SANASA PTCCSs and DUs have accounts with commercial banks for their current account transactions. Some also keep part of their savings and fixed deposits with commercial banks. One of SDBL's strategies to compete is to develop some 1000 PTCCSs as agencies. These "agency" PTCCS will allow SDBL to increase its rural outreach. It hopes leverage these linkages with PTCCSsto gain comparative advantage over other financial institutions.

SDBL established a Banking College in July 2004. The college trains and develops internal staff, conducts courses in banking and finance for SANASA PTCCSs, and is licensed to conduct professional courses of the Sri Lanka Institute of Bankers.

Management and Governance

SDBL is governed by an 11 member board. Eight board members are representatives of SANASA PTCCSs and the rest are professionals from various fields of expertise with extensive knowledge and experience in their respective fields. The chairman of the board is the General Manager of the SANASA Federation. According to SDBL's bylaws, one third of elected board members must retire every year but are eligible for reelection in the same year. The board has four committees: an Audit Committee, a Credit Committee, a Human Resource Development Committee, and a Business Development Committee.

SDBL's management team headed by a General Manager, who is assisted by a Deputy General Manager and an Assistant General Manager. The senior management team has seven persons. At the end of 2005, SDBL had 302 people in its staff, up from 226 at year end 2004. Its internal audit department is currently receiving technical assistance from a Rabo Bank internal control/audit expert.

Products and Services

SDBL has a wide variety of savings and loan products. Savings products include savings accounts, fixed deposits, and a variety of savings linked to microfinance loan access. Credit products include loans for small business finance, leasing and pawning. Lease products are available for machinery, solar systems, and private and commercial vehicles. A pension product is offered against of 10 years of monthly saving deposits of S Rupees 500 (US$4.93).

Microfinance loan products include short and medium term loans. These are available to individual entrepreneurs and groups, either directly or through PTCCSs, CBOs and NGOs. Activities financed include microenterprises, electrification, water and sanitation equipment, small hydropower systems, and agricultural production. SDBL also offers some loan products exclusively for women.

Financial and Operating Performance

Table 7 shows that SDBL has recorded significant growth in deposit accounts, deposits, advances, and total assets over the past five years. Despite the portfolio growth, portfolio quality has improved significantly.

Table 7. SDBL: Operational Performance 2001–2005, Amounts in S Rupee Millions

	2001	2002	2003	2004	2005
Deposit accounts	37,633	51,099	73,524	109,158	141,962
Deposits	1,200	1,329	1,520	2,310	2,945
Advances	718	841	1,181	2,072	2,937
Non-performing assets (%)	24.76	17.61	13.98	7.68	6.18
Total assets	1,702	1,920	2,101	3,030	4,023

Source: SDBL Annual Report.

The remarkable operational performance has been matched by a very good financial performance. SDBL has shown increasing trend in profits in the past five years. In 2005, it declared a 12 percent dividend. Interest revenues are SDBL's largest source of revenues. Net income has increased by three times over the past five years. After a significant decrease in 2002 the cost to income ratio as remained fairly constant despite major expansions of both staff and branches. Return on share holder's funds in 2005 was 15.96 percent, an increase of 28.5 percent from 2004. Return on assets was 1.36 percent, an increase of 21.4 percent over 2004. SDBL has maintained adhered to all of the CBSL's statutory requirements concerning capital and liquidity levels.[9]

Table 8. SDBL: Financial Performance 2001–2005, Amounts in S Rupee Millions

	2001	2002	2003	2004	2005
Revenues	247.49	279.50	282.48	358.95	525.81
Net income	88.55	101.88	144.23	189.70	260.43
Profit after tax	9.58	17.37	28.46	28.70	47.99
Cost/income ratio (%)	74.19	68.94	65.66	69.58	67.4

Source: SDBL 2005 Annual Report.

SANASA INSURANCE COMPANY

SANASA Insurance Company evolved from All Lanka Mutual Assurance Organization (ALMAO) was set up 1993 to provide micro-insurance services to SANASA PTCCSs and other community based organizations. In 2005, it became a composite company providing both life and non-life insurance products and the name was changed to the SANASA Insurance Company Limited. In addition to its HQ located in Colombo, SANASA Insurance Company Ltd has eight branches. Four were opened in 2004 and four additional branches in 2005. The Company has its own insurance training college, open to the whole industry, at the SANASA Educational Campus.

The company provides a variety of life insurance products, vehicle and other property insurance products, loan protection products, and disability insurance. As in the case of other sector companies, its main shareholders are PTCCSs. The core of the company's business is with SANASA members, but it also provides services to community organizations such as Death Benevolent Societies, which are common in both rural and urban areas.

The company plans to expand coverage to lower income clients in urban as well as rural areas. It plans to use its competitive advantage in rural areas to provide low cost services by expanding and integrating its services with SANASA PTCCSs. This is to include: 25 Development Centers, 29 Collection Centers, and 1,251 Insurance Service Offices at SANASA PTCCSs. These units will operate under the supervision of SANASA Insurance Company branches. The Development Centers and Collecting Center's role will be to coordinate the Insurance Units.[10]

[9] Core capital ratio of five percent, total capital ratio of 10 percent, and liquid assets ratio of 20 percent.
[10] 2006-2008 Corporate Plan

Management and Governance

The company is governed by an eight person board. Dr. P.A. Kiriwandeniya is the Chairman and Managing Director. The company is managed by a professional team with extensive experience in the insurance industry. It includes Chief Executive Officer, General Manager, Finance Manager, Manager Underwriting (Life) and Manager Underwriting (General).

The company has a strong international partner NTUC Income Insurance Cooperatives of Singapore which provides reinsurance. The company is required to comply with Insurance Board of Sri Lanka (IBSL) regulations including annual external audit, providing three-year corporate plans to IBSL, and meeting mandated capital increases.

Financial and Operating Performance

Table 9 shows the trend in the financial performance of the SANASA Insurance Company. The dip in profits in 2004 is because the company was only allowed to sell life insurance products in this year of transition from ALMAO to SIC. The un-audited results for the first nine months 2005 shows the impact of the company's expansion to general insurance products.

Table 9. SANASA Insurance Company Financials 2002–2005, Amounts in S Rupee Millions

	2001	2002	2003	2004	2005
Revenues	22.9	30.1	27.0	31.2	56.4
Costs	16.1	22.8	22.8	30.1	34.8
Net profit	6.8	7.3	4.2	1.1	11.4

Source: ALMAO, SIC Annual Report. ALMAO Financials 2000 to 2002 and SANASA Insurance Company Financials 2003–2005.
Note: Data for 2005 for 9 month period from three year plan and un-audited.

OTHER SANASA COMPANIES

SANASA Educational Campus

SANASA Educational Campus conducts several training courses for PTCCSs staff, managers and board members. The topics on which training is provided include cooperative principles, government guidelines, management and governance, credit and accounting, and marketing agricultural innovations. It also conducts training courses targeted to women in microenterprise development and skill development. The Campus also provides training and certification courses for SDBL and SANASA Insurance Company staff.

From being a program of the Federation, the Campus was converted into a company in 2004. It now has a shareholding structure (with a share capital at the end of 2004 of S Rupees 42.5 million) and the SANASA Federation is the largest shareholder. It is managed by a General Manager with the support of managers and trainers for different programs.

The Campus made a loss of nearly S Rupee 4.5 million in 2004. Its Banking and Insurance Colleges are funded by SDBL and the SANASA Insurance Company. It also generates a significant portion of its revenue on banking and insurance courses through fees. Its key challenge is developing a revenue model for the training provided to PTCCSs and members.

SANASA Engineering and Development Company

The SANASA Engineering and Development Company (SEDCO) was set up in 1999 to provide engineering advisory and architectural services, and carries out construction projects for SANASA Societies. It has a General Manager, a board made of seven elected officers representing SANASA PTCCSs, and an external auditor. As in the case of the Educational Campus, SEDCO also has not yet broke even. It made a loss of over S Rupee 6 million in 2004.

SANASA Consumer Producer Alliance

SANASA Consumer Producer Alliance (SANEEPA) was stared in 1995 to provide marketing and production solutions for SANASA DUs and PTCCSs. It is managed by a General Manager. The services provided by SANEEPA can be categorized broadly into four:

- *Technology Transfer for Production Enhancement:* Services provided improve the quality and quantity of agricultural products with export potential.
- *Marketing:* On a commission basis, SANEEPA facilitates marketing of agricultural products to national and international markets
- *Business Consulting Services:* In collaboration with SDBL and PTCCSs, SANEEPA prepares business plans, project reports, and feasibility studies for entrepreneurs.
- *Information Sharing:* SANEEPA has created and maintains a data base on production and marketing of agricultural products well as information on local and national economic and conditions.

4. LESSONS AND RECOMMENDATIONS

SANASA's is a remarkable turn-around story. Prior to changes in the SANASA PTCCS's model in 1978, SANASA PTCCSs had been in a state of decline. They were mainly savings clubs for the village elite. The new SANASA model broadened the membership, introduced microenterprise development through microfinance, and engaged community through social activities. As the model evolved, several new institutions were created. Some of them have showed good performance and are already profitable. SDBL, in particular, has been posting impressive growth and returns over the past five years.

However, to grow further SANASA needs to make some hard decisions concerning their different business activities. The future of SDBL and the insurance company appear to be positive. The future of the other companies is less clear. The sustainability of SANASA Campus is uncertain because of basic weaknesses in the centralized training model.

PTCCSs and DUs are relatively weak parts of the network. This is caused by several factors including absence of an appropriate regulatory and supervisory framework, as well as a business model that fits the current market situation. There are examples of PTCCS that are "bankrupt" that are still mobilizing deposits. In the case of PTCCSs, development of a strategy and plan that allow SANASA PTCCS to merge and consolidate will be a major success factor. The stumbling block in doing so is that the Ministry of Cooperatives, which needs to approve mergers, generally discourages them because they view the PTCCS as village organizations.

SANASA DUs are at a cross road and need to redefine their roles. The traditional mission of SANASA District Unions has been to mobilize equity, provide savings and credit services, training, managerial services and representation for their PTCCSs at the District and federation level. Some of these services are now provided by SDBL branches, and PTCCSs can now directly purchase shares in the Federation and SDBL. As the DUs expanded their services dramatically during the 1980 the majority of their expenses were funded by external sources. Now the DUs rely on credit and savings margins for around 60 percent of their revenues, the rest being made up by a variety of revenue generating activities.

DU's ability to carry out their traditional business model faces serious challenges because of weaknesses in their business model and poor performance in their core credit activities. Of the *twenty-five DUs,* seven are not functioning and are not able to meet their financial obligations (deposits and equity to their PTCCS). However, none have been liquidated to date. PTCCSs that are members in these DUs stand to lose their deposits and equity. Other DUs face serious overdue problems which reduces their primary source of revenue and thereby their financial sustainability. The Federation has shown a much greater ability and willingness to restructure its operations than the DUs. The DUs that are able to redefine their role and restructure their operations may survive. Many will not.

STRENGTHS

Leadership: The visionary leadership provided by Dr P.A. Kiriwandeniya, the network's founder, has been critical in its achievements. Dr. Kiriwandeniya's ability to share his vision with the cooperatives, and provide guidance and motivation to community members and staff has been remarkable. Equally critical has been his ability to raise funds, establish national and international linkages, and maintain political independence.

Autonomy and political independence: SANASA cooperatives are small, member-owned and operated village based societies. This contrasts dramatically with the government controlled/financed cooperative sector with large multipurpose cooperatives focused on agricultural production with huge credit and political risk profiles. The autonomy of the cooperatives have been critical in their ability to remain apolitical and grow over the past three decades. They have been successful in surviving and restarting after difficulties. PTCCSs are the only financial institutions that has been able to maintain some level of functionality in conflict areas in the north-east section of Sri Lanka.

Rural Outreach and Investment: SANASA PTCCSs have a very large rural outreach, the largest of all private institutions (only Samurdhi, a government program that channels government stipends to the poor, has a better rural outreach). In addition to their outreach, SANASA cooperatives are also the most successful of financial institution in investing savings mobilized in rural areas in rural areas itself. In 2004, for example, 74 percent of PTCCS's savings were invested in loans to their members. In contrast, Cooperative Rural Banks loaned locally only 54 percent of the savings they mobilized.[11]

Focus on Microfinance: The SANASA Model is dramatically different from the worldwide credit union movement. The later has been most successful in urban areas where it caters to savings and consumption needs. The vast majority of credit unions in developing country rarely have credit portfolios with more than 25 percent of the portfolio financing microfinance.

SANASA PTCCSs ability to provide a majority of their credits for microfinance including both productive farm and off-farm rural enterprises stands in stunning contrast to the majority of credit unions worldwide, which are primarily urban and focused on consumer loan products. Most credit unions in developing countries rarely have more than 25 percent of their portfolio in microfinance. They generally do not handle microfinance loans well because of lack of experience in analyzing business and production loans.

[11] SANASA 2004 Statistical Report, CBSL 2005 Annual Report.

WEAKNESSES

Weak legislative and regulatory framework: The lack of a viable system, to date, for regulating credit unions endangers all existing financial cooperatives in Sri Lanka. In the current situation, financial cooperatives and District Unions are not adequately supervised. The Cooperative Department's inadequate audit/supervision capacity and desire to micro manage a vast network translates into failures to address individual and systemic weaknesses in PTCCSs and DUs in a timely manner. Failures of PTCCSs and DUs are not preempted and often happen in isolation causing members and non-members to loose their savings.

Weak supervisory capacity of the Cooperative Department: The Cooperative Department does not have the technical skills or personnel to effectively supervise PTCCSs and DUs. This has not allowed the government to adequately address the specific needs, requirements, and fiduciary responsibilities of financial cooperatives. Absence of regulatory standards has resulted in widely differing approaches/interpretations for supervision and regulation by the district cooperative departments.

- *Inadequate systems to deal with growth:* The rapid growth of PTCCSs has not been accompanied by adequate support services for capacity building of PTCCSs and DUs (including training, didactic materials development and consulting services). This has resulted in a large number of PTCCSs becoming financially unviable and significant number of DUs becoming defunct.
- On the other hand, some PTCCSs have grown very rapidly and have very large deposits, loan portfolios, and other services. The accounting and operational procedures for management of the credit portfolio, risk and delinquency have not evolved in parallel. Adequate systems (policies and procedures) and controls to deal with a wide variety of new savings and loans products.
- *Lack of standards and controls:* The high level of autonomy of PTCCSs and DUs, while being a strength from the perspective of being able to operate in remote villages and ability to survive even in areas of ethnic conflicts, has also meant the absence of prudential standards and controls. Absence of network-wide standards and absence of a system of controls results in the network's inability to monitor performance and ensure compliance with standards. This increases the risk to member and non-member deposits that would result from a failure individual PTCCSs and the DUs (because PTCCSs hold some of their deposits with DUs). Furthermore, since all SANASA PTCCSs and DUs share a common name, failure of a significant number of DUs or PTCCSs also carries the risk of regional failures.

Some initiatives that address these weaknesses include SDBL bank having standards that PTCCSs have to comply to borrow from it and the recently introduced system of Cooperative Rupees, that introduces PTCCSs to the concept of prudential ratios. [12]

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[12] Coop Rupees was developed by the SANASA Federation in collaboration with the Department of Cooperatives, and is based upon WOCCU's PEARLS system of prudential ratios.

DUs

The problems facing the DUs are due to several key reasons including weak:

- Each DU board is free to set their own prudential rules. Experience has shown that theses are inadequate.
- Weak internal control systems do not allow credit decisions to be made transparently, thereby translating into poor loan quality.
- Involvement of DU boards in credit decisions has led to loans that are influenced by relationships rather than financial criteria.
- Inadequate skills of most DU's board, management and staff in investment skills has often resulted in investments in non-credit investments (costly office building, office rentals, and other businesses) that are not supported by the local market.
- Inability to charge for services, primarily training, initially provided free with extensive donor support.
- Inability to attract qualified managers because of inability to pay market rates, lack of a performance based incentive systems, and excessive involvement of boards in operational decisions.
- Competition from SDBL and the SANASA Insurance Company for providing services to the better PTCCSs, often leaving DUs with the weaker, riskier societies.

Network Companies

The key challenges that SDBL face include meeting the Capital requirements while still retaining their autonomy, managing rural-specific risks, and integration of its activities with that of its 'agency' PTCCSs. SDBL also faces the challenge of managing the conflict with DUs and PTCCSs that are currently excluded from getting credit because they do not meet the bank's criteria. PTCCSs perceive that SDBL is a for-profit entity and not sensitive their needs. As SDBL is supplanting DUs financing role, DUs view SDBL as a competitor. Key challenges of the SANASA Insurance Company include increasing operations with partner PTCCSs and raising external capital.

RECOMMENDATIONS

At the present time, the SANASA faces several serious challenges including weaknesses within the primary and secondary levels and frictions with new structures, in particular SDBL, due to the lack of effective policies and procedures and increased levels of external competition. The Federation can not directly resolve all of these issues. It can play a leading role in opening up and orienting a dialogue, defining a process to identify the problems, propose solutions and a plan for moving forward through the creation of viable global strategy.

While the Federation has the ability to shape the dialogue, the process of identifying the problems and putting together a strategic /business plan needs to be carried out with external assistance. This external assistance could come in the form of an institution such as the Institute for Policy Studies[13] which has the ability to carry out detailed surveys and focus groups and management consulting firms that can put together strategic/business plans. Based upon the results of the surveys, focus groups, works shops, and the strategic/business plan, the Federation can facilitate change in PTCCSs and DUs, and also redefine its role and make changes in its own operations. Some key recommendations are discussed below.

Improve Systems and Controls in PTCCSs and DUs: It is critical to update accounting and operational procedures for the wide variety of new savings and loans products. Key areas include: loan aging, provisioning, loan write offs, system for monitoring and dealing with maturities miss matches.

Training System: The training system for PTCCSs needs to be revised so that it can be carried out in a sustainable way. This requires a change in the training model and development of appropriate training materials (practical exercises and real life problem solving).

Risk Assessment and mitigation: SANASA needs to assess and mitigate the risks to PTCCS members, arising particularly from the long term savings and pension plans. Because of the length of their commitment horizons pension products are particularly risky and perhaps should be only offered through SDBL.[14] The global risk assessment should see how it can deal with the failures that have occurred at the PTCCS & DU levels.

Information and Statistics: The SANASA network needs to improve its information systems at the PTCCS level. This includes developing a system to provision and write off loans, and teach board members and managers how to track and respond to changes in key prudential ratios. Due to the autonomous nature, it is difficult for SANASA to have a fully integrated information network. However, the Federation can develop a system of small surveys and focus group discussions (which can be outsourced) for overall business planning and coordination. Without this, the Federation cannot provide more effective leadership and guidance to the PTCCSs.

[13] IPS has developed significant skills in carrying out surveys on microfinance and conditions in rural areas.
[14] A PTCCS with 100 or even less members are offering pension products based upon 10 years of monthly contribution followed by 10 years Plus monthly pension.

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