# Market Analysis of the Credit Services Market System
# Kilinochchi and Mullaitivu Districts, Northern Province, Sri Lanka
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Dr. Neavis Morais
Gregory Matthews
Saviriappu Thevathas
Sinniah Kokularajah

Oxfam

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## I. Introduction

Access to financial services is a key necessity for households seeking to re-start their livelihood activities following resettlement. Previous assessments in Kilinochchi and Mullaitivu have shown high numbers of households resorting to pawning jewelry and taking loans at very high interest rates from moneylenders in order to meet household-level cash-flow needs. This assessment seeks to build on the findings of previous assessments looking at household asset holdings and losses by mapping out the various sources of credit available in Kilinochchi and Mullaitivu districts and identifying the constraints households face in accessing these credit options. Specifically, this analysis seeks to answer three key analytical questions:

1. Who are providers of credit in the targeted area?
2. What are challenges faced by the target population to access credit? How best support can be provided to open access to credit for the target population?
3. What opportunities exist to open access to credit for the target population?

The analysis has found that there are a wide array of credit options available to households in the two districts, however access to these opportunities is dependent on a variety of criteria including how well established a household is in the community, membership in different community and cooperative groups, previous creditworthiness, current asset holdings, and connections to neighbors or community officials. Additionally, the extent to which a household can meet these criteria is strongly tied to how the length of time they have been resettled and their opportunities to build up community relationships and accumulate assets. Based on these findings, the report recommends actions to re-capitalize community-based organizations active in financial lives of households, improving the organizational capacity building of cooperative organizations, using financial literacy workshops/training as a tool to link households with financial institutions, and advocacy for changes in the collateral and loan structure requirements of the formal banking system.

## II. Current situation / Context

More than three decades of armed conflict between the Sri Lanka Armed Forces (SLA) and Liberation Tigers of Tamil Elam (LTTE) led to a steady deterioration of the food security situation along with social and economic infrastructure in Northern Province of Sri Lanka. Kilinochchi and Mullaitivu are two districts in the north that were severely affected in the final phase of the war during January to May 2009. The final war displaced nearly 300,000 people, kept in the transit camps located in 'Menik farm' in the Vavuniya district. In mid-2009, resettlement programs began returning those displaced in the war to their home communities in Kilinochchi and Mullaitivu, and as of February 2012 around 6,000 IDPs (1800 families) remained in the Menik-farm camps awaiting return to their homes[1].

[1] OCHA Joint Humanitarian and Early Recovery Update, February 2012 – Report #40.

Returnees have had access to basic relief services in terms of shelter material, food, and water and sanitation facilities, in order to re-start their lives and livelihoods[2]. While basic relief services have helped improve protection and resume the livelihood activities, poverty levels in these areas remain high, and the household-level income generated by returnees is far below the poverty line. Surveys in 2011 found that returnees from Kilinochchi earned a per capita income of only 2,189 per month and around 26% live below half the poverty line[3][4]. Expenditure patterns reveal that average households spend nearly 60% of income on food, mainly rice, vegetables and fish, while other expenditures include education, debt repayments, household consumables and transport[5].

As a result, up to 25% of the population of Kilinochchi District is highly food insecure with a similar proportion likely in Mullaitivu District once food distributions cease[6][7]. Although food is available, prices are high and communities living in the North have low incomes, which lead to very low purchasing power and limited access the available food items. Lack of sufficient production and income sources have resulted in large reductions of household assets (between March 2010 and March 2011, families who reported owning jewelry dropped dramatically from 80% to 5 % in Kilinochchi and from 80% to 41% in Mullaitivu[8]) and an increase in indebtedness, reinforcing risks and occurrence of food insecurity.

The population of Kilinochchi and Mullaitivu largely pursue livelihood strategies in three areas – agriculture (including livestock), fishing, and wage labor. The two districts are primarily agricultural areas that cultivate lowland irrigated rice, highland crops such as groundnut and green gram, and vegetables. Ocean and lagoon fishing also provides significant livelihood opportunities for nearly 3,000 households. Lastly, recent food security study estimated that 24% of household income is generated by non-agricultural daily wage labour, representing the third largest livelihood activity.

## III. Methodology

EMMA (Emergency Market Mapping and Analysis) is a rapid market analysis approach designed to be used in the short-term aftermath of a sudden-onset crisis. It is premised on the rationale that a fuller understanding of the most critical markets in an emergency environment enables key decision makers (donors, NGOs, government policy makers, etc.) to consider a broader

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[2] Detailed account of the relief interventions by the humanitarian actors can be found in the Joint Humanitarian and Early Recovery Update by OCHA, February 2012.

[3] Food Security in the Northern, Eastern and North Central Provinces: Food Security Assessment Report, Sri Lanka, April 2011, by Ministry of Economic Development, HARTI and WFP

[4] The National Poverty line for the period March 2011 is LKR3, 318.

[5] ibid

[6] *Source: Food Security in Northern, Eastern and North Central Province, WFP, Ministry of Economic Development and Hector Kobbekaduwa Agrarian Research and Training Institute, May 2011*

[7] The termination of WFP general food distribution six to nine months into the resettlement period results in a reduction in available sustenance of families in Kilinochchi and Mullaitivu.

[8] *Source: Food Security in Northern, Eastern and North Central Province, WFP, Ministry of Economic Development and Hector Kobbekaduwa Agrarian Research and Training Institute, May 2011*

range of responses based on market realities. The methodology used for this credit services study uses a markets approach to understand the different actors and pathways through which the target population accesses credit. Although it draws heavily on the Emergency Market Mapping and Analysis (EMMA) tools, this is not a true EMMA analysis in terms of seeking to assess the functioning of the credit markets system in order to meet a certain gap in credit needed or demanded. No comparison to a baseline credit market system is made, given the development-oriented, post-war recovery context, and there is no analysis of a gap in credit needed to maintain life and livelihoods. Instead, this paper uses the market map tools provided in the EMMA Toolkit to map out the various pathways and actors through which credit is made available to households and to identify possible constraints or blockages in those pathways that limit credit access for households.

The EMMA team was made up of 17 members from three organizations – Oxfam (lead), Danish Refugee Committee, and NGAGDO – and four external consultants, including two value chain specialists, a financial systems specialist, and one lead facilitator providing overall technical support for market analysis and reporting. Six of the team members had completed a full EMMA training prior to this assessment. In addition, four-day EMMA refresher training was provided for two members of each critical market system team prior to the start of fieldwork. Following the refresher training, the team was divided into five sub-teams, and each sub-team was responsible for analyzing one critical market system.

This assessment took place from 1-18 May, including seven days of desk-based secondary research and EMMA refresher training in Colombo, and 11 days of field work in Kilinochchi and Mullaitivu districts of Northern Province. The credit services analysis relies on qualitative and quantitative information from secondary sources as well as primary data collected during 9 households interviews, and 24 semi-structured key informant interviews, and 6 focus group discussions with early and recently resettled credit consumers.

## IV. Target population

The target population for this analysis is war-affected and resettled population in Kilinochchi and Mullaitivu districts, Northern Province, Sri Lanka, totaling 230,800 people. The entire target population was displaced from their homes at the end of the war in 2009, seriously disrupting livelihood activities, food and income sources, and resulting in near total loss of financial and physical assets.

Although they have received varying degrees of support to restart income generation activities following resettlement, the target population still relies heavily on credit to re-start livelihoods and to meet their immediate needs. There are three main livelihood patterns in the target districts, mainly agriculture, fishing, and wage labour. Households have different credit needs and opportunities according to the type of livelihood strategy pursued and credit schemes available. However, the majority of population in Kilinochchi and Mullaitivu rely on credit not only to re-start and expand livelihood activities, but also to rebuild homes, to meet food and household needs, and to pay down other debt.

Approximate number of the population groups representing different livelihood systems.

| | Farmers | Fishers | Livestock keepers | Women Headed Household |
|---|---|---|---|---|
| Kilinochchi | 24,935 | 3,129 | 7,240 | 3,713 |
| Mullaitivu | 20,558 | 4,032 | 6,097 | 5,469 |
| | | | | |

Source: Statistical Handbook of Kilinochchi and Mullaitivu, 2012.

## V. Selection of Critical Market Systems

Five critical markets were selected for this study using a three-step approach during the EMMA refresher training and fieldwork preparation phase prior to the start of data collection. Market selection focused on identifying those market systems that were most critical for ensuring survival, for promoting and protecting livelihoods, and for ensuring income for the target population.

First, a long list of market systems critical was generated for each of the three primary livelihood groups in the two target districts (wage labour, agriculture, and fishing). These lists were then prioritized based on how critical each market is for the food security, livelihood, and income needs of each livelihood group. In total, a long-list of 84 market systems for wage labour, agricultural, and fishing livelihood groups was prioritized into 21 market systems. Those prioritized include: red rice, coconut oil, dhal, bicycles, mammoty (hoe), farm labour, fishing labour, construction labour, cassava, wheat flour, eggplant, corrugated tin sheeting, kitchen utensils, sugar and tea, canned fish, chili, coconut, brinjal, tomato, okra, and transitional shelter materials.

These 21 markets were then ranked according to six criteria to determine which markets were most appropriate for each livelihood group. The criteria used for ranking were:

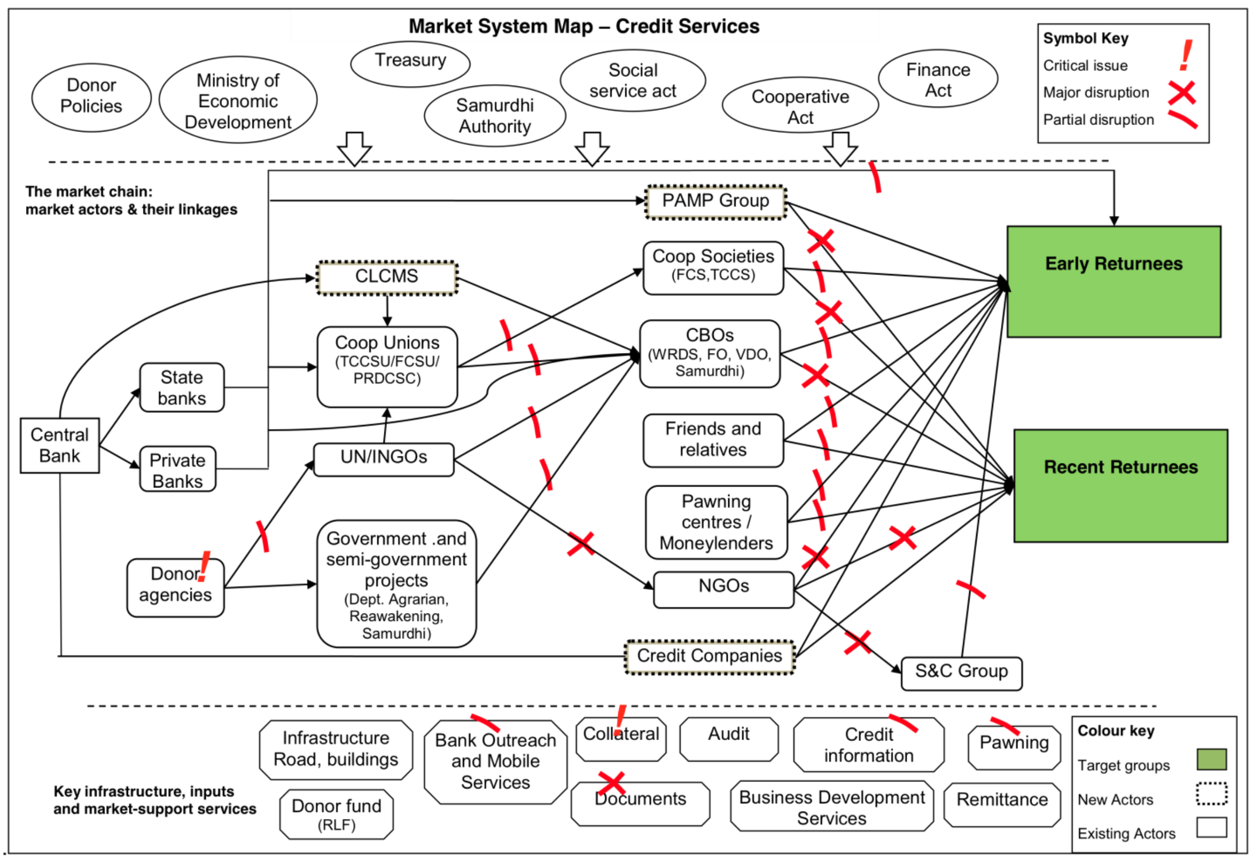
1. The market is related to significant or urgent need
2. The market system is affected by the emergency
3. The market system fits the agency mandate
4. Seasonal factor and timing are appropriate
5. The market system is consistent with government or donor plans
6. Programming options in the market system are likely to be feasible

The high-ranking market systems were then compared across the three livelihood groups and there were several market systems that overlapped, being critical for multiple livelihood groups. The five highest-ranking different market systems were deemed to be the most critical for the target population and selected for this study.

The five critical markets examined by this EMMA team are: 1.) Red Rice – supply market; 2.) Groundnut – income market; 3.) Credit services – supply market; 4.) Masonry labour – income market; 5.) Milking cow – supply market.

## VI. The Credit Market System

The credit market system is characterized by a series of government, private and donor-supported organizations operating at the national, district, and community level. These organizations are linked by credit flows and interest payments, and supported by a variety of laws and regulatory bodies as well as market inputs and services. The map here is a visual depiction of the credit market system in Kilinochchi and Mullaitivu districts.




**The Market Chain –** National-Level

- **Central Bank**[9]: Although a regulatory body, the Central Bank's Regional Development Department provides liquidity to commercial banks and offers them interest concessions in return for extending loans to rural households. These credit schemes, the New Comprehensive Rural Credit Scheme (NCRCS) and Agro Livestock Development Loan scheme (ALDL), are implemented through state-run and private commercial banks. The Central Bank guarantees payment of 6% interest for the loans offered under these credit programmes. The banks participating in the scheme offer loans at 8% interest to households, and in total the bank offering the loan receive 14%. Additionally, the Central Bank also guarantees 60% of any non-performing loans (willful default) [10]. These credit programmes are targeting farmers in all parts of the country, so these are not specifically designed for the war-affected people. No specific flexibility is introduced in the war-affected areas.

  The Central Bank also promotes the Poverty Alleviation Microfinance Program (PAMP) whereby formal banking institutions adopt community-based and savings-based credit methodologies, partly to circumvent collateral barriers. The Central Bank received funding from JICA for this programme, in which 16 state owned as well as private financial institutions took part in the delivery of financial services to the rural people, with re-financing arrangements. Subsidized funds, at 4.5%, were made available to the banks to offer loans to the groups, at 12%. Therefore, unlike NCRCS, refinancing scheme offers a wider margin to the implementing banks (margin up to 11% allowed). Although previous available in other districts, PAMP has only recently been introduced in Kilinochchi and Mullaitivu following resettlement[11].

  There are other loan facilities, designed for people in the north and east, such as *saubhagya*, an investment loan, Northern Province Development Special Loan scheme/"Awakening North", and Provincial Development Loan Scheme. These special programmes are supported by the Central Bank with refinancing arrangements. The interest rates range from 9% to 12%, which is much lower than the market rate.

- **State-managed commercial banks**: Bank of Ceylon and the Peoples Bank are the major state-run commercial banks supporting rural development through the NCRCS and ALDL guaranteed credit schemes from the Central Bank[12]. In the resettled areas credits are mostly extended through NCRCS[13]. Under NCRCS farmers are eligible to obtain loans for

[9] The information regarding the Central Bank's rural credit operation was obtained from the Regional Development Department of the Central Bank, and from the Coordinator for the Poverty Alleviation Microfinance Project.
[10] Source: PAMP coordinator at the Central Bank of Sri Lanka.
[11] PAMP credit scheme was introduced in the war-affected areas as PAMP II; other districts in the country had already been covered by PAMP. Since JICA programme is being phased out, the Central Bank has planned to continue the PAMP scheme as PAMP Revolving Fund (PAMPRF), using the recoveries.
[12] ALDL scheme is not very active in the resettled areas. The comments from the bank staff indicate that livestock investments received less priority among the resettled people, partly because livestock keeping in many households is only a secondary income earning activity.
[13] Source: Manager, Bank of Ceylon, Kilinochchi.

a range of cultivation activities; mostly obtained for rice cultivation. Those households that are currently linked to the banks include clients with a good previous credit history, those with proper land titles, recommended by the farmers' organizations and agrarian department, and those who can have the guarantee of a government official. A cross guarantee system is also adopted where 3 farmers (mostly paddy farmers) sign sureties for each other. This scheme is mostly beneficial to primarily male paddy farmers who are members of Farmer Organizations and can demonstrate they are genuine farmers.

- The BOC branch at Kilinochchi has distributed 1,900 NCRCS loans in the past 2 years after the resettlement. The loan size ranges from Rs. 20,000 to Rs. 100,000 at 8% interest. The loans are recovered just after the paddy harvest. Rs. 25,000 is given for an acre of paddy land, and the farmers can receive up to Rs. 250,000 per season.

- BOC branch at Mankulam, Mullaitivu has distributed 1,500 loans of similar range under NCRCS.

- **Private commercial banks**: Private commercial banks have entered the resettled areas, mostly located in the town areas. There are 4 banks located along the A9 road - HNB, Commercial Bank, Sampath Bank and Sanasa Development Bank. These banks have similar collateral and guarantee requirements as the state banks, including good previous credit history, proper land titles, and those who can have the guarantee of a government official.

    - HNB has resumed NCRCS scheme and distributed 650 loans using a cross-guarantee system (guarantee by two other borrowers). HNB has also distributed around 200 loans under the 'Gami Pubuduwa' (village awakening) scheme using their own funds. The interest rate is 18%, higher than NCRCS rate. The loan size is up to Rs. 200,000 and collateral is required for that scheme.

    - Sanasa Development Bank also has distributed nearly Rs. 92 million worth micro loans, through the refinancing scheme of the Central Bank, obtained through the 'Re-awakening North' scheme. The activities funded are small businesses, agriculture and livestock keeping.

- **Credit Companies**: Credit Companies are formal financial institutions offering specialized financial services like credit, insurance and leasing services for small and medium businesses. Entrepreneurs from the resettled population are accessing these services for agricultural vehicles and for other transport services. However, rates of seizure of these assets by the leasing companies, mainly due to non-payments, is increasing, indicating the challenges faced by entrepreneurs and businesses in benefiting from these financial services. These institutions also collect savings from those obtaining loans to minimize the risk of default. A receipt is provided when money is deposited, but there is no issue of record books. The local people generally consider these leasing services exploitative and high risk.

**The Market Chain –** District-Level

- **Cooperative Federations**: Cooperative Federations, such as the Thrift and Credit Cooperative Societies Union (TCCSU) and the Federation of Fisheries Cooperative Societies (FFCS), are district-level umbrella groups for many village-level cooperative societies within the same district. At Federation level they provide technical assistance and grant/loan funding arrangements to the local cooperative societies, and in turn receive savings and interest payments from the societies, which they then invest with banks, in business schemes, or in livelihood-based services available to all members. The local societies use the savings of members as well as funding from the Federations to provide loans to members. The Federations lost significant amounts of money as well as assets during the war and are struggling to provide even minimal funding and services to those local societies that have been re-organized following displacement and resettlement. Additionally, only about 50% of the local cooperative societies have been re-organized following displacement, hampering the Federations' ability to collect savings, invest, and extend credit.

    - **Thrift and Credit Cooperative Societies Union (TCCSU):** This federation lost large amounts of money and other assets during the end of the war and displacement, and is only gradually regaining control of its other assets such as a tile factory, cashew estate occupied by the military, and the 2 rural banks it operated. In the case of Mullaitivu TCCS Federation, it was reported that it lost nearly Rs. 80 million during the final stages of war, out of Rs. 90 million they owned. The Federation has begun to re-capitalize its operations through Rs. 11 million from well-wishers abroad that was provided as grants to widow members, and also received 7.5 million from CLCMS for credit purposes. However, the CLCMS facility does not have a grace period for repayment and as such is not suitable for farmers (note, CLCMS has since revised this policy on repayment periods to allow repayment after harvest). Additional constrains on the Federation operations include difficulty in re-starting primary societies due to security restrictions on visiting households, loss of its computerized database and credit tracking system, lack of field staff to monitor loans and motivate new societies, and lack of funds to recapitalize primary societies.

    - **Federation of Fisheries Cooperative Societies (FCS)[14]**: The Federation has resumed its credit functions at a much lower level than before displacement, and is still not able to meet the credit needs of all members to restart fishing livelihoods (a household needs nearly Rs. 500,000 to re-start fishing activities).

[14] The information regarding the credit facilities for fishers was mainly obtained from the personal interview with the officers of the fisheries cooperative societies in both districts of Mullaitivu and Kilinochchi.

Since resettlement, FCS has received a subsidized loan at 5% interest rate through the Ministry of Fisheries and Bank of Ceylon and has used its own bank deposits to distribute as loans to roughly 300 members. However, between Mullaitivu and Kilinochchi there are several thousand members who have expressed a need for credit. Currently less than 25% of the fishing boats in operation prior to displacement are in use, mainly due to lack of funding to replace motors, buy fuel, etc. With so few members earning income from fishing, FCS's income base is very small, meaning it is very difficult to extend further loans to more fishermen to re-start their boats. With the loss of loan funds from the war, the lack of savings from the member societies and so few members earning income to pay off existing loans, the federation faces a challenge to meet the credit needs of its members. Their largest constraint is lack of capital to loan out to members to re-engage in fishing.

- **Centre Livelihood Credit Management Services (CLCMS)**: CLCMS is a newly formed, intermediate level agency, which is coming under the Northern Provincial Authority. It receives finance mainly from the government (funds earned from the rehabilitation and development projects implemented in the north) as well as from the Central Bank through refinancing arrangements, and from the savings of the societies that it is managing. It supports the re-organization of village-level societies, such as Women's Rural Development Societies (WRDS) and TCCS, in order to financially support them. There are 32 societies in Kilinochchi with 1836 members (both TCCS and WRDS), and 28 societies with 1465 members in Mullaitivu (both TCCS and WRDS). These societies are required to channel their savings directly to CLCMS, although they are supervised by the respective regulatory bodies. CLCMS is also mobilizing new groups based on PAM model (5-7 members).

  Since resettlement, CLCMS has distributed around Rs. 30 million in Kilinochchi and another 28 million in Mullaitivu to households through local societies. The loan size ranges from Rs. 20,000 to 25,000 in the first round, while savings is not required to receive loans. In the second cycle the returnees may receive loans up to Rs. 50,000, and savings is required. These are mostly one-year loans. The interest rate is 10% charged on a reducing balance basis. Although the loans are given for livelihood purposes, there are instances of clients using the loan for multiple purposes such as renovation of house and consumption. CLCMS estimates that nearly 50% of the loans are used for consumption purposes.

  CLCMS faces several key challenges. First, reductions in government funding have limited increases in loan sizes to meet borrowers' needs. However, there are plans to increase the loan size to Rs. 150,000 for individuals with innovative business proposals. Secondly, most CLCMS staff are working on a contract basis, and the officers are taken from other government departments for a specific period. This limits the capacity of CLCMS in expanding its operation to the newly resettled areas.

- **UN/INGOs/NGOs**: Before the displacement, most of the UN/INGOs were supporting credit programmes implemented by local NGOs and CBOs. These organizations were also involved in mobilizing savings and credit groups (Self Help Groups). For instance, CARE formed and supported more than 10 groups with grants for Revolving Loan Funds (grants matching the savings of each group). Similarly Oxfam also formed several savings and credit groups before the displacement. The end of the war and displacement completely disrupted these programs, and in the post-war situation UN/INGO involvement in the credit market and in re-organizing SHGs is minimal. Several UN agencies have provided financial support in grants and/or loans to the Federation of FCS to support fishermen, but the level of support is small relative to need.

**The Market Chain –** Village-Level

- **Community Based Organizations**: The community-based organizations include the WRDS, Village Development Organizations (VDOs), Farmers Organizations (FOs) and PAMP groups. These CBOs serve as immediate sources of finance for the returnees.

    - **Women Rural Development Societies (WRDS):** In the case of WRDS there are 81 societies in Kilinochchi. After the resettlement nearly 36 million has been issued as loans for livelihood purposes.

    - **VDOs** are formed after resettlement to engage communities in the rehabilitation and development programmes of the government, particularly the re-awakening projects of the Ministry or Economic Development, and are also responsible for credit functions as well. There are 62 VDOs comprising 1,748 small groups with 12,000 members, in Kilinochchi.

    - **Poverty Alleviation Microfinance Program (PAMP) Societies**: These societies are mobilized by the banking institutions with the support from the Central Bank. The banks, employing field officers, mobilize small groups (Grameen Groups) of 5-8 members and offer credit based on their performance in savings. Rural households with less than Rs. 7,500 monthly gross income are considered for membership in the groups, and after 3 months of saving they become eligible for loans from the banks that mobilized them[15]. 1536 small groups, with over 7000 members, have been formed in Kilinochchi and Mullaitivu by the state banks (BOC and PB), and nearly 80% of the members are women in these groups. Roughly 2000 members have been given loans at 12% interest, and the total loans distributed by these banks amounts to Rs. 120 million. The loan size ranges from Rs. 20,000 to Rs. 100,000, taken for diverse activities, primarily livelihood expansion[16].

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[15] Source: Interview with PAMP coordinator, Central Bank, Colombo.

[16] Information regarding the PAMP societies was obtained from the interviews with the field officers who are directly dealing the clients.

However, the PAMP groups face significant challenges in the resettlement context. Since savings is a condition for loans, people have been reluctant to join without the option for immediate credit. This trend is slowly changing as communities see the benefits of saving to access credit. However, many households find it difficult to continue to save while repaying the loan and effectively stop saving after obtaining loans and drop out of the groups. Additionally, those that do use loans to develop a stable income flow tend to leave the groups, likely in search of greater credit amounts. As a result of these group dropouts, the group guarantee system is threatened and it is challenging to find replacements who can consistently save. Lastly, bank field officers seeking to mobilize groups must first receive approval from the military in order to meet households and conduct mobilization activities, which greatly inhibits expansion of the PAMP groups.

- **Cooperative Primary Societies (TCCS, FCS)[17]**: The primary societies of the cooperative federations are village-level cooperative groups that engage cooperative members in savings, provide loans, and make available other livelihood-specific services for members. Displacement at the end of the war completely interrupted the functioning of the primary societies, and all lost significant amounts of savings and other financial and physical assets. Since resettlement, only about 50% of both the TCCS and FCS primary societies have re-organized and are functioning at a vastly reduced level in terms of savings, resources, organizational capacity, and service provision to members.

    - **TCCS**: These are basically savings based societies that take time to evolve or reorganize. Before the displacement, there were 240 primary societies operated in both Kilinochchi and Mullaitivu districts. After the resettlement, at the time of the study, only 104 societies are functioning. These societies have received nearly Rs. 20 mn external funds for credit purposes, and were able to support around 2000 members at the grassroots level, mostly women. However, loans are not available to the majority of the members, nearly 4000 members who have rejoined the societies, due to the lack of funds. Small loans are distributed to limited number of people, primarily for farming and small business purposes. However, traditionally TCCS has not had any restrictions on the purpose of loans, and members acknowledge that funds are to some extent obtained for consumption purposes.

      In order to support re-starting of primary societies, TCCS has relaxed certain rules, including reducing the period of savings required to be eligible for loans from six to three and cutting in half the normal membership fee from Rs. 100 to Rs. 50.

[17] The data with regard to the present situation of the TCCS societies and their level of operation was obtained from the discussion and interview with the members of the Societies gathered at the Federation office in Kilinochchi and Mullaitivu, and data obtained from their office documents during the field visits.

Additionally, the TCCS Federation reduced the interest rates on loans, such that the present interest rates vary between 6% and 12%, which was 18-24% before displacement.

- **FCS:** Like the TCCS primary societies, the FCS has been making efforts to reconstitute primary societies in fishing villages and to extend new loans to members. In Mullaitivu there were previously 24 societies with over 5000 members, while currently only 12 societies are reorganized with 3264 members. Similarly in Kilinochchi there are 14 societies functioning with 1979 members. Additionally, the FCS reports that over 2,000 members have still yet to be resettled in their former communities, which represents nearly one-third of the membership capacity of the cooperative, meaning that these members will require a great deal of assistance once resettled later this year.

  FCS societies have so far provided small-scale loans to resettled people engaged in the fishing sector, including men and women, but only a small number people have benefitted. Around 35 women members have received loans from the federation. These women are engaged in small-scale fish vending as well as dry fish making. Also, 20 women members of a society are selected for loan support through an NGO, mainly for fish processing activities. Additionally 300 male members have received loans for fishing nets, with loan sizes of around Rs. 190,000.

- **Savings and credit groups**: These are self-help groups with the objective of improving savings and credits facilities of the members. Yuvashakthi Federation in Mullaitivu has 150 societies with 2,900 individual members. Similarly, in Kilinochchi Mahashakthi women federation has 110 societies with 2,100 individual members[18]. Around 3,500 women members have taken loans, ranging Rs. 15,000 – 50,000. The interest rates vary between 10-12%. The total loan disbursement amounts to 14 mn, and the recovery is reported between 90-100% in the individual societies. These groups were formed with the support of the local NGOs operated in Vanni before the final war; as a result they seem to face certain difficulties in being recognized as legitimate savings and credit groups in the present environment. However, these groups remain an immediate source of funds for war-affected women.

- **Moneylenders / Pawning centers**: District level data is not available on the presence or activities of moneylenders, but in the resettled areas visited there are at least some moneylenders operating. Interviewees indicate that there are fewer money lenders operating, compared to pre-displacement period, reportedly because like everyone else in the communities, the money lenders were also heavily impacted by the displacement and lost significant assets. In several areas, respondents reported that there were no moneylenders in their areas. Where moneylenders are present, they charge varying interest rates (between 1% and 5%) based on a daily basis.

[18] Source: Personal interview with office bearers of the federations in Kilinochchi and Mullaitivu.

Additionally, pawning remains an important service offered at interest rates ranging from 16% - 17.5%. These rates appear lower than some formal bank loans, however the borrowers also lose access to their collateral (often jewelry) until loans can be repaid and jewelry bought back. Of the total pawning 40% is obtained for domestic purposes (household occasions, education, health and settling loans). Households somehow buy back the gold jewelry, as the loan value is smaller than the market value of gold.

- **Friends and relatives**: Household interviews revealed that the strategy of borrowing from friends and relatives is not seen as a reliable option as their friends and relatives are also severely affected by war. The households interviewed had no relatives abroad and reported that few families in their communities had members abroad or received remittances. The low level of remittances reported appears to limit the opportunities to borrow from better-off family members or friends. However, respondents did report that it was common for those members of cooperative societies or Savings and Credit groups to share parts of the money they take out on loan with other family members. This redistributive aspect of the village-level credit groups suggests that expansion of these groups can have secondary benefits to the wider community, not just those who are members.

**The Market Chain –** Credit Consumers

- **Early returnees**: Early returnees are those returned before July 2011, starting from the latter part of 2009. In the early-resettled areas the credit infrastructure has improved; banks and credit institutions have established their presence, Federation of cooperative societies are functioning and a number of primary societies have been reorganized. Part of the membership in these societies has had access to small loans, and grants made available to certain vulnerable groups like women headed households. For instance, the Rs. 34,000 grant offered to widows of Oddusuddan area of Mullaitivu, through the TCCS federation. Additionally, this population has had longer to develop cohesive relationships within their resettle communities and with government officials, relationships that can be used as guarantees on formal bank loans (particularly government officials).

- **Recent returnees**: For the purpose of this study we defined recent returnees as those returned from July 2011. Many of these families are still waiting to receive livelihood assistance, like the Rs. 35,000 livelihood package that was made available to the early returnees. Credit infrastructure in the recently resettled areas is poor. Banks have not still extended their presence, and the community level credit institutions are also not yet mobilized. Food rations either have already been phased out in many villages or will be very shortly. In the absence of credit facilities and the lack of capacity of friends and relatives, people in these areas seek other ways of coping with their cash needs. For instance, a respondent at a newly resettled location reported that women in that area buy groceries at several shops on credit, say up to Rs. 2,000 each, and settle when their husbands come back home after days of wage labor. Such incidents indicate that household-level cash flow is very thin, consumption needs are very high and that recently resettled households face greater challenges to access longer-term credit that can be used not only to meet food and immediate needs but to also restart income-earning activities[19].

**Market Infrastructure, Inputs and Support Services**

- **Bank Outreach and Mobile Services:** Several banks have begun limited mobile banking services to reach communities slightly removed from the urban areas. Banks employ field workers who are expected to mobilize resettled households to link them with the financial institutions either in groups or individually to sell their financial services. The field workers are not necessarily an integral part of the organization and may not be well trained. While there is a benefit of extending various financial services to the deep rural areas, there are also problems of selling high-risk services to the poor without much awareness, and adverse selection by the returnees that make them vulnerable to indebtedness. Additionally, the extent of these services is limited to a small radius outside Kilinochchi.

- **Collateral:** In order to access formal bank credit, collateral is required, often in the form of land title or gold jewelry. However, the vast majority of returnees have been issued only a 'permit' to the land allowing them to live and cultivate a certain number of acres. This lack of title limits many households' ability to access loans from formal institutions.

- **Documentation of ownership:** During the rapid displacement at the end of the war, many households abandoned their belongings and proof of ownership. As a result, ownership of a wide range of assets, including land, vehicles, homes, etc. is nearly impossible to prove for many households, and thus these assets cannot be used as collateral. This also means that households face difficulties in claiming insurance and payments from the government for any assets lost during the war.

- **Credit Information:** Many households are unaware of the credit opportunities available from a variety of different actors, particularly those not physically present at the village level, such as banks. Experiences of family and neighbors, and a perception of trust of different banks informs household-level decisions on which credit opportunities to pursue, rather than an understanding of the terms, conditions, and complete knowledge of the different credit products available.

[19] Source: Field data obtained from households in Kaiveli area in Mullaitivu, which is a recently resettled area.

## VII. Key findings

The post-war credit market system in the Vanni seems to be changing gradually with more actors entering the market. Banking institutions and other financial institutions have moved in to the resettled areas, mainly locating themselves along the A9 road, to offer a range of financial services and re-establish links with trusted clients. However, these services do not reach the majority of the resettled people, particularly the recent returnees. The two branches of BOC, situated along the A9, were able to offer only around 3400 NCRCS loans during the past two seasons of paddy cultivation. Households reported that the loan requirements, particularly the need to demonstrate membership in a farmer organization or to prove land title, made these opportunities inaccessible, especially for recent returnees.

At the micro level, primary cooperative societies are struggling to resume functioning, particularly the TCCS societies and FCS Societies. The limited reorganization of societies and the limited funds available to recapitalize those societies results in limited livelihood activities of farming, fishing, small business and livestock, which have a direct impact on food security.

Other impacts due to the market constraints include increased mortgaging of the assets; land and gold jewelry. These reduce their ability to enhance productive activities. The returnees have to redeem their assets using the proceeds of their little investment leaving no capital for re-investment on livelihoods. Therefore, lack of credit access contributes to keeping them in poverty.

**Key Constraints limiting access to credit for target groups:**

- **Limited access to formal credit opportunities:** Access constraints for the target population are both physical and financial. Physically, many formal institutions do not operate in the areas of return and are difficult for households to reach. Outreach and mobile services are starting, but still at a very minimal level, mainly because reaching greater numbers of 'less-bankable' war-affected households increases the financial risks to the bank. Financially, access to formal credit is limited by collateral requirements and repayment terms[20]. The loss of documents proving ownership of assets and lack of title to land limits many households from seeking bank loans.

- **Credit supply constraints**: Because formal banking institutions are often inaccessible, households heavily rely on community-based organizations and cooperative societies as sources of credit. Where these groups have re-started (and 50% of them are still not functional following the war), they suffer from a lack of liquidity. Accumulating savings take a long time, and currently the savings levels are inadequate to promote their credit programmes at a meaningful level, leading to a rationing of credit and exclusion of needy

[20] This is similar to the finding of a study conducted by Oxfam GB, in 2010, on Promoting Access to Financial Services in Post-conflict Sri Lanka: A Policy Brief for Key Stakeholders. The study concluded that, while formal financial institutions quickly established their presence in the war-affected areas their outreach was low.

members. Previously, the primary societies were able to access loans and grant funding from the district-level federations to expand their credit programs, but the cooperative federations are facing similar constraints in terms of accessing additional funding and the capacity to monitor loans and repayment. Access to credit by the recent returnees is severely affected as many societies have not re-started in their areas, or recent returnees have not obtained membership in the existing savings and credit societies.

- **Organizational Capacity constraints**: This is particularly relevant in the case of community based credit institutions. These institutions play a vital role in providing immediate access to credit for a large number of people. Loss of funds, loss of experienced members and loss of previous records and physical assets pose severe challenge in the process of reorganization of these societies[21]. On the other hand, the returnees also face problems of re-establishing linkages with the formal financial institutions due to the lack of collaterals in the form of land permits, difficulty in finding people for personal guarantee or depletion or loss of gold jewelry.

- **Financial literacy constraints**: While the returnees are aware of the credit schemes available with the banks, lack of knowledge on the procedure to obtain loans, documentation, and lack of information on collateral and interest rates, and inability to formulate viable business plans restrict their participation in the credit programmes offered by the formal financial institutions. On the other hand, lack of information about the market actors and their behavior leads to purchasing high-risk loans and leasing services, exposing the returnees to further vulnerability of indebtedness.

- **Reduction in informal credit availability***:* Borrowing from family and friends is considered unreliable as all households in a community are facing similar challenges after resettlement. The presence of moneylenders appears to have decreased following resettlement, likely for the same reasons, as inter-family lending has decreased. Where moneylenders and pawning is available, this can be difficult for households to access because of depletion of stocks of gold jewelry over the last three years of displacement.

**Gender differences in accessing credit**

Men and women do not access credit in the same manner, and this analysis shows a fairly distinct difference between access to formal banking structures and those credit opportunities available at community level. In the case of grassroots level actors such as in PAMP and TCCS groups, it is reported that 80% of their members are women, and for the WRDS groups, membership is open exclusively to women. Women appear to have a significant advantage over

[21] This is also in line with the finding of the previous study by Oxfam GB, in 2010, on Promoting Access to Financial Services in Post-conflict Sri Lanka: A Policy Brief for Key Stakeholders. The CBOs faced capacity constraints in terms of managing the funds. Further, they also faced problems of misappropriation of funds by better-informed members.

men in accessing these credit opportunities based on numbers of members, but this pattern is not the same in all communities. For instance, of the 270 loan beneficiaries of a PAMP location, 264 are females and 6 are males, but in another location in Kilinochchi, out of 612 beneficiaries, 265 are males, which is more than 40%. Despite the predominance of women in these groups, it is also not clear to what extent the women members are indeed able to access similar or greater amounts of credit relative to the fewer male members. Additionally, it is worth noting that even if women do have great access to credit than men through these societies, these credit opportunities continue to be fairly limited due to the small number of groups re-organized since resettlement, organizational capacity constraints of the societies, and the limited funding available for loans.

There is traditionally male dominance in registered Farmer Organizations and Fisheries Cooperative Societies, where more men tend to have greater access to credit, but women are not necessarily excluded. Farmers Organizations are largely made up of paddy farmers, who are mainly male. In the case of Mullaitivu Fisheries Federation, while being a male dominated cooperative (95%), women are also benefiting from the loan programmes and are actually prioritized for some loan opportunities. In this case, women's activities in terms of cleaning and marketing fish is integral to the benefit of the industry and the FCS seeks to support women as well as men. Both Farmers organizations and the Fisheries Cooperative rely heavily on formal banking institutions, and actively link their members, majority of whom are male, with bank loans.

Because of these links with supportive organizations such as FOs, men are also more likely to have access to formal bank loan opportunities. Land title, a key collateral requirement, is often in the name of men, and men can rely on their trade organizations for support in accessing loans. Women are not excluded from accessing bank loans, but access is considered more difficult. One respondent described how she was able to access formal loans by having a government official co-sign her loan.

**Reasons for taking loans**

The three major livelihood sectors, for which loans are requested, are farming, small business and livestock. Individual respondents revealed that they would use the loans for buying inputs for their chosen livelihood activity. Farming is the mostly cited reason for taking loans; understandably farming is practiced by a large section of the returnee population as they have access to lands. The next popular reason is operating small business. In this, trading activities, including mobile trading, are most preferred reason for taking out loans. Livestock keeping is the third popular activity chosen by the loan recipients. Backyard poultry keeping, goats and cattle keeping are the specific activities cited in the application forms.

However, the field officers of PAMP and VDO projects revealed that households divert nearly 40% of the loan for other purposes; presently to finance certain housing needs. Using the credit substantially for consumption purposes is not generally observed, in line with the feedback from the field workers. Using the loans to settle previous loans or to buy vehicles on leasing arrangements is also observed in some cases.

In the case of recent returnees, the expression of the need for credit was high. In a context where recent returnees are still struggling to re-start livelihood activities and where support for household food needs through distributions is tapering off, it is anticipated that a large portion of credit taken by recent returnees will likely be spent on consumption and housing needs. While the recent returnees would like to take loans, this might finally increase their burden in terms of repayment.

## VIII. Programming Recommendations

Based on the analysis presented in this paper, there are a series of programming responses that can be taken to greatly increase the availability of credit to early returnees and those recently resettled. The large barriers currently facing these groups to access adequate financial resources to re-start and to expand their livelihoods and income opportunities limits their ability to meet their immediate food, housing, and household needs and to economically progress into sustainable livelihoods

The following actions are recommended to increase access to credit for the resettled population in Kilinochchi and Mullaitivu districts, and to speed economic recovery:

(i) <u>Increase loan funds available to CBOs and cooperative societies:</u> At the community-level, aid agencies could directly support the savings and credit societies in terms of reorganizing and injecting loan funds to these societies. This would help increase cash availability at the grassroots level, and there is potential for the vulnerable groups, especially women, to have access to credit.

(ii) <u>Improve organizational capacity of cooperative federations</u>: At the district level there is a need to increase the capacity of federations - financial, physical as well as human capacity. This would have a beneficial impact on the functioning of the primary societies. In terms of livelihood development, Federations play a vital role in facilitating market access to the small producers. This is evident in the case of the Federation of Fishing Cooperative Societies.

(iii) <u>Improve financial literacy of resettled communities:</u> The study also suggests that lack of capacity in terms of financial literacy and business development knowledge hampers access to already available credit facilities. Therefore, intervention to improve financial literacy at the grassroots level, potentially through cooperative societies, will help maximize the available in the credit market. This would also help avoid adverse selection of credit facilities by unsuspecting rural clients[22].

(iv) Advocacy for changes in collateral requirements: Land title is a core requirement for formal bank loans, yet the majority of resettled population only has a land permit. For many loans, banks require either proof of land ownership (for large loans) or several personal guarantees and an endorsement from a government official. Membership in a farmers' organization, which is often dependent on land ownership or title, can serve as a guarantee for a loan. So, those households who do not have full title to their land or who otherwise have difficulties being accepted into a farmers' organization have difficulty accessing formal loans. Advocacy towards banks to accept the land permit as proof of means to a productive agricultural livelihood and means of repaying the loan would vastly expand credit opportunities for agricultural households. Similarly, advocacy targeting the government to transform land permits into land deeds would have a greater lasting beneficial impact on credit access and long-term livelihood sustainability of the population.

(v) Advocacy for expansion of credit: At the institutional level, there is a need for advocacy for formal financial institutions to develop more flexible credit practices, similar to the approaches used in the PAMP groups. While commercial banks have adequate capital, their system of banking is not conducive for increasing access to credits by returnees. The strength of the formal banking sector, particularly the state banks, is their increasing presence in the resettled areas. The State needs to commit more resources for such flexible credit programmes through formal banking channels targeting the war-affected people, and facilitate the banks' outreach operations to meet growing numbers of communities. Additionally, bank interaction with other actors, such as NGOs, farmers' organizations, and agrarian services department through a multi-stakeholder forum will greatly expand the possibilities for new, flexible credit products through formal banking channels.

(vi) Establish a District-level steering committee for credit services: Given the diversity of needs of the war affected people, credit related interventions need to adopt a broader approach to include stakeholders at different levels while maintaining the returnees at the centre of any intervention. A steering committee with the participation of all actors will facilitate more interventions that can build on the relative merits of the various programs and credit delivery mechanisms currently available. Such dialogue and cooperation can increase the transparency and coherence of credit services for the target population, improve livelihood opportunities, and speed long-term recovery and growth.

[22] In the case of PAMP groups the field officers reported that many women members became more knowledgeable about banking activities, and gained confidence in approaching banks by themselves without any support from other family members or relatives, as they were able to learn about banking, through the field officers.