Microfinance and Post-Conflict Reconstruction: Organizational Capacity-Building of a CARE International Microcredit Project in Jaffna, Sri Lanka

by

KALAIVANI ANPALAKAN
B. Sc. (Agriculture), The University of Jaffna, 1995

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Department of School of Community & Regional Planning

The University of British Columbia
Vancouver, Canada

Date 10.1.2003
Abstract

The purpose of this thesis is to examine the challenges of capacity building of Community Based Organizations (CBO) in the microfinance sector, focused on poverty alleviation in Jaffna, Sri Lanka. This has been achieved by examining a case study of the pilot project, capacity building of CBOs in Jaffna (CAB-J project), being carried out by CARE International, Jaffna. For this purpose CARE has selected twenty CBOs to build their capacity in financial services to provide savings and credit services to vulnerable group of people. The ethnic conflict in Jaffna has caused massive destruction to the society, economy, public and private properties. Various subsidy and grants programs has developed a dependency syndrome among poor and they still remains as poor. They don’t have adequate capital to invest in self employment activities. So there is an urgent need to build the local capacity in microfinance. The impact of the CAB-J microcredit program is analysed and discussed. Various challenges and implication of capacity building in microfinance in Jaffna post conflict context are also examined. A multiple method was used to collect necessary data and information including interviews, participatory observations, secondary data and comprehensive literature review regarding Jaffn context. The interviews primarily focused on the socio-economic impact of the project, various challenges and implications related to capacity building at institutional and grassroot level. The analysis was primarily based on the qualitative data.

The study revealed that the CAB-J microcredit is an ideal tool in alleviating poverty in the post conflict context like Jaffna by strengthening the socio-economic structures of the Jaffna community rather than merely depend on grants or subsidy. But the actual impacts should be assessed in regards to the long term effect and sustainability of the program. But the project faced several challenges primarily lack of fund and human resources, high demand for non financial services, prevailing uncertain political situation, in building local capacity in microfinance. The study suggests that to achieve maximum outreach and sustainability some special components such as incorporating non financial services, blending the microcredit program with relief assistance, increasing human resources, and pouring more fund into the program should be incorporated into the existing programs.
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<table>
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<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>UNHCR</td>
<td>Office of the United Nations High Commissioner for Refugees</td>
</tr>
<tr>
<td>UNICEF</td>
<td>United Nations Children and Education Fund</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Program</td>
</tr>
<tr>
<td>SCF</td>
<td>Save the Children Fund</td>
</tr>
<tr>
<td>RRDB</td>
<td>Regional Rural Development Bank</td>
</tr>
<tr>
<td>SBS</td>
<td>Samurdhi Bank Society</td>
</tr>
<tr>
<td>GPU</td>
<td>Gami Pubuduwa Upadeshka (village reawakening)</td>
</tr>
<tr>
<td>HNB</td>
<td>Hatton National Bank</td>
</tr>
<tr>
<td>NDB</td>
<td>National Development Bank</td>
</tr>
<tr>
<td>TCCS</td>
<td>Thrift and Credit Cooperative Society</td>
</tr>
<tr>
<td>FTCCS</td>
<td>Federation of Thrift and Credit Cooperative Society</td>
</tr>
<tr>
<td>CRB</td>
<td>Cooperative Rural Bank</td>
</tr>
<tr>
<td>MPCS</td>
<td>Multi-Purpose Cooperative Society</td>
</tr>
<tr>
<td>CBSL</td>
<td>Central Bank of Sri Lanka</td>
</tr>
<tr>
<td>SEEDS</td>
<td>Sarvodaya Economic Enterprises Development Services</td>
</tr>
<tr>
<td>NDTF</td>
<td>National Development Trust Fund</td>
</tr>
<tr>
<td>AGA</td>
<td>Assistant Government Agent</td>
</tr>
<tr>
<td>GA</td>
<td>Government Agent</td>
</tr>
<tr>
<td>CLG</td>
<td>Commissioner of Local Government</td>
</tr>
<tr>
<td>WTCCS</td>
<td>Women Thrift and Credit Cooperative Society</td>
</tr>
<tr>
<td>FCS</td>
<td>Fisheries Cooperative Society</td>
</tr>
<tr>
<td>WRDS</td>
<td>Women Rural Development Society</td>
</tr>
<tr>
<td>SCG</td>
<td>Savings and Credit Group</td>
</tr>
<tr>
<td>GTZ</td>
<td>Deutsche Gesellschaft fur Technische Zusammenarbeit GmbH</td>
</tr>
<tr>
<td>SLR</td>
<td>Sri Lanka Rupees</td>
</tr>
<tr>
<td>MFI</td>
<td>Microfinance Institution</td>
</tr>
<tr>
<td>CBO</td>
<td>Community Based Organization</td>
</tr>
<tr>
<td>CAB-J</td>
<td>Capacity Building of CBO in Jaffna</td>
</tr>
<tr>
<td>CB</td>
<td>Capacity Building</td>
</tr>
<tr>
<td>SEWA</td>
<td>Self Employed Women Association</td>
</tr>
<tr>
<td>NGO</td>
<td>Non Government Organization</td>
</tr>
<tr>
<td>INGO</td>
<td>International Non Government Organization</td>
</tr>
<tr>
<td>IDP</td>
<td>Internally Displaced People</td>
</tr>
<tr>
<td>SAP</td>
<td>South Asia Partnership</td>
</tr>
<tr>
<td>PTCCS</td>
<td>Primary Thrift and Credit Cooperative Society (SANASA)</td>
</tr>
<tr>
<td>WDF</td>
<td>Women’s Development Federation</td>
</tr>
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</table>
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...to my father
CHAPTER 1
Overview of the Study

1.1 Introduction

The purpose of this study is to examine the challenges of capacity building of Community Based Organizations (CBOs) in the microfinance sector, focused on poverty alleviation in Jaffna, Sri Lanka. This has been achieved by examining a case study of the pilot project, Capacity Building of CBOs in Jaffna (CAB-J project), being carried out by CARE International, Jaffna. Even though many INGOs (International Non Governmental Organizations) have been supporting several microfinance programs where CBOs act as an implementing arm, an increased number of people are still living below the poverty line. At this point, the lack of capacity building of institutions is considered a major obstacle in the success of those programs. This thesis explores the various issues that affect the outreach and sustainability of microfinance programs in post-conflict reconstruction. Microfinance that is being practiced as a poverty alleviation strategy in various developing countries with a relatively normal peaceful environment differs from that in a conflict or post conflict environment. This study thus concentrates on how microfinance programs work in the post-conflict environment of Jaffna and explores the aspects that needed to be taken into consideration in the design of microfinance programs in the post conflict reconstruction.

This chapter consists of the research background, problem statement, objectives of the study, and research methodology. It will also briefly describe the organization of the thesis.
1.2 Research Background

Sri Lanka, a large island of nearly 66,000 square kilometers, is located in the Indian Ocean to the southeast of India. It has a population of approximately 19.0 million (ADB, 2000e) and is growing at a rate of 1.2 per cent annually (ADB, 2000f). It consists of 24 districts which come under the administrative jurisdiction of nine provinces. In spite of ongoing civil conflict, Gross Domestic Product (GDP) has grown at an average annual rate of 4.8 per cent over the last decade, to $15.1 billion at the end of 1997 (ADB, 1998). Poverty is predominantly a rural phenomenon in Sri Lanka, with over 85 per cent of the poor in rural areas, seven per cent in urban areas and six per cent in estate sector (ADB, 2000f).

According to the 2001 census about 1,803,028 people of the country's population live in the North and Eastern provinces where the civil war has been going on since 1983 (Dept. of Census and Statistics, 2001). The ongoing civil conflict in the north and east of the country has had a major impact on poverty. It is difficult to accurately quantify its socio-economic impact, but it has substantially disrupted economic activity and over five per cent of GDP is being used to finance the conflict (ibid). The conflict has caused severe damage to physical and social infrastructure and public facilities including schools, hospitals, cultural centers as well as civilian properties. Moreover, it has led to the displacement of many families from their own homes and sources of livelihood. Thousands of children have lost one or both parents. This conflict has also resulted in a loss of male bread winners, thus leading to the increase of female headed households that are experiencing greater economic hardship.

For development activities to focus on poverty alleviation in Sri Lanka, CBO and NGOs must take the conflict into consideration when designing development programs or projects. In Sri Lanka many international development agencies, particularly UN system agencies consisting of the UNDP, UNICEF, and UNHCR, other international non-governmental organizations including CARE international, FORUT, Oxfam, SCF etc are doing several poverty alleviation programs in
different areas of Sri Lanka. A good example is the Asian Development Bank (ADB) which plays a major role in poverty reduction in a post conflict context. The specific role of ADB in poverty reduction in the conflict situation is seen in the following aspects: first it provides direct assistance to the conflict-affected areas through development of basic infrastructure and projects that target employment generation especially for the youth and the poor and to bring them into the economic mainstream. Second, it serves to mainstream conflict concerns either by including specific components in development projects to address the needs of the conflict-affected people or by ensuring development projects do not exacerbate conflict. Third, the ADB serves to build local capacities to support the government's policy of decentralization and devolution of power through both sector and integrated approaches (ADB, 2000f).

The Sri Lankan government has a three-pronged strategy for poverty reduction. First is by improving economic and social opportunities for the poor and broad-basing the benefits of growth; second, providing security to people unable to participate in mainstream economic activities and protecting excluded, marginalized and vulnerable groups; and third, empowering people to lead decent lives (ADB, 2000f). At the same time the government poverty reduction framework also aims to identify new roles for local governments, the private sector, and civil societies in poverty reduction. At this point the capacity building of grassroots civil societies becomes important in poverty reduction. Several government as well as non government organizations have already been involved in the process of building the capacity of local CBOs for poverty reduction in various parts of the country, including both conflict and non-conflict areas. But the capacity building process in conflict areas faces more constraints than other areas. Capacity building in conflict zones must be undertaken with care, so as not to fuel or prolong the war (Hyndman, 2000). Furthermore Hyndman (2000) said that the objectives of capacity building may be well-meaning and practical in peace time but they become highly politicized in a war zone.
Because of the conflict environment in the North and East provinces, a considerable portion of the population experience deprivation in economic welfare, especially those in the Jaffna district located in the northern area of the North province which has been the center of the conflict. The ethnic conflict has had a disastrous impact on the Jaffna district and its entire population. It was the focal point of armed conflict for more than 13 years (Jaffna Plan, 1998). This came to an end only after the Sri Lankan Army succeeded in clearing the Jaffna peninsula from rebel occupation in 1996 (ibid) Jaffna faced several periods of ethnic violence in the period before 1996. This has caused massive destruction to the society, the economy, to public and private properties and to the social and economic infrastructure. In addition to conflict destruction, Jaffna people became increasingly isolated from the rest of the country and the world, which affected social and economic life. Low performance of economic sectors in Jaffna caused high rates of unemployment. Because of this more people are living under or near the poverty line. Nearly 75 per cent of Jaffna people depend on monthly free dry rations being given out by the Sri Lankan government. If this program is stopped for even a month those people will die by starvation (CARE International, Jaffna, 2000-2001).

Furthermore much of the money coming into the Jaffna district is mainly from government grants and relatives living abroad. The role of the banking sector in Jaffna in handling remittances from abroad is not significant, although it plays a major role in mobilizing money from the north to the southern part of Sri Lanka. This is because the banking sector in Jaffna on the whole during the past year was able to mobilize 30 million rupees but the lending amount is below 10 million rupees (ibid). As a result the Jaffna people, especially the poor, face difficulties in accessing money to meet their personal needs. Even though several INGOs have been functioning in Jaffna for a long period during and after the war to uplift the socio-economic standard of conflict areas, there was a significant turning point in their activities after the massive exodus of Jaffna people in 1995.
Since 1995 many NGOs have started to select CBOs as partners for their program implementation (ibid). CBOs are a part of the community and when people move, CBOs could also move with people. This mobile nature points to the importance of building the capacity of CBOs in the financial sector so that people could access financial services in any critical condition. Commercial banks differ from CBOs on this point as they need to wait for security clearance from their superior authorities to start their operation. This vacuum creates a difficult situation for financial and banking services to survive in conflict condition.

Besides most of the financial assistance programs run by both government and non-government organizations come under the welfare or subsidy category. This has developed a dependency syndrome and leads them to remain small and limited in reach and scope. These characteristics also emphasize the importance of building the local capacity of the Jaffna community to mobilize local resources and reduce dependency on external funds.

There are many types of CBOs that have been functioning in Jaffna such as Community Development Centers, WRDS (Women Rural Development Societies) and others. Most of the CBOs have been involved in welfare activities and few of them such as TCCS (Thrift and Credit Co-operative Society), WRDS, and Co-operative societies have been involved in financial activities. So it is important to encourage other non-financial CBOs to get into financial services. After the massive exodus in 1995, most of the CBOs lost their assets. After this displacement many efficient CBO members and administrative leaders have not returned to their native places. The lack of skilled members makes it very difficult to provide satisfactory financial services and many CBOs, both financial and non-financial, need to build their capacity in financial activities.

In Jaffna, there are also several INGOs that have been carrying out many developmental programs including strengthening of financial services to the Jaffna poor. For example, the INGOs such as CARE International, FORUT, SCF
(Save the Children Fund) (U.K), GTZ (Deutsche Gesellschaft für Technische Zusammenarbeit Gmb) and others have been carrying out micro credit programs. Generally donor agencies are mostly interested in the implementation aspect rather than monitoring and evaluation (Noponen, 1997 and Khan, 1998). But the evaluation of a project or program is important for further modification or development of new strategies in the future. There is also a lack of documents on micro credit in Jaffna and thus, there is a need for more documentation. This research is an attempt to fulfill this need through undertaking an in-depth study of the CAB-J project carried out by CARE International, Jaffna.

1.3 Problem Statement
This research has been designed to address the following research question: How can microfinance services run by international aid agencies contribute to community capacity building in post conflict areas like Jaffna? In attempting to answer this research question, several other key questions could also be addressed: What are the challenges that have emerged in the capacity building of microfinance program in post conflict context? What are the factors that influence the sustainability and capacity building of microfinance program in post conflict areas? How can the capacity building of grassroot organizations in microfinance support community empowerment? / In other words, how can it contribute to the reconstruction and redevelopment of the community in post conflict areas like Jaffna? What are the capacity building needs and strategies to be addressed in microfinance program development in post conflict context?

Capacity building in this study refers to the focus on the material and tangible aspects of the capacity of an organization and its people to be critically self-aware (Kaplan, 2000). There should be some fundamental shifts in attitudes and capacities which would both be entailed and generated by concentrating on the practice of the development practitioner in relation to organizational development rather than focusing on external appearance or rushing to the training manuals. At this juncture I would like to introduce the phrase,” fragile transitional post
conflict situation" (OECD, 1997) to describe the post conflict situation of Jaffna. The transitional situation exists within some sort of peace accord or expectation of peace accord but it is characterized by insecurity, uncertainty and repeated cycles of violence before settling down and theoretically, it may include an immediate post conflict stage and a later stage that lies in between the normal situation and the immediate post-conflict stage. The situation of Jaffna is also in the later stage of immediate post conflict to a normal situation. The significance of this research question lies in the potential that a microfinance program particularly designed for post-conflict situation like Jaffna which addresses security, uncertainty, and repeated cycles of violence, can play a major role in the development of cohesive civil society and in alleviating vulnerability and poverty. Economic survival is the major problem immediately after conflict has subsided. But microfinance programs are often designed in a way to enable people to make a sufficient daily income to meet their basic needs while repaying their loan. Moreover, it also makes the people think about how they could earn a living and help reduce their dependency on welfare and charity based financial assistance (Doyle, 1998). Microfinance is then used as a tool to mitigate disaster effects and at the same time it is also used to facilitate reconciliation and conflict resolution (ibid). Besides civil society development, professionals propose using microfinance programs as a vehicle to increase grassroots and cross-ethnic cooperation.

The microfinance program of CAB-J on which I have carried out an in-depth study is also strengthening community-level financial management capacity. This will make the community independent of commercial and charity based financial assistance being given by the government or any other welfare organization. Furthermore, training of community based organizations in microfinance facilitates the building of the local traditional social network and trust among people in order to create a cohesive society. Finally, the types of financial services provided via the CAB-J project are intended to promote savings and
thus prepare the recipients for the jump-start of their income generation activities once permanent peace is restored in the region.

1.4 Objectives of the Study
The research study has the following five objectives.

- To understand how microfinance services work to mitigate the economic effects by human-made disaster during a post conflict period such as that experienced presently in Jaffna, Sri Lanka.
- To explore the specific roles and impacts of microfinance programs in Jaffna as they relate to community empowerment.
- To identify and compile experiences related to microfinance services particularly the activities on organizational capacity-building for better delivery of such services.
- To acquire an understanding of the implication and challenges for microfinance service providers in a post-conflict area.
- To identify the factors which influence the capacity building of Community Based Organizations in microfinance.
- To determine the modifications and specific conditions that should be considered in the design of future microfinance programs in a post conflict context such as that found in Jaffna.

1.5 Conceptual Framework or Hypothesis of the Study.
When a community undergoes conflict almost all infrastructure in that community collapses, leaving little room for development or reconstruction activities. The socio-economic conditions of the community devastated by the long lasting war ultimately leads to the destruction of the community. Low income or poor people are more vulnerable to this situation than middle-class and high income level people. Poor are embedded in a socio-economic class system. They were dependent on the richer for employment and for resources (Weisman, 1998). The economic survival of those poor people is the major problem immediately after conflict has subsided. Providing grants or subsidy to those vulnerable people will
develop a dependency syndrome, instead of empowering the community. These grant programs only leave the poor people with bare hands. This situation emphasizes the necessity of building local capacity of the community rather than merely providing subsidy or grants.

Jaffna ever enjoyed a strong, healthy, and well-balanced society (David, 1972) in the pre-conflict period and it was destroyed by ethnic war. Building the local capacity of the community enables the poor to think about their future income generation and economic reconstruction. Through community empowerment we could create strong, healthy, and well balanced society which is important for community development. Microfinance is one of the poverty alleviation tools for the poor in both peaceful times and post conflict context by making financial access to the poor who have deprived of formal financial services.

The socio-economic conditions of the poor are harder in post conflict context when compared to peaceful context because the degree of vulnerability of the poor is aggravated by long lasting war/ conflict. Their vulnerability is worsened by the very low amount of capital available for production (See Figure 1.1A). This leads to low levels of per-capita earnings and ultimately leads to low levels of saving. Due to lack of saving, the community faces hardships in attempting to fulfill their basic needs. This trend also affects future production related to the insufficient capital or lack of inputs available for production.

This vicious cycle trend is common in a vulnerable poor community and this trend always creates negative socio-economic impacts. For uplifting the living standard of a conflict affected community the prevailing vicious and cyclical process should be broken. It could be done by pouring micro finance services into that disrupted community development process (See Figure 1.1B). Providing micro finance services to a community will increase capital available for self
Figure 1.1B: Vicious Cycle in Conflict Context

Figure 1.1A: Microfinance and Capactiy Building in Post conflict context
employment and thus reduces its vulnerability and increases the involvement of the community in further production activities. This will lead to increases in per-capita earnings and savings.

Finally this will fulfill the required consumption needs or increase the personal consumption level. At this level the community will show its positive impacts on socio economic and political aspects.

To achieve the ultimate goal of micro finance development program for poverty reduction in a community, the program should include the following aspects in its program/project activities.

- Capacity building of microfinance institutions (CBOs, NGOs etc.)
- Capacity building of beneficiaries.

All the players in microfinance such as donor agencies, intermediary organizations like INGOs, local NGOs and grassroot level organizations etc. should posses adequate institutional capacity to provide the micro credit services efficiently to the target people (See Figure 1.2). The CAB-J project involves various stakeholders as it is at the intersection of program activities jointly implemented by CARE International, other donor agencies, local partner, and community based organizations. Without enough capacity building in microfinance program it will struggle to attain maximum outreach and sustainability and thus affect the viability of the institutions as well the program in the long term. Furthermore recipients or beneficiaries of this program should have enough knowledge to efficiently and effectively utilize the money received from this micro finance program and must be trained to repay their premium back to the CBOs.
Figure 1.2: Core Elements of CAB-J Project

Source: Workshop on baseline survey, CAB-J project, CARE, Jaffna

Figure 1.3: Needs of Microfinance - Capacity Building

Issued by donor agencies/intermediary organizations-INGOs: need capacity building to get maximum outreach and sustainability.

Representatives of the community; issue the finance to the people, need capacity building

Need capacity building for efficient utilization of fund & for proper repayment
Figure 1.3 shows the Capacity building needs at different levels in microfinance program. Beneficiaries/ people are the target group of the program and they should have adequate capacity for the efficient utilization of micro credit. The intermediary organizations utilize CBOs as the representative of the community to implement the programs. So CBOs should have adequate capacity to provide the microfinance services efficiently to the people. At the same time donor agencies and intermediary organizations should build their capacity in various aspects of microfinance programs to achieve maximum outreach and sustainability. Capacity building at an institutional level and grassroots level could be the turning point towards rehabilitation and reconstruction and ultimately to a macro-level development of the community.

1.6 The Methodology of the Study
This section describes the research methodology adopted for this study. This research focuses on the on-going project of CAB-J being implemented by CARE International, Jaffna. For this project CARE has selected twenty CBOs from all over the Jaffna Peninsula (See Map 1.1). The necessary information and data for this research have been collected by using multiple methods.

1.6.1 Types of Data
Primary and secondary data were collected to fulfill the objectives of the proposed research. The research was conducted during the period from May to August 2001. Primary data were collected from interviews with CBO leaders, CAB-J project staff and purposively selected loan recipients from each CBOs. Purposive non-random sampling was used for the selection of loan recipients for the interview process. For that purpose the lists of loan recipients were obtained from each CBO. From that list I prepared a new list based on my sampling criteria: 1) loan recipients who have already started loan repayments, 2) loan recipients who have household members not less than five to ensure the presence of different
age levels and different social effects, for example, school age children and the effects of education on loan use, 3) loan recipients from a variety of occupation. From the newly prepared list, every second recipient was selected for interview.

The interviews lasting 30 minutes each were conducted in Tamil language and focused on the improvement of socio-economic factors such as education, occupation, housing, status of family, family income, usage of microfinance money, income generation activities, social cohesion etc. after introducing this program. The total number of beneficiaries interviewed was one hundred, or five beneficiaries from each of twenty CBOs.

CBO leaders were interviewed separately regarding the capacities and performance of their CBOs, member’s opinion about the particular project, level of member interest and their degree of participation in the program, and the strengths and weaknesses in its functions etc.

The staff of CAB-J were also interviewed separately regarding their view of the project, implications and capacity building challenges they face during the implementation period, constraints that exist in the institutional aspects, future ideas and modification of the project, and the effects of the civil war on the project etc.

In addition to the interviews, further information was collected through participant observation. I worked along with the CAB-J project team during the research period and attended regular meetings of each CBO. I also attended as an observer the training programs of each CBO conducted by the CAB-J project trainer. During all those visits information was gathered through observation, participation and discussion with CBO members.

In addition to the information generated from field research, necessary secondary data such as member list of each CBO, baseline survey data carried out by
CAB-J team before starting the project and other relevant data was extracted from various documents at the CARE office in Jaffna. Moreover, available quantitative data related with loan provision, repayment rate, etc were derived from the relevant portfolio of each CBO. Furthermore supplementary information was collected from library research regarding the history of the Jaffna peninsula, the impact of the civil war on the people of Jaffna, statistical data on Sri Lanka microfinance, etc.

1.6.2 Data Collection Procedure
For the interviews with loan recipients, the interviewees were selected by using selection criteria. An interview guideline (See appendix 1) was prepared based on the baseline survey questionnaire prepared by CAB-J team. Five students from the University of Jaffna who have previous research experience involving field data collection gave research assistance in conducting interviews with loan recipients. Before getting involved in the interview process, they were given detailed explanation about the research, including CAB-J project details and the interview process. This helped them in conducting interviews and adding probing questions beyond the interview guideline. Interviews were mostly conducted by way of informal discussion and brief notes were taken. In addition to the interview, relevant information was also collected by direct observation. At the initial stage of the interview period I accompanied each student. Everyday after finishing interviews with loan beneficiaries, discussion were carried out between the interviewers and myself to help me study the project further, including various views and opinions on the project progress made by the interviewers who are part of the community.

Moreover I conducted interviews with CBO leaders and CAB-J project staff. Most of the interviews were undertaken informally. Even though this research study involved both qualitative and quantitative data, the qualitative data was used mostly in the analysis and quantitative data was utilized minimally.
1.7 Limitation of the Study

The selection of the Jaffna peninsula as a case study area for this research had several difficulties because of its uncertain condition. Even though Jaffna peninsula has been under the control of Sri Lankan government after 1996, there were continued threats of LTTE (Liberation Tigers of Tamil Eelam) invasion. Because of this threat, there were several checkpoints and barriers of government forces. These protective measures restricted the free movement of people. This caused certain limitation in the field level data collection. During the interview period, the interviewers group including myself were stopped at many check points and subjected to many inquiries.

Furthermore some areas in Jaffna especially the island part, had been restricted from entry by strangers who are not permanent residents in that area. The non-resident people need special permission from high ranking army forces. The CARE International employees have already been provided special passes to visit these areas more often due to the CAB-J project. I couldn’t travel along with them to these areas because I am not a CARE International employee. As a result, I could not visit those CBOs frequently and this restricted my field data collection in these areas.

Frequent displacement due to the conflict in Jaffna resulted in most existing CBOs losing their previous records, loan portfolio etc. This limited my secondary data collection. Most of the CBOs have now relocated in remote areas. Moreover, lack of access to transportation, communication and financial support for research limited the data collection. A limited time period for research also constrained the data collection. With the available resources, time and facilities research was carried out to get the optimum results for the proposed research study.
1.8 Organization of the Study
The study is organized in seven chapters. Following this introductory chapter, the second chapter reviews the literature on microfinance and capacity building for community development goal. Chapter three reviews the literature on international case studies dealing with the application of microfinance in a post-conflict context. The fourth chapter focuses on Sri Lankan microfinance to situate the CAB-J project in its proper context. The fifth chapter discusses the micro credit capacity building activities and impacts of the CAB-J project in Jaffna. The sixth chapter provides an analysis and discussion of the challenges of capacity building for the CAB-J micro credit project in post conflict reconstruction. The final chapter presents the summary of the study, conclusions, and recommendations.
CHAPTER 2
Microfinance and Capacity Building for Community Development Goals

"If we are looking for one single action which will enable the poor to overcome their poverty, I would focus on credit".

Grameen Bank’s founder Dr. Muhammad Yunus

2.1 Introduction
This chapter focuses on microfinance and capacity building for community development goals. It provides the following information: 1) definition of capacity building, 2) concept and role of capacity building in microfinance and poverty reduction/community development, 3) the importance of microfinance, and 4) the challenges of microfinance and capacity building. Furthermore, this chapter addresses the following key questions: What are the linkages between capacity building, community development/poverty reduction and microfinance? Why is microfinance increasingly seen as being functional to poverty reduction and community development? How can capacity building support or strengthen microcredit programs, and poverty reduction/community development goals?

Microfinance has been primarily considered as an antipoverty strategy because its main purpose is to provide credit with a view to generate income that could alleviate poverty. In the late 1970s the microfinance system was introduced in the Asia-Pacific region and elsewhere. The most popular models of microfinance are the Grameen Bank in Bangladesh, Bank Rakyat in Indonesia and Self-Employed Women Association (SEWA) in India. In Sri Lanka, microfinance has been operating since 1911 with thrift and credit societies acting as an important element in microfinance sector. The details of the microfinance sector in Sri Lanka are discussed in chapter four. Even though microfinance generally refers to the provision of financial services, primarily credit and savings to poor and low income households who do not have access to formal banking system, its
outreach is very small compared with demand. Most of poor people’s demand for financial services is substantially unmet. This is because the microfinance sector doesn’t have adequate capacity to reach its maximum achievements and sustainability of its programs.

Most micro enterprise programs have turned their focus to capacity building. Capacity building is now one of the most frequently invoked development concepts and it still continues to elude a shared definition of what it means in practice.

2.2 Definition of Capacity Building
What is ‘capacity building’? The concept of capacity building has originated in the 1950s and 1960s, when it was based largely on the idea of equipping developing countries with a basic inventory of public sector institutions and, later strengthening them to improve their program (Smillie, 2001). Capacity building, often used synonymously with institution building, institutional development, and organizational development, is in some ways development assistance itself (ibid).

Even though Capacity Building (CB) is now one of the most frequently invoked development concepts, it still continues to defy an appropriate definition of what it means in practice. The basic concepts underlying in this term involves the whole network of relationships in society: within, between and among households, neighborhoods, grassroots or community-based organizations, various religious organizations, training institutions, research bodies, government ministries, the private sectors, NGOs and donor agencies and are concerned with creating new relationships of mutuality and reciprocity within a given society and beyond (Eade, 1997).

But strengthening local capacity is easier to say than to do in practice because knowing whom to work with is as important as knowing how to work with them. Sometimes the wrong capacities may be enhanced or the capacities of the wrong
people may be strengthened, as in the case of freelance militia in Somalia or Hutu militia in the Goma camps (Smillie, 2001).

Kaplan (2000) said that conventional capacity building has tended to focus on the material and tangible aspects of the capacity of an organization and its people to be critically self-aware. There should be some fundamental shifts in attitudes and capacities, which would both be entailed and generated by concentrating on the practice of the development practitioner in relation to organizational development, rather than focusing on external appearances or rushing to consult the training manuals.

Most discussions of capacity building recognize conflicting approaches to the term. But the emerging international experience is slowly leading theorists and practitioners to an obvious conclusion to this definition (Morgan, 1994). Morgan (1994) revealed that a common definition of capacity building is only possible at a high level of abstraction. Once people start to struggle with problems and constraints to progress in situation, they need to make use of a wide range of approaches to capacity building. In the same way, private entrepreneurs use different strategies to achieve commercial success in a variety of situations. But the strategies vary over time and according to the needs of different sectors and organizations. Furthermore, Morgan (1994), said that building effective and sustainable capacity that produces value both for individual citizens and for countries as a whole was difficult, demanding, and in many cases, intractable work in any country.

Moreover he said that in many instances, capacity building remains a rather ill-defined, cross-cutting issue and an osmotic by-product that will result hopefully from the overall design and implementation of development program. However, capacity building could be considered as a development objective and it should command its own resources, management attention and evaluation standards along with gender, poverty or the environment (Morgan, 1994).
Even though several definitions of capacity building have been provided by several researchers, some say that these definitions are long and vague and invoke all manner of good things. From the definitions, one may infer that capacity-building contexts differ so widely. This is because the intent of capacity building effort may differ from one agency and situation to another. So context, purpose, and target will ensure that an appropriate approach in one situation is inappropriate to another situation.

2.3 Concept and Role of Capacity Building in Microfinance and Poverty Reduction/ Community Development

Capacity building, microfinance and poverty reduction/ community development are related to each other. Microfinance institutions need proper and adequate institutional capacity to provide satisfactory financial services to the poor who have been refused access to formal financial services. Through microfinance, the poverty or vulnerability of poor people could be eliminated, thus leading to individual and community capacity building. Finally it will lead to community development when individuals organize themselves and work together to improve the quality of life in their community. So to achieve the goal of community capacity building microfinance institutions need institutional capacity building as an input that leads to institutions getting maximum outreach and sustainability in their programs. Moore (1995) said that if development is to be a sustainable and people centered one, capacity building is seen as an essential element along with empowerment, participation, and gender-equity. The building of social capital / community capacity and the emergence of a strong civil society are essential ingredients in achieving long-term, sustainable development at the national level. The following table shows the concepts of the capacity in various types of organizations.
Table 2.1: Various Concepts of Capacity-Building:

<table>
<thead>
<tr>
<th>Means</th>
<th>Process</th>
<th>Ends</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building the capacity of an organization: organizational development.</td>
<td>Strengthens the organization’s ability to perform specific functions, such as refugee-camp management</td>
<td>Builds coherence within internal operations; develops the possibility of continued learning and adaptation.</td>
</tr>
<tr>
<td>Building the capacity of an institutional subsector (e.g., health, credit, emergency assistance): sectoral development</td>
<td>Strengthens the ability of the sector or subsector to improve its overall impact.</td>
<td>Develops mutually supporting relations and understanding within the sector or subsector.</td>
</tr>
<tr>
<td>Building the capacity of civil society: institutional development.</td>
<td>Improves the ability of primary stakeholders to identify and carry out activities to solve problems.</td>
<td>Enables and stimulates better interaction, communication, conflict resolution in society, enhancing social capital.</td>
</tr>
</tbody>
</table>

Source: Adapted from Smillie, Ian. *Patronage or partnership: local capacity-building in humanitarian crises.* Bloomfield, Conn.: Kumarian Press, c2001, pg 11
Smillie (2001) describes the concept of capacity building based on three types of organizations which are functioning at different hierarchical levels in the community. These concepts may apply to many organizations working in different areas. In the case of microfinance sector, traditional village based financial organizations, and various community based organizations comes under civil society. Local NGOs and some INGOs which are involved in microfinance services come under institutional sector. But institutions may be both organizational and non-organizational. Formal financial institutions like state owned or private banks and some INGOs associated with microfinance program come under the organizational sector (Smillie, 2001).

Microfinance as an idea has been generated in low-income countries for poverty alleviation goals. It has been practiced in both normal and post conflict context all over the world. But anti-poverty strategies have to be implemented in a sustainable manner to strengthen people's own inventive solutions, rather than substitute for, block or undermine them. In that way, capacity building is a new strategy in various developmental activities and programs carried out by several INGOs, donor agencies and other private development organizations. Experiences in the Bangladesh context show that there is a change in the relationship between Northern nongovernmental organizations (NNGOs), which have their roots in industrialized countries, and local Southern NGOs (SNGOs), which exist in many aid-recipient countries. Many NNGOs have moved from the implementation of development projects toward a partnership approach in which they fund and attempt to work with SNGOs. This has increasingly led to the idea of NGO "capacity building" as a key objective, but a significant growth in SNGO capacity in a country such as Bangladesh increasingly renders such objectives less meaningful. (Lewis, 1998)

Microfinance promises both to combat poverty and to develop the institutional capacity of financial systems through finding ways to cost-effectively lend money to poor households (Brugger and Rajapatirana, 1995; Hulme and Mosely 1996;
Otero and Rhyne, 1994 and Morduch, 1999). A financial systems approach to microfinance is introduced to develop the capability of many institutions to provide financial services to the poor on a sustainable basis. Microfinance programs are based on the proposition that the structure of the financial system in most developing countries, characterized by market distortion and financial repression (Gallardo, Bikki and Sacay, 1997:1-3), is the main reason why the poor and small borrowers do not have access to financial services. Based on the discussion by Otero and Rhyne (1994) the core elements of microfinance are: 1) Strengthening financial institutions which have the capacity and motivation to focus operations on targeted poor households is crucial for poverty alleviation; 2) Microfinance operations need to be market-driven because full coverage of costs is necessary for continued business and intermediation benefits to clients, and 3) A financial systems approach promotes functional specialization and market coverage among different microfinance institutions and enhances their integration into a country’s formal financial markets. So to reach those core elements, microfinance institutions should build their capacity in various aspects such as finance, designing products, innovation of efficient finance intermediation, technical training, human resource development etc. Through these capacities, they could achieve the intended outcome of the program that could be viable for a long period, thus leading to program sustainability.

2.4 Importance of Microfinance

After more than a decade of debt and recession, and of economic stabilization and structural adjustment policies, in both developing and transitional economies, structural poverty reduction has re-emerged as a central development priority (Moser, 1998). Furthermore Moser (1998) said that this focus on poverty not only renewed conceptual and methodological debates about meanings and measurements of poverty, it has also challenged policymakers to reassess the viability of current interventions for poverty reduction. Despite many decades of “economic development”, too much of the world’s wealth is still concentrated in too few hands and instead of lessening the gap between the rich and the poor in
this world, this gap has actually increased. So it is very essential to innovate new development models for developing the economies of low income countries. So microfinance has been introduced as a strategy to reduce poverty in low income countries.

Microfinance is increasingly seen as an effective poverty reduction tool because of the following reasons given by Ledgerwood (1999) and Khandker (1998a).

**Reaching the poor**
Microfinance services can provide support for income generation activities operated by poor people (Ledgerwood 1999, pg 3-4).

**Leading to financial sustainability**
Microfinance provides savings and credit services to the poor, helping to build up financial self-sufficiency over the long term (ibid).

**No collateral requirements**
Microfinance services solve the problem of lack of collateral in accessing loans by the poor, by using group-based and character-based micro credit approaches and repayment collection through social and peer pressure (ibid).

**Potential to build on traditional system.**
Microfinance services sometimes resemble traditional systems such as the Rotating Savings and Credit Association (ROSCA). This could make microfinance services very attractive to poor people because they already rely on the traditional system (ibid).

**Empowerment of women**
Most of the microfinance programs focus on women. Women are able to become involved in income generating activities. This leads them to participate in production and community activities in addition to their reproductive role. This leads women to become empowered among societies (Khandker 1998a, pg 11-20).
Poor households are typically excluded from the formal banking system for lack of collateral, but the microfinance movement creates new risk and costs in providing small, uncollaterized loans (Morduch, 2000). Micro-credit programs, having made their mark in providing credit and other development services to the poor in a non-traditional way, are able to make significant changes in the rural economy. Descriptive and econometric analyses of the three most important micro-credit programs of Bangladesh, namely Grameen Bank, Bangladesh Rural Advancement Committee (BRAC), and Bangladesh Rural Development Board's (BRDB) RD-12 project show that these programs have positive impacts on income, production, and employment, particularly in the rural non-farm sector (Khandker, 1998b). The idea of micro-credit has gained popularity not only in Bangladesh but also in countries like Malaysia, the Philippines, India, China and United States, and is a model that should be taken seriously (Hossain, 2000).

It is recognized that providing efficient microfinance services to poor people play out in three ways to uplift their living standards and future development.

- Acting as a poverty reduction strategy
- Supporting community development
- Empowering women

These three general outcomes of microfinance are discussed below:

2.4.1 Microfinance and Poverty

Even though the world economy is growing rapidly, poverty levels remain the same or are increasing instead of decreasing. Much of the earlier development literature states that the benefits of economic growth will trickle-down to even the poorest members of society but the gap between the rich and poor has been widening continuously instead of narrowing. This "trickle-down" effect is assumed to happen through the creation of more jobs as the economy expands; better wages as the country earns more, and higher prices for farm produce as towns grows (International Labor Office, 1979:10). In Asian countries, poverty is a widespread phenomenon, especially in rural areas. In terms of poverty
incidence in countries like Bangladesh, India, Pakistan, Philippines and Sri Lanka, anywhere from one-third to half of the rural population are considered poor (ADB, n.d :4). But another ADB report indicated that in most of the countries in Asia-Pacific region, between one third and one half of the population live below the poverty line (ADB, 2000a).

Generally poverty describes a situation in which people are not able to satisfy their basic food, shelter and clothing needs. But Khan (1996) states that there is no consensus on a single definition of poverty. Another well known author, Gunnar Myrdal, identifies poverty both as a cause and consequence of the soft state (Myrdal, 1968). A “soft state” is one that has very weak political and economic structures with less resources to spend on the people. This is particularly true in developing countries where many poverty alleviation programs carried out by state have resulted in the poor getting poorer. Now the developed countries are introducing several new strategies to eradicate poverty in the developing world. The goal for all poverty reduction programs today is to empower the poor, eliminate inequities, and give the poor the opportunity to support themselves and their families and contribute to the sustainable growth of their societies.

Poor households lack the finances to establish any self employment activities to support themselves and their families. However, the formal financial system rarely provides access to financial services for poor households in developing economies (Banerjee, 1994). Robinson indicated that about 90 percentage of the people in developing countries lack access to financial services from banking institutions (Robinson 2001). Thus, Women’s World Banking (1995) estimated that in most developing countries, the financial system reaches, at a maximum, only the top 25 percent of the economically active population, and thus leaves the bottom 75 percent without access to financial services apart from those provided by moneylenders and family members (ADB, 2000a). But borrowing money from a local money lender is far more expensive than borrowing from a
commercial bank (Robinson, 2001). So there is an urgent need to develop financial systems that can reach low income grassroots level people. Many developing agencies currently concentrate on microfinance programs which reach grassroots level people without requiring any collateral from them.

Microcredit has been identified in international development circles as a key mechanism to fight poverty in developing societies (Hossain, 2000). The microcredit summit, held in Washington D.C in 1997, sought to ensure that 100 million of the world's poorest families continue to receive microcredit loans (ibid). An effective set of microfinance techniques has been developed and applied by various institutions especially the Grameen Bank in Bangladesh and Bank Rakyat in Indonesia. Microfinance has enabled better income generation for households through a variety of economic and other activities. This is accomplished particularly through training and skills development beyond financial assistance which has led the poor to get jobs and attain higher incomes. The successful microfinance institutions' lending outlets are located near the clients, application procedures are simple, and loans are disbursed quickly. Furthermore, the interest rates to cover both the operational and financial costs are affordable to poor families.

2.4.2 Microfinance and Community Development

From an international perspective, it is clear that community development has been one of the most significant social forces in the process of planned change (Chekki, 1979). This is reflected in the first development decades of the 1950s and 1960s, when, under the direction of the UN and its affiliated organizations, Community Development was actively promoted throughout the developing world as part of the nation-building process and as a means of raising the standards of living among the poor (Campfens, 1997). In recent years the Community Development process emphasizes the empowerment of marginal groups to participate in community and institutional decision-making processes, either through their own social organizations or as representatives of grassroots
organizations community wide. This indicates that Community Development underlies various social values in itself such as the creation of active communities, public participatory processes, community integration, empowerment of marginalized groups, etc. So the creation of a healthy and strong society is essential for community development because social capital is a major constructing element of a community and it is also the basic foundation for the community development.

Social capital refers to the institutions, relationships, and norms that shape the quality and quantity of a society's social interaction (World Bank Group, 2002). Social cohesion is critical for societies to prosper economically and for development to be sustainable. The group-based microfinance programs produce social capital through the networks of social interaction, trust and co-operations that they foster. Microfinance programs provide not only financial assistance to the poor but are also owned by poor people. But there is an argument regarding how microfinance organizations create new social capital. Anderson et al (2002) discussed that microfinance programs use existing social capital, particularly in their group lending techniques, but arguably also create new forms of social capital through meetings and other services.

Microfinance has many effects on community development either directly or indirectly and it strengthens and empowers grassroots people economically and socially. It can directly affect community organizing and development as a part of the microfinance activities, and it can also indirectly enable and facilitate community development as an externality of credit itself (Srinivas, H. & Pallen, D., 2002). Microfinance programs make local people come and work together as a group, enabling collective action among the community.

Microfinance has the potential to enable collective action, the coming together of the community, and more sustainable community-based organization.
In as far as microfinance interventions allow investing in education and training, members of the community can acquire skills that will allow them to locally design, develop and manage community projects (Schrieder & Sharma, 1999, P.74). Collective action is an important aspect of participatory processes in community development. Furthermore, beyond financial assistance, microfinance beneficiaries are involved in various formal and informal education, training and skill development processes. These processes empower the local poor people and enable them to participate community development projects.

2.4.3 Microfinance and Women

In developing countries, traditional socio-cultural constraints have restricted women’s participation in the economy. The current lack of dynamism in most national economies has meant there are fewer economic opportunities for women. So with limited education and skills, and few formal employment opportunities, poor women in developing countries often turn to self employment as a means of supporting themselves and their families (Berger, 1989). But they lack the capital, technical and managerial know how and the access to credit, markets, raw materials, and services necessary to expand or even make marginal improvements in productivity and income. Due to restricted access to formal credit institutions most of the self-employed women tend to rely heavily on informal sources of credit and social assets from family and friends, not only for emergency purposes but also for their routine household needs (ibid). At this point microfinance programs play a major role to overcome those problems.

Many of the micro credit programs have been designed to reach the informal sector and they have included high proportions of women among their borrowers, even when women are not specifically targeted. The Badan Kredit Kecamatan in Indonesia, the Fundacion Carvajal in Colombia, Accion Comunitarian in Peru, FEDECREDO in El Salvador, the Self-Employed Women’s Association (SEWA) and Working Women’s Forum in India, and the Grameen Bank in Bangladesh are longstanding examples of women priority programs. Mohammed
Yunus, the founder of Grameen bank offers the explanation why 94 percent of Grameen bank loans reach to women, “Women have plans for themselves, for their children, about their home, the meals. They have a vision. A man wants to enjoy himself.” Women’s access to credit ensures that it will be put towards meeting the household requirements of food, health, and children’s education, much greater than if access to credit was given to men (Rahman, 1986).

Microcredit programs often target female-headed or female-maintained households. In developing countries there are many reasons that make households become female-headed or female maintained families. Sex specific migration, marital disruption and increases in unpartnered adolescent fertility, erosion of extended family system and traditional support networks, and sex ratio imbalances caused by war deaths and civil conflicts result in surplus females in a community (Buvinic et al, 1997). These trends increase the importance of women’s participation in the economy. In developing countries, female headship is more frequent in Latin America, the Caribbean and in Sub-Saharan Africa and is less frequent in Asia and the Near East (Buvinic et al, 1997). But in Jaffna, Sri Lanka civil war had increased the number of female headed households, where women bear the responsibility to provide financial support to the family. Many of these households are widow-headed families (Jaffna Plan, 1998).

Microfinance programs create empowerment-promoting conditions for women to move from a position of marginalization within household decision-making processes and exclusion within the community, to one of greater centrality, inclusion and voice (Sabharwal, 2002). One of the studies about Bangladesh credit programs reveals that the micro credit programs had increased the empowerment of Bangladeshi women in several ways such as increasing the magnitude of women’s economic contribution, mobility in the public domain, purchasing power, ownership of assets, involvement in household decision making, and freedom from family domination and political awareness (Hashemi et al, 1996). Gender equity in the distribution of income, resources and power at
the household level creates a healthy society and thus leads to a broader development process.

2.5 Challenges in Microfinance

Even though microfinance programs have been designed to alleviate the poverty of poor people, their implementation faces many challenges. Microfinance programs may also cause some negative effects in the society where they are implemented. The achievement of the expected outcome depends on what degree the program is consistent with sustainability and the institutional capacity. Financial sustainability is the major problem in many microfinance institutions and due to this problem, most of them face difficulties to continuing the program beyond the project's lifespan. The details of these issues will be discussed in Chapter Three. It would be appropriate to discuss these issues in both a normal and conflict context and to compare them in two different circumstances.

Microfinance programs aimed to reduce the poverty levels may also enhance poverty. Fernando (1999) reported that according to a Central Bank report in Sri Lanka, every year the number of beneficiaries of these programs, who are categorized as poor, had increased. In such circumstances, if poverty remains unchanged there is no point in continuing this program. Because microfinance program may enhance the trend of the poor depending continuously on credit/loan and this is more possible in a subsidy-based microfinance program than in a program that depends on local savings and resource mobilization. The incorporation of savings mobilization in microfinance program could eliminate this trend and allow low income households to build up assets to use as collateral and to enable self finance investments rather than always turning to creditors (Wright et al, 1997).

Another negative impact is the utilization of production loans for consumption purpose. The poverty level of the households forces them to spend loan money for food, clothing, rituals, social obligations and other forms of consumption. This
makes them continuously dependent on credit to meet their expenses and also results in a lack of interest in self employment activities. Ultimately it leads to default of loan repayment, thus affecting the sustainability of the program.

2.6 Challenges of Capacity Building in Microfinance

The micro finance sector everywhere in the world lacks the capacity to support a growing microfinance market that has the twin objectives of significant outreach with sustainability. Giving the poor access to financial services is actually part of a broader development process to reduce poverty by empowering many people who were once excluded. But the analysis of the outreach costs of those microfinance systems reveals that the additional costs of microcredit stem from the small credit size that poor people require, on which transaction costs are relatively high. These high costs threaten the sustainability of microcredit system. This kind of experience was obtained in the microfinance program in Philippines where the credit programs of the government were found costly and unsustainable, leading to gross inefficiencies, financial market distortion and poor private sector incentives to innovate (Getubig et al, 1997, pg 104-105). Furthermore the Philippine experience shows that microfinance institutions that focus on the poor lack the capacity to reach the poor in large numbers. The capacity of credit NGOs to develop and offer innovative financial products was also found to be quite restricted due to their lack of competence in product development; and their lack of appropriate legal status (ibid). This leads towards to the necessity of capacity building in the micro finance sector.

There are a few good providers of quality training in the sector particularly for technical assistance and the design of products and mechanisms. All stakeholders in this sector, particularly donor institutions, banks, microfinance institutions (MFIs), technical assistance providers and accounting firms require capacity building. But few of them specialize in the training. In addition the available training is not much relevant for developing countries. Most of the training programs are either not affordable or not responsive to the needs of
developing countries. Such training programs are neither useful nor practical for all. So it is important to rationalize the key areas of concern to related institutions of microfinance program in building capacity for the betterment of poor community in developing countries. When developing strategies of capacity building, it is mandatory to consider social and institutional factors which play a major role in determining the most appropriate forms of participation in a given context. Furthermore it is important to determine the priority areas of capacity building that leads to the sustainable outreach and further development of the particular program.

Various factors influence the institutional capacity building which in turn influence program sustainability. But the influencing factors vary based on the context and location or place where the microfinance program is being practiced. Microfinance is practiced as a poverty alleviation tool in both normal developing context and disturbed/post conflict context. But the post conflict situation is entirely different from normal context where high population movements, high social and economic devastation, political instability, insecurity, low trust levels, and uncertainty exist. These conditions are absent in normal developing context. These factors point to the need for microfinance institutions to develop their capacity where working in post conflict environments. The microfinance practitioners have to develop relevant strategies or make modifications in the original microfinance strategy to suit them to existing conflict environments. Microfinance approaches being practiced in post conflict context are basically the same as in normal context but they need slight modification. Chapter Three will describe some issues of microfinance in a post conflict environment, especially various factors influencing the sustainability and capacity building of microfinance program in both normal and post conflict context.
CHAPTER 3
Microfinance in a Post Conflict Environment

3.1 Introduction
This chapter will focus specifically on microfinance in a post conflict context. For this purpose comparative international case studies and their contexts will be used in discussing the capacity building challenges of microfinance in post conflict areas. Microfinance is practiced in post conflict situations as a tool in the renovation of crippled economy as a result of hostilities. Micro enterprise could survive during conflict periods and thrive after the conflict because self employment is especially important for income generation in this situation. The post conflict context creates an urgent need to uplift the economy of the conflict affected people. Subsidies and government grants however may make the people dependent on those forms of assistance. Even though people may be interested in creating self-sufficient income generation activities they don’t have enough capital to initiate them.

At this juncture microfinance plays a major role among conflict affected people to reduce their vulnerability by starting new income generation activities. However there are some serious concerns in the implementation of microfinance in post conflict context. Nagarajan (1999) suggested that it is still debatable if microfinance is an appropriate poverty alleviation tool to enhance welfare in a post conflict situation. Lessons emerging from various post conflict situations show that starting microfinance programs immediately after the conflict has subsided may have disastrous results. The stage immediately after the conflict is characterized as more uncertain, more insecure and more susceptible to repeated violence, so it is not the ideal time for starting microfinance or any other development programs. Since the immediate post conflict stage may not be the ideal time to start microcredit, interest free loans or grants are often preferred by war affected people at this stage (Tsilikounas, 1999). But this type of grant giving program tends to develop a dependency syndrome particularly observed in
Uganda, Ethiopia, El Salvador and Nicaragua. On the bright side, the immediate post conflict stage may be suitable for initiating capacity building efforts for efficient provision of financial services so that once the suitable environment is available they would be able to jump-start self employment activities. Microfinance practitioners should thus know the different phases of conflicts, and based on that knowledge they could design appropriate microfinance programs for implementation in post conflict context.

There are four overlapping but distinct phases of conflicts such as situations of submerged conflict, situations of rising conflicts, open and violent conflicts, and fragile transitional, post-conflict situations (OECD, 1997). The transitional stage differs from others because it exists within some sort of peace accord or expectation of peace accord but it is still characterized by insecurity, uncertainty and repeated cycles of violence before settling down. Theoretically it may include an immediate post conflict stage and later stages from immediate post conflict to a normal situation (ibid). The absence of conflict is not a requirement for the start up of microfinance in a post conflict situation (Doyle, 1998). But the area should satisfy the following conditions such as low intensity of conflict, reasonable safety for clients and microfinance officers, ample donor funds, re-emergence of markets, returnees and refugees settling down, minimal social capital, emergence of opportunities for economic activities and presence of NGOs willing to experiment with financial intermediation (Doyle, 1998; Nagarajan, 1999; Larson, 2002).

The rest of the chapter will focus on preferred situations in a post conflict context for the start up of a microfinance program. It will deal with special populations to be considered in post conflict situations. And finally it will discuss various factors that impact the capacity building of microfinance institutions and the sustainability of their programs.
3.2 Preferred Conditions for a Microfinance Program in a Post Conflict Area

Post conflict conditions differ in various aspects from normal developing conditions. In post conflict conditions, social capital is lacking and people get displaced geographically. Big devastation occurs within the basic economy and people tend to depend on welfare or subsidy money. Moreover, basic institutions are dysfunctional, seen in the inefficient operations of the banking system. People lack trust in formal financial institutions and prefer dealing with informal ones. These factors have serious implications for institutional sustainability of microfinance program. Certain preferred conditions such as efficient functioning of the banking system, economics free of hyper inflation, enabling government legislation for microfinance institutions, strong social bonds, availability of a skilled and educated work force, among others are needed for the implementation of microfinance programs especially in the long term.

3.3 Special Population Groups within a Post Conflict Environment

A post conflict area consists of different categories of population groups such as inhabitants, returnees, internally displaced people (IDP) and refugees. The types of microfinance services and demand levels for such services also differ according to the characteristics and needs of each special population.

3.3.1 Inhabitants

Inhabitants are individuals who remain in their own communities for almost all of the conflict. They may have some assets but their ability to use their possessions for economic activities depends on the intensity of the war. But they are very keen to find a way to stop receiving assistance and welfare and seize the economic opportunities after a conflict subsides. Microfinance programs are generally better off including inhabitants in service delivery rather than limiting services to groups in more urgent need (Doyle, 1998).

3.3.2 Returnees

These are former refugees or IDPs who are returning to their original homes or to a new area within their home country. They have probably lost their assets but sometimes they may have some assets like land. Usually they have received
some incentives for their return and resettlement in their native places. Sometimes they may return with some savings earned in the host village or country. So like inhabitants, returnees are also important candidates for microfinance services (Doyle, 1998).

3.3.3 IDPs
IDPs are people who have shifted their homes but lived within their country. They are mostly living with their friends and relatives. They may have property like land, and houses but are unable to access them. IDPs may have the opportunity to earn income during displacement but it depends on how the host community receives them. IDPs can be integrated into credit and savings programs. For example in Bospo in Bosnia and Mozambique, IDPs have been included in microfinance programs. As a result they have been able to leave the displacement camps due to the income generated from their new business (Doyle, 1998).

3.3.4 Refugees
Refugees live outside their country. They are separated from or have lost everything they owned. They are geographically, culturally, or socially isolated and unable to join the host community (ibid). They face tremendous financial hardships and they may be dependent on the black-market or informal sector to fulfill part of their needs (ibid). A micro credit program can provide a way to overcome some of these financial barriers and promote self-reliance among refugees.

So a post conflict area may consist of several special groups of populations created by the conflicted environment. The demand and service needs of each population group emphasize the necessity of different approaches for the economic upliftment of these people. Thus, the governments of the countries affected by war and other foreign funding agencies provide several kinds of subsidies and grants to those people to rehabilitate, reconstruct and redevelop their life. But this strategy doesn’t work well, instead, it develops the dependency syndrome among those people who may remain poor forever. This realization
has led to a turning point in the work of several INGOs and donor agencies that now emphasize building local capacity as an ideal strategy rather than merely giving subsidy or grants to the affected people. Microfinance Institutions also concentrate on this new concept and have added it in their agenda. The capacity building in normal context and post conflict context is basically the same but microfinance practitioners should clearly understand the post conflict context and the need to make slight modification or alteration in their basic microfinance strategy to address the special needs the existing post conflict environment. The next section will describe the capacity building of microfinance in post conflict context, particularly the different challenges experienced in building the local capacity for microfinance in normal and post conflict contexts.

3.4 Capacity Building of Microfinance in Post Conflict Area
In recent years there has been an important turning point in building local capacities in conflict and post conflict situations. International and local agencies have long failed to identify indigenous resources and skills, and they have missed actual opportunities to involve civil society such as local NGOs, Community Based Organizations, religious based organizations, and other grassroots level organizations in the management of relief and peace building in conflict and post conflict areas. Relief assistance alone can undermine rather than strengthen indigenous capacity, leaving poor people with bare hands after the relief assistance period.

Today's internal war or border conflicts are highly destructive and the impacts on civilians are high. They increase the vulnerability of the population and weaken local capacities. Besides having a heavy toll on lives, conflicts also destroy the physical, human, financial and social capital, and reverse economic progress achieved thus far (Nagarajan, 1999:4). It takes about ten years for a post-conflict country to return to the level of economic and human development conditions that existed before the conflicts (Haughton, 1998). So it is essential to fully utilize local capacity for institutional capacity building in post conflict areas.
The quality of local capacity may differ in the pre and post conflict environment (Nagarajan, 1999:11). For an instance, heavy involvement by foreign consultants was necessary in Mozambique since the local capacity to develop and manage microfinance programs was low before conflict and at the initial stages of post-conflict era (Larson, 1999; Vletter, 1999). But there are some instances indicating contrary opinion to the above mentioned trend. For example in Bosnia, while foreign consultants were required for designing programs, they were considered as intrusive in the management of microfinance programs. This indicates that local capacity existed to effectively manage programs in the pre conflict and post conflict years (Goronja, 1999).

Most programs in post conflict areas assume significant risks to personnel and financial viability (Doyle, 1998). This implies a long term view of sustainability than is normally considered in microfinance. The progress towards sustainability depends not only on the usual financial factors, but also on the development of local institutions that can assume the management of these programs (Ibid). So this stresses the importance of institutional capacity building in post conflict areas.

3.4.1 Factors Influencing the Sustainability and Capacity Building of Microfinance Program in both Normal and Post Conflict Context
It is recommended that any micro finance institutions should possess the following five characteristics: 1) demand-driven operations, 2) responsive to the needs and capacities of the poor who are not homogenous, 3) innovative and adaptive with the aim of reducing costs and 4) creating financial services for the poor that can be sustained, 5) able to supplement credit services with other forms of support such as additional opportunities for profitable investment that can strengthen borrowers capacity to repay ( Schneider, 1997 ). Microcredit program should be able to adjust their rules for loans to reduce costs without increasing risk. Similarly, the fund-providers should allow adequate time for microfinance systems to emerge and mature, which means refraining from
setting short, unrealistic deadlines for becoming profitable. The support and promotion of innovations, even if risky, are essential for financial institutions that serve the poor. In some cases, this may mean support for the development of existing institutions rather than creating new micro-credit projects (Schneider, 1997). The following section describes the various factors influencing the sustainability and capacity building of microfinance in both normal and post conflict contexts.

3.4.1.1 Establishing Microfinance Networks

It is very important to establish a stakeholder forum/ network that can co-ordinate and implement all essential activities to support capacity building within the microfinance sector (Nayar, 2000). It plays an effective role in identifying the key constraints and gaps in the capacity of microfinance practitioners. It co-ordinates Capacity building, technical assistance, and knowledge building efforts within the sector, using internal and external resources. Coordinated efforts among policy level stakeholders are nonetheless paramount for the successful development of financial institutions since they avoid unhealthy competition that undermines the market and wastes resources through duplication of efforts (Nagarajan, 1999:11). So it is important to form organizational and informational networks in the microfinance sector.

Organizational networks create linkages among various levels of organizations working in one sector or discipline. At the same time information networks create linkages within an organization, or among various branches of an organization, that enable them to share or transfer updated information and innovations efficiently. Finally both kind of networks in the microfinance sector help to create strong solidarity groups and strong networks among the clients who are highly disturbed in post conflict areas.

Furthermore, networks and partnerships are badly needed even in the most integrated rural development programs that may incorporate microcredit projects. The lack of a comprehensive network leads to limited success and thus
necessitates changes in those projects and programs. Breaking the rural poverty cycle requires multi-sectoral approaches at the macro level, such as the political, legal, and economic environment for the effective working of poverty-alleviation measures. At the meso-level, the specific organizational and institutional environment must be shaped, and at the micro-level, the effective management of social, technical, and organizational innovations has to be put in place. All three levels are highly linked and balanced. Therefore the central administration, local government bodies, and self-help organizations of the rural population should be incorporated as partners. (Gsanger, 1995).

Several initiatives in post conflict countries suffer from uncoordinated activities. In post conflict areas coordination is necessary among donors, between donors and government, and between donors and local organizations (Nagarajan, 1999:11). The success of some of the programs in EL Salvador can be attributed in part to the improved coordination among donor agencies and local organizations (Nagarajan, 1999:12). Goronja (1999) stresses field-level stakeholder coordination in post conflict areas because it helps in the better use of resources and screening of applicants by exchanging client information, planning geographic expansion of program and sharing field level experiences. In the northwestern region of Tuzla Canton in Bosnia, several microfinance programs have achieved success due to regular field-level coordination (Goronja 1999).

In addition to inter-organization network, information networking is another instrument of sustainable development. The Grameen Bank, the pioneer of microcredit, is using its vast network of village banks to establish a network of village telephone service businesses around Bangladesh. They are using digital, wireless telephone technology, targeting poor village women to become village phone operators (Chanda, 2000). The combination of communication services and other development activities creates an opportunity for co-capacity building in that the implementation of one builds capacity for more successful implementation of the other. Integrating connectivity, content, and capacity-
building initiatives in a decentralized network for exchange of information on sustainable development can result in greater progress than individual improvement of each of the parts (Funk, 1999).

3.4.1.2 Strategic Planning and Management
In local capacity building, strategic planning and management are potential tools because they hold the key to capacity building for sound governance (Edralin, 1996-1997). The former enables particular institutions to manage the organization and its future direction in relation to its environment and the demands of external stakeholders. The latter guides the institution in developing and managing the organization’s capacity to assess and adjust the fit between its mission, environment, and operations.

Post-conflict strategies mirror those of normal microfinance strategies in many respects, but there are some key differences (Doyle, 1998: 54). Strategies tend to be more flexible to respond to changing circumstance. Programs include greater focus on mechanisms to build trust among clients. They may offer lower interest rate or grace periods in the initial stages and could be increased as normalcy returns; they often deemphasize savings for security, inflationary, or legislative reasons. Nagarajan (1999) discussed that in order to achieve the objectives and plan the intervention in immediate post-conflict situation and after that, three main strategies can be followed such as (i) relief only, (ii) relief to development continuum strategy; building specialized institutions for every stage of relief, rehabilitation, reconstruction, and development stages, and (iii) linking relief with development and doing no harm to local capacities. This meshing of relief and economic strategies may occur intermittently as crisis reoccurs.

3.4.1.3 Resource Mobilization
The single most important factor which undermines the sustainability of microfinance institutions is their dependency on external resources. Incorporating local savings mobilization in microfinance programs makes sense for a number
of reasons (Robinson, 1995). These include providing an inexpensive source of capital, building up assets of the poor, enabling self finance investments to the poor rather than always turning to creditors (Wright, 1997, and Camillia, 1999: 21). Encouraging the poor to save also represents a way to "encourage aspiring borrowers to take a long term and disciplined view of their money" (Havers, 1996:147). But in the Asia-Pacific Region microfinance institutions have concentrated mostly on providing credit facilities and savings mobilization has yet to receive adequate attention (ADB, 2000c).

In Sri Lanka many local organizations are dependent on external support, so that they are unlikely to persist beyond the life of the project (Goodhand, 2000: 48). Even though the Grameen-type microfinance has been recognized as a successful model in the world, these institutions have the poorest performance in terms of financial self sufficiency. They relied heavily on external funds and lacked emphasis on savings mobilization. But this will likely cause uncertain financial futures for microfinance institution because the grants and subsidies from government and donors have instead stunted the growth of credit NGOs into viable and sustainable financial intermediaries.

The Bangladesh case shows that Grameen institutions have stopped growing, and many of its existing branches could not continue the program due to lower repayment rate. Competition in areas densely populated by microfinance institutions are forced to lower interest rates and donors are also having second thoughts in continuously providing support (Getubig, 1997). As a result, those institutions themselves are looking at new ideas-savings, regulation and so forth. From the Philippine experience, it is recommended that to stay competitive and viable, the microfinance institutions must raise substantial deposits and develop various instruments, especially for the small savers, which will help build their financial base (Getubig, 1997 ). Furthermore while NGOs play a major role in the microfinance sector when compared to government institutions in developing countries, they are not chartered to hold savings and thus face an important
practical constraint to savings mobilization. (Morduch, 2000:626). So this situation does not put them in a position to mobilize and hold the deposits directly.

Comparisons between the demand for savings services and the demand for credit services is still uncertain in post conflict areas. Some practitioners believe that people in conflict-affected areas actually are more inclined to save rather than to invest due to the disturbed situation (Doyle, 1998). In addition, practitioners observe that program managers are preoccupied with the seemingly more urgent demand for credit and, therefore, are not prepared to experiment with different savings products. However most deposit-taking is compulsory, carries risks, and offers little or no interest in post conflict areas (Doyle 1998). The level of economic activity is also a factor influencing the demand for savings. For example, in Tajikistan, Angola, and Mozambique, practitioners report that the potential to mobilize cash deposits on a significant scale is limited due to the fact that the clients and their customers are extremely poor (ibid:24). In the case of Malange, Angola, the managers of the programs chose to eliminate forced savings initially, to avoid screening out poor individuals who the program sought to serve (Gray, 1997). But the greatest hindrance to microfinance program in post conflict area is not demand, but a lack of capital to meet that demand. At this point savings mobilization becomes an important component but what form of savings and the time frame of savings remain uncertainties. Both financial broadening and deepening are needed, comprising the development of new product lines and services; and the implementation of new microfinance technologies and practices that strengthen their financial base.

3.4.1.4 Outreach

Outreach of a microfinance institution consists of two components such as scale of outreach indicating the number of clients served with different types of instruments and the depth of outreach indicating the type of clients reached and their level of poverty (Ledgerwood, 1999: 225). There is a critical need for the
existing microfinance programs to improve their outreach and sustainability, and simultaneously for new programs to be developed. But this will require a considerable amount of resources from the microfinance institutions, donor agencies and governments for administrative expenses and seed capital/fund of microfinance institutions. Getubig et al, (1997) argues that such funding will not lead to sustainable microfinance with maximum outreach without adequate support for the capacity building programs of microfinance institutions. These capacity building programs include training staff and clients, improving lending policies and procedures, developing effective means to target the most disadvantaged people in the community, developing strategies for improving operational and financial self-sufficiency, improving financial management, developing effective information systems, and establishing effective and independent governance structures. Outreach of microfinance to poor households remains small in the Asia Pacific region. ADB (2000c) notes that 95 percent of the 180 million poor households in the Asia-Pacific region still have little access to financial services. Even though Asian microfinance programs are cost effective, they are financially unsustainable due to low interest rates (ADB, 2000a:11). Hence they are not able to achieve maximum outreach.

3.4.1.5 Training of Staff
The guidance and leadership by management, and conducting of staff training courses are important factors in achieving the right kind of staff orientation in microfinance institutions. This is because much of the microfinance institutions’ work is oriented by group formation and motivation of people, through which only adequate borrower commitment can be developed to enable a sustainable program expansion. Outreach depends to a great extent on the number of the microfinance institution’s field staff. The experience from India shows that the outreach of the microfinance programs have grown slowly because there was lack of motivation amongst the field staff to form new groups and to develop the existing members’ capacity to utilize larger volumes of funds (Getubig, 1997).
The experience of microfinance institutions in India reveals that the key factors in improving outreach and impact are client's acceptance of and identification with the program, combined with intensive staff orientation towards motivation work. Furthermore it was revealed that a high level of program acceptability among clients could be achieved through members getting involved in decision-making and the management of group funds (ibid). This leads to the members being able to identify their interest and take initiatives for the enrolment of new members and in motivation work.

In countries devastated by war the human resources of the entire generation has been eradicated because of the migration of educated and skilled people or death through violence or disease. Studies on these aspects cite limited human resource capacity as one of the greatest constraints, which is a common theme in post conflict settings (Larson, 2002:4). Therefore, the lack of qualified people to staff microfinance programs and guide institutional development is a significant problem in these environments (Doyle, 1998:11). Another problem is experienced by organizations as they attempt to evolve from a relief or social services agency to a microfinance service provider shifting staff from a relief to microfinance mentality is so difficult that practitioners advise hiring new staff to initiate credit operations (ibid: 51). This is due to the fact that relief staff are accustomed to large grants from donors and they look after a range of clients' needs other than that of the microfinance program. The microfinance budgeting emphasis is placed on efficiency and cost recovery, which differs from relief programs. Some of these problems could be overcome by intensive staff training.

3.4.1.6 “Credit Plus” Approach

First it is important to discuss the minimalist approach. Minimalist credit means offering only financial intermediation to the poor. The “credit plus” approach takes a more holistic view of the clients’ needs including non-financial services such as social intermediation, enterprise development and social services in addition to financial assistantship (Ledgerwood, 1999: 65-66). Poor people have a lack of
formal education and business training. So they may require special training or technical assistance (Fernando, 1999: 12; Gallardo et al, 1997: 24-27 and Camilla, 1999: 31). Many credit institutions require the possession of skills training as a prerequisite to obtain a loan (Berger, 1989: 1025). The “credit plus” approach fulfill this need to the poor. But the provision of these non-financial services raises the costs of credit projects and adds a further administrative burden, potentially interfering with the program’s ability to be self-sustaining (Berger, 1989: 1026). The addition of training components has been justified as a means to guarantee effective use of credit and improvement in productivity and income for borrowers (ibid).

The incorporation of non financial services into financial services is also emphasized in war devastated areas. As several program designers acknowledge, clients soon realize that qualifying for a loan does not prepare them for the challenging, post conflict business environment (Doyle, 1998: 25). Non financial services are required because many individuals in post conflict areas carry out self employment out of necessity but oftentimes, they lack the experience working outside in the formal employment sector before, and thus lack technical knowledge in self employment activities. As they attempt to grow their enterprises, they greatly need non-financial services. For example, in CARE’s Bosnia-Herzegovina program CARE plans to create a national non-financial services provider called “MikroBizNiz” which will offer technical assistance and training on a demand driven basis along with trade promotion services designed to address the lack of dynamic markets and trade links in present day Bosnia (CARE, 1998).

Training programs should be demand-driven and provided separately from financial services. In Ethiopia, training in tailoring by a microfinance organization was less successful since the market was already saturated with tailors (Colletta, 1996). Further, in El Salvador the training program was less effective in
increasing loan repayment since loans were considered by the local people as payment for the participation in the training programs (Nagarajan, 1999:14).

3.4.1.7 Reaching Target Group

In addition to resource mobilization, the capacity of the microfinance institution to transform mobilized resources into loans for the poor is another important factor for the success and viability of the program. The volume of loans outstanding as a proportion of total resources mobilized indicates the extent of funds available to the microfinance institution for the provision of loan to the poor. In developing countries, several categories of people such as rural inhabitants, women, poor, and uneducated people, continually have been under-saved by financial institutions and micro financial services should reach those people.

Nayar (2000:37-38) discussed how credit for the poor in Sri Lanka based on the traditional micro credit approach (credit only) cannot serve the ultra poor successfully as they need a range of welfare and other services before entering microfinance programs. There are several gaps identified in microfinance service provision in Sri Lanka, such as the poor in remote inaccessible villages, conflict zones and coastal areas. Reasons for these gaps are high cost of delivering services to remote areas, difficulties in accessing the populations living in conflict zones, political influences, lack of infrastructure to access poor, and insufficient knowledge about microfinance intermediation (ibid). Furthermore, in a subsidized microfinance program, loans often end up subsidizing well off, politically connected entrepreneurs (Morduch, 2000: 626) rather than poor households (ADB, 2000a:11). But in Bangladesh and possibly Indonesia microfinance has reached a significant proportion of poor households (ADB, 2000a:11). In Bangladesh over 80 percent of poor households are reached by microfinance services.

In post conflict areas microfinance programs may strive for inclusion, cohesion and participation of eligible members of the community rather than for strict
targeting of a particular clientele (Nagarajan, 1999:18-19). For example, both survivors and refugees need to be included to avoid further conflicts due to rationing of scarce resources (ibid). But in general, microfinance is easier to promote among returnees and internally displaced populations compared to refugees (Tsilikounas, 1999). This is because refugees hesitate to invest their money in self-employment activities in their current residential areas that they view as a temporary place in the hope of returning back to their native place once the war subsides. Elzoghbi (1999) states that the provision of microfinance in newly created refugee camps is to be strictly avoided. The efficiency of the microfinance program in reaching the target group is also influenced by the location where the target people are living in the post conflict context. Practitioners observe that rural microfinance programs may suffer if expansion areas are inaccessible because of un-repaired infrastructure damaged in conflict (Doyle, 1998:22). Urban programs may also suffer delays due to repairs even though urban people may be the first to see a return of the banking infrastructure.

Microfinance agencies operating in post conflict areas also tend to focus on women rather than men because of high rates of female headed households after conflict, greater repayment rate among female borrower, and attempts to empower women as peacemakers in a war-torn society, etc (ibid). But in a post conflict environment, there is a demand for microfinance services from men and women alike, because of failed banking systems and high un-employment (ibid). In most instances men tend to request larger amounts than women.

3.4.1.8 Influence of Informal Credit Source
Most of the poor people in low-income countries practice traditional and informal methods of savings and credit. People have a stronger belief and trust in these saving methods than the formal institutions, while they also face psychological barriers in approaching banks that doubt their creditworthiness (Getubig, 1997). Many bankers, economists, and government official assume that the informal commercial credit market works efficiently, satisfies demand, and helps the poor
(Robinson, 2001: 13). A common view is that widespread use of informal finance suggests that it is well suited to most rural conditions (Von Pischke et al, 1983). Gonzalez (1993) revealed that most informal lenders provide valuable financial services at a reasonable cost to borrowers. In some cases however, poor borrowers are usually charged higher rates by moneylenders than others because they have few options, and low bargaining power (Robinson, 2001: 16). In Sri Lanka the shares of formal and informal credit in the Rural Sector (1981/82) are 40 percent and 60 percent respectively, including 14.7 percent money lenders; 45.7 percent semi-professional money lenders; 34.4 percent friends and relatives; 5.2 percent others, respectively (Central Bank of Ceylon, 1981/82).

Microfinance institutions face no competition from the formal financial sector because the latter consciously avoids the poor. But traditional sources of informal credit continue to be the major source of microfinance for the poor and this limits outreach and concentration of microfinance institutions in any given area. Getubig (1997) said that in Nepal the outreach of informal financial institutions, particularly rotating local savings and credit groups, appear to be far greater than that of the formal system such that finance companies have started to mobilize savings throughout the informal sector.

People in post conflict areas also have more faith in informal financial sources than formal ones. In post conflict environments, often the currency has changed and the banking system has collapsed. As a result, microfinance practitioners observe initial resistance from clients who have a fundamental mistrust in financial institutions (Doyle, 1998:11). In Afghanistan, Save the Children has been able to use traditional informal structures for transferring money to branches (Larson, 2002:4). The Save the Children office in Kabul gives money to a Kabul-based family member, who in turn instructs a family living near the branch office to give the amount to the local savings branch. So, most
microfinance programs overcome resistance by establishing credibility with local community representatives and by demonstrating results early in the program.

3.4.1.9 Social Network
Trust among clients is an important base for the success of a microfinance program. But in post conflict areas social capital is highly disturbed or destroyed by war and it is necessary to rebuild it. Furthermore conflicts do not end after the fighting stops (Larson, 2002). Violence can affect the behavior of people in various ways such as lack of respect for the rule of law and incidents of threats, intimidation, and violence. So the program should spend considerable time to form strong solidarity groups and strong network among clients (Doyle, 1998:11).

3.4.1.10 Flexibility
A microfinance program should be flexible. There is no single model suitable for promoting the development of microfinance. Studies on microfinance in Indonesia show that it had made great progress in extending financial services to almost all segments of the population because of developing its own approach instead of replicating successes of other countries like Bangladesh (Getubig, 1997), Indonesia has found its own unique way of managing rural finance and eradicating poverty. It includes upgrading of informal, semi-formal and formal microfinance institutions and linking up those with banks as refinancing institutions, thus strengthening their financial service capacity and deepened outreach. The major conclusion from the Indonesian experience is that no single approach or single type of institution will achieve success in mass poverty eradication. Instead, a systems approach to microfinance is preferred to promote access of financial services for all segments of the population.

In post conflict areas program implementers initiate programs with similar strategies as in normal developing settings but they are doing it with more flexibility. But flexibility in design should not undermine the credibility of the organization. The majority of modifications made subsequent to program start-up
relate to low trust levels, the lack of physical collateral or assets, and the need to address major barriers through additional training (Doyle, 1998:32). Collateral substitutes such as the use of religious leaders as loan guarantor in Uganda (Colletta, 1996), land tax receipts to verify property titles in Cambodia (Nagarajan, 1999:15) and others are effective in post conflict situations. This facilitates potential poor people to get into this program. For example in Cambodia, microfinance institutions started cautiously with pilot programs and set very modest objectives (Larson, 2002:4). This allowed them to adjust policies and practices, systematize operations, train staff and understand the operating context.

3.4.1.11 Monitoring and Evaluation

The two criteria of outreach and self sustainability act as a yardstick of micro credit program evaluation (Mahajan and Ramola, 1996). An ideal method for program evaluation is therefore an integrated approach that carries out cost-benefit analyses of alternative programs promoting the welfare of both target and non-target households (Khandker, 1998a:14-15). But in most developing countries' monitoring and evaluation systems are concerned with the progress of implementation, rather than the assessment of the social, economic, and environmental impacts of projects. One of the most neglected professional capacities of development organizations is their ability to adequately monitor and evaluate their development projects (Noponen, 1997). In developing countries, many donor agencies have been playing a role in planning, implementing, and financing various socioeconomic development programs and projects, but in many cases, the outcomes of these interventions do not match the intended objectives and many governments and donor agencies fail to see the benefits of the evaluation (Noponen, 1997; Khan, 1998).

Evaluation and monitoring of a program or a project is a very important tool if an organization is to efficiently learn from its experience and feed this learning back in for improved program performance, expansion, documentation and adaptation.
into other areas. But the success of the initiatives to evaluate capacity building in developing countries seems to have been constrained by a lack of a unified approach; inadequate appreciation and analysis of governmental culture; confusion about concepts and methodologies; lack of long-term commitment; and lack of interest or resources from recipient governments (Khan, 1998). Future evaluation of capacity-building work will need to make a careful analysis of these constraints and approach the subject with far greater sensitivity and technical knowledge.

Another evaluation strategy is rethinking of participatory monitoring and evaluation that centers on the participant community where the participant community becomes not only data gatherers, but also analysts and data archivists (Noponen, 1997). This is similar to participatory action research in that community members collect, analyze, act upon and ‘own’ their data and they also use the internal learning system to reinforce program values, to celebrate achievements and to chronicle their path of struggle and development. Noponen (1997) described a prototype model for an Internal Learning System to monitor and evaluate livelihood and microcredit programs which highlights the following characteristics: 1) participatory vs. extractive learning process; 2) use of simple, pictorial systems suitable for people of low literacy skills; 3) decentralization of data collection and use; 4) flexibility in structure and content; 5) data collection other than inputs and outputs, e.g., data on changes in living conditions, socioeconomic impact, and social status; and 6) creation of a longitudinal panel data set. Uses of the model include data collection, assessment of change or impact, analysis of patterns or causes of change or problems, plan or feedback information, and documentation of results and achievements.

Reviewing the literature reveals that viable and sustainable microfinance programs need sound capacity to meet various demands in every stage of the development cycle. In that way, every microfinance institution has to build up its internal management capacity.
In post conflict areas it may be difficult and may not be cost effective to evaluate young programs operating in an immediate post conflict stage. Problems due to attribution and lack of counter-factual evidence may lead to spurious results even in a normal peaceful country (Nagarajan, 1999:9). An indication of growth, real interest rates, good recovery, good governance and aptitude to become sustainable may suffice for programs operating at very early stages of post conflict (ibid:20). But evaluation of programs in a conflict affected country after three to four years of reasonable stability may follow the same set of rules applicable to a normal country (ibid).

This chapter has described the application of microfinance in post conflict context and also discussed the influencing factors on institutional capacity building as well as on program sustainability. The next chapter will focus on the microfinance experience in the Sri Lankan context.
4.1 Introduction

The previous chapter on issues of microfinance in post conflict context used various comparative international case studies to discuss the capacity building challenges of microfinance in post conflict areas. This chapter is going to narrow its focus area from the international context to the national context of Sri Lanka. It is going to cover several aspects of Sri Lankan microfinance under the topics of poverty in Sri Lanka, need for microfinance at different levels— the poor, various microfinance providers, different microfinance approaches, government interventions, and finally it will discuss the issues and problems of capacity building and sustainability. The efficiency and weaknesses of the microfinance sector could be identified in these topics, particularly how much it could reach the poor in conflict areas. This discussion could suggest the capacity building needs for sustainability in this sector, especially the challenges of capacity building of microfinance institutions in post conflict areas.

The commencement of formal microfinance in Sri Lanka might be as early as 1906 with the establishment of the SANASA society which is also called Thrift and Credit Co-operatives (TCCS) (ADB, 2000d). These societies were formalized in 1911. This sector grew most rapidly during the last twenty years. Microfinance has been given a central role in government poverty reduction programs since 1989 and in 1992 a presidential commission on finance and banking supported the development of a “pluralistic” approach to rural financing (ADB, 2000d: 283). Even though formal financial services play a major role in the provision of credit to the poor, many informal credit providers including money lenders, merchants, friends, relatives, etc., compete with formal Microfinance Institutions (MFIs). From 1986 to 1987, a central bank survey revealed that approximately three quarters of credit transactions in Sri Lanka came from the informal sector (Senanayake, 1999).
In Sri Lanka approximately 350 MFIs are functioning and this figure even excludes the government sector (Nayar, 2000). The microfinance service providers in Sri Lanka can be listed under three categories: 1) government, 2) non-government or private and multilateral, and 3) bilateral and international non-governmental organization (details are given in the later section). The experience gained from various microfinance programs revealed that overall microfinance has been successful in mobilizing savings and providing emergency credit for the poor. But generating small scale enterprise among the poor has been more difficult. Even though the microfinance sector is growing rapidly, there is a concern about the extent it meets the needs of poor and the sustainability of the programs in the long term.

4.2 Poverty
In Sri Lanka almost 85 per cent of all poor reside in rural areas. Poverty is therefore a major problem in the rural sector. Table 4.1 shows the incidence of poverty in Sri Lanka by sector.

Table 4.1: Poverty in Sri Lanka by sector

<table>
<thead>
<tr>
<th></th>
<th>Incidence of Poverty %</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Lower Poverty Line</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>27</td>
</tr>
<tr>
<td>Rural Sector</td>
<td>32</td>
</tr>
<tr>
<td>Urban Sector</td>
<td>16</td>
</tr>
<tr>
<td>Estate Sector</td>
<td>14</td>
</tr>
</tbody>
</table>


Between 1985/86 to 1990/91 rural poverty declined slightly, indicating that the eradication of poverty is relatively difficult. But urban poverty increased
marginally during this period and this is probably due to the elimination of food subsidies under structural adjustment programs (Nayar, 2000). Among the 24 districts in Sri Lanka, poverty is highest in the Moneragala district and lowest in Colombo and Gampaha districts if conflict areas are excluded (Gunewardena, 2000). Poverty is probably highest in districts experiencing frequent conflicts but relevant data of those districts are rarely available.

In the Sri Lankan poverty situation, the majority of poor people are closely concentrated around the poverty line\textsuperscript{1}. This indicates that poverty rates will fluctuate by small changes depending upon economic conditions (Nayar, 2000). Because the majority of poor people are engaged in day to day earning work such as laborers in agricultural field, and construction areas, informal sector work, animal husbandry, fishing etc., they are unable to attain a regular, stable income and to accumulate savings. These poor people are facing several problems such as lack of assets, lack of credit access, physical infrastructure facilities, raw materials, market facilities etc.

Since the late 1980s, poverty alleviation has become a major issue in Sri Lanka's development policy framework (Nayar, 2000). Earlier Sri Lankan governments did conduct subsidy programs. But since the 1980s the government has developed a new approach to poverty alleviation, with the primary aim of improving access to credit by the poor who have lack access to capital, considered the major constraint among the poor in starting any income generating activities. At this point, microfinance programs play a major role in Sri Lanka's poverty alleviation programs.

\textsuperscript{1} Lower Poverty Line=791.67 rupees per person per month; Higher Poverty Line=950.00 rupees per person per month. Source: Gunewardena (2000)
4.3 Needs of Microfinance

Poverty is not uniform or homogeneous. Instead, it has several gradations (Remenyi, 1991). In Sri Lanka, the microfinance poverty pyramid has four strata (See figure 4.1). The microfinance needs of the poor vary based on where the poor are located in the poverty pyramid.

**Figure 4.1: Microfinance Poverty Pyramid**

- Enterprising poor (<10%)
- Above survival poor (<35%)
- Below survival poor (>35%)
- Ultra poor (<20%)


According to the Sri Lankan microfinance pyramid, 10 per cent of enterprising poor households located at the top of the pyramid need credit and the ultra poor (20 per cent) located on the bottom of the pyramid, need microcredit. Approximately 70 per cent of the poor cluster near the poverty line. They lack access to capital and need money for their income generating activities.
The enterprising poor are located in both rural and urban areas and they face difficulties in the business cycle. They need to increase both quality and quantity of their product to compete in the market. Therefore such poor need larger loans ranging from SLR 20,000 to 50,000 for their business activities but those clients do not have adequate collateral to secure these loans (Nayar, 2000). Moreover the success rate of their business is fairly low, about 15 per cent because of political favoritism, unfavorable policies, market competition, lack of marketing facilities and lack of technical know how (ibid). In addition to credit, these clients need non-financial services such as management training, account training, markets, and other technical training. This increases the service cost of MFIs and these expenses are often subsidized by financial resources from donor grants or in collaboration with the government.

The segment of the poor at survival and below survival levels require basic micro credit loans ranging from just under SLR 5000 to SLR 15,000. These loans are used to establish small income generating activities at a very small scale. In the long term, a few of these businesses become large scale business but in most cases their size remains the same because many household level activities, especially consumption needs, are fulfilled by using income derived from these self employment activities.

The ultra poor and internally displaced people are marginalized populations in Sri Lanka who are living in remote and inaccessible rural areas. Their main occupations are labor work and seasonal work in agricultural fields. This category also includes the internally displaced people from conflict areas. The ultra poor require non-financial services rather than credit to prepare themselves to become active participants in savings and credit programs.

Moreover, the needs of internally displaced people are more complex and acute than those of the ultra poor. They face frequent displacement from their homes and native places, causing them severe economic dislocation. In addition to this
material destitution and the indignity of life in refugee camps, they also suffer from post-traumatic stress while continuing to face the fears and insecurities associated with living in an area of conflict and violence (Nayar, 2000). Furthermore credit lending to this kind of poor people involves high risk because they don't have permanent housing and long term perspectives, and instead tend to focus on their immediate needs. They may utilize production loans for consumption purposes. Micro credit provisions in conflict areas are far more difficult and frustrating than those found in other places in the country (ibid).

4.4 Microfinance Institutions
Table 4.2 shows the brief overview of microfinance providers in Sri Lanka and details of major institutions are given below.
### Table 4.2: Microfinance Institutions in Sri Lanka

<table>
<thead>
<tr>
<th>Sector</th>
<th>Government</th>
<th>Non-Government</th>
<th>Multilateral / Bilateral &amp; INGOs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formal sector</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Institutions associated with microfinance program</td>
<td>Central RRDBS</td>
<td>Hatton national bank (HNB)</td>
<td>UNDP</td>
</tr>
<tr>
<td></td>
<td>Bank</td>
<td>National development Bank</td>
<td>UNHCR (conflict Areas)</td>
</tr>
<tr>
<td></td>
<td>Peuples' Banks</td>
<td>Development Finance Corporation of Ceylon (DFCC)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>State Bank of Ceylon</td>
<td>Pramukha Development Bank</td>
<td></td>
</tr>
<tr>
<td></td>
<td>owned National Savings Bank</td>
<td>Ceylinco Development Bank</td>
<td></td>
</tr>
<tr>
<td></td>
<td>banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Microfinance Institutions (MFIs)</strong></td>
<td>MFIs set up by Central Bank</td>
<td>Sarvodaya/ SEEDS</td>
<td>CARE</td>
</tr>
<tr>
<td></td>
<td>Samurdhi Banks</td>
<td>SANASA Bank &amp; PTCCs</td>
<td>SAP</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Janashakthi Banku Sangam-Hambantota (WDF)</td>
<td>FORUT</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Agromart Foundatuion Ltd</td>
<td>SCF</td>
</tr>
<tr>
<td></td>
<td></td>
<td>NFPO</td>
<td>Oxfam and others</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sewa lanka</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Co-operative Rural Banks</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>And others</td>
<td></td>
</tr>
<tr>
<td><strong>Traditional village based financial services</strong></td>
<td>Merchants/ Money lenders</td>
<td>Community based organizations</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(CBOs) such as Death</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Benevolent Societies</td>
<td></td>
</tr>
</tbody>
</table>

Most of the finance institutions above are providing services to the southern part of the country. Due to the prevailing conflict situation most of the credit programs are absent in the conflict zone including the northern and eastern parts of Sri Lanka. The government is carrying out several micro credit programs all over in Sri Lanka but it has extremely limited its activity in the northern part of the country due to the ongoing civil war. The government is conducting very few programs in the areas along the border areas in the northern and eastern parts of the country which is a combination of cleared, under the fully control of the government, and uncleared areas. However the Liberation movement dominated some areas not under fully control of the government. Samurdhi (prosperity) a national government program has also started credit and bank operations in conflict zones but its activities are also limited. A 1999 CARE study on microfinance in northern Sri Lanka, found that the marginalized and vulnerable people didn’t have timely access to credits. There are about 31 branches of commercial banks and about 9 branches of the National Savings Bank functioning all over the Jaffna Peninsula. Two state owned banks such as the Bank of Ceylon and the People’s Bank deliver 85 per cent of the credit services for the Jaffna population and the National Savings Bank provides the rest of the credit facilities (CARE International, 2000-2001). But the National Savings Bank gives credit on a secured basis and the borrower must have some amount of savings in the National Bank. The People’s Bank was established to provide services to the population who were overlooked by the Bank of Ceylon. Because of the failure of government’s attempt to reach the rural poor, too many rural banks were created which were mainly located in the rural areas all over the island. In Jaffna many Rural Banks have been established to cater to the rural poor.

4.4.1 International NGOs
The various UN agencies consisting of the UNHCR (Office of the United Nations High Commissioner for Refugees), UNICEF and UNDP (United Nations Development Program) are major players in conflict zones and they are doing
several micro credit programs. Furthermore many INGOs have been involved in microfinance activities all over Sri Lanka but their activities are most significant in the conflict zones because they are perceived as neutral agents. In conflict zones the INGOs such as CARE International, Oxfam, FORUT, ACF and SCF play a significant role in providing microfinance services to the conflict affected people. CARE is the major player in providing microfinance services in conflict areas. Oxfam and SCF are also doing some microfinance programs in a few selected areas. FORUT has been doing microfinance programs in border areas.

4.4.2 Government Institutions
The Sri Lankan government provides a significant contribution in both the formal banking sector and the pro-poor MFI sector and it plays a major role both in terms of financing and outreach. Microfinance borrowers tend to rely largely on informal credit sources (Gunatilaka, 1999) because of the greater flexibility, easy accessibility and quick services despite the very high cost of finance. The Sri Lanka government has used both commercial banks (state/private) and Regional Rural Development Banks (RRDBs) as a channel for its poverty alleviation program. For example, the Janasaviya program operated from 1989 to 1994, and included micro credit disbursed through the state commercial banks and RRDBs (ADB, 2000d). In addition to this the Samurdhi program implemented since 1995 relies on credit managed by the two state banks.

The Samurdhi (Prosperity) movement is a wholly government funded program which commenced in 1995. It provides income support services and other welfare transfers and also aims to address unemployment problems among the youth. Apart from this, Samurdhi has also operated a microfinance scheme since 1996. For that it has formed Samurdhi Bank Societies (SBSs) which are practicing a self-help group method to promote savings and disburse credit. The major objective of SBSs microfinance lending is stated as reducing the “income vulnerability” of the poor. Its loan comprises about 70 per cent of self employment loans and 25 percent loans for cultivation (ADB, 2000d). By the end
of 1997, about 260 SBSs mobilized more than 400,000 members with savings of SLRs 49.2 million ($0.7 million) (CBSL, 1998). SBSs are also used as vehicles for a variety of other government financed lending channeled through the two state commercial banks.

Even though the government is carrying out several microcredit programs all over the country the state owned programs are not very viable because the government institutions do not possess the necessary capacity to deal with the various types of clients ranging from the ultra poor to the enterprising poor. Furthermore the government microfinance institutions are also prone to political interference, causing micro credit to go improperly to ineligible clients, thus affecting the sustainability of the program. The government institutions do not have adequate technology in intermediating microfinance in efficient ways. They also lack human resource capacity in microfinance field. Due to this problem they couldn't maintain close contact with clients and do intensive monitoring, thus leading to more incidences of loan default. Besides most of the government program always stick with the subsidy based program, and there is a lack of innovation in financing the poor in sustainable way. Most of the government institutions are not transparent in their activities, in that they do not document their learnings from their programs, their successes or failures, and they are not ready to exchange their experiences with other private program implementers. Because of this they tend to do the same mistakes repeatedly. So these weaknesses enhance the institutional capacity building of this sector.

4.4.3 Non-government/ Private Institutions
The non-governmental sector has been historically associated with the microfinance sector in Sri Lanka. When compared with governmental institutions, the private sector plays a major role in the microfinance sector. It has recently expanded significantly and is mainly dominated by larger NGOs and TCCS. NGOs are a major class of organizations operating MFIs. They get a legal personality through various paths such as registering as nonprofit organization
under the Companies Act of 1982, or registering under the Societies Ordinance. Some NGOs like Sarvodaya are functioning under their own legislation. Some NGOs including MFIs operate without registration. But modes of registration are important for MFIs operations and without legal personality NGOs are unable to enter into contracts with financial institutions (ADB, 2000d). NGOs are not subject to restrictions on lending in Sri Lanka but the prohibition applies to deposits from members of MFIs as well as to those from non members, and to savings collected as a compulsory condition for receiving a microfinance loan (ibid). Any such savings must be deposited in a regulated financial institution and may not be used by MFIs for re-lending. But Samurdhi has an exemption and operates under its own legislation, the Samurdhi Authority Act, and is empowered to collect savings through Samurdhi bank societies and self-help groups. This activity creates confusion regarding government policy on the microfinance sector in Sri Lanka. Although it has been stressed that finance companies legislation should be amended to permit NGOs to accept deposits, this has not been pursued further.

Furthermore, state owned commercial banks have not engaged in microfinance to any significant extent except Samurdhi and Janasaviya programs. In contrast, the Hatton National Bank (HNB), the leading private commercial bank in Sri Lanka, has created an innovative and successful program called *Gami Pubuduwa Upadeshaka* - ("village reawakening") (GPU) which commenced in 1989 (Fernando, 1999; ADB, 2000d). GPU targets small and micro savers and borrowers in rural and semi-urban areas. Most banking transactions are carried out at the grass root level rather than at the bank level. Then most loans are processed on an individual basis. Local NGOs provide social intermediation services which link the poor with HNB.

The National Development Bank (NDB), Pramukha and Ceylinco have recently entered into the microfinance sector, though they don't have much experience in microfinance. NDB currently functions as an apex and direct lender for the credit
guarantee schemes aimed at the small industrial sector financed by the World Bank and the Asian Development Bank (Nayar, 2000:12). Among formal, non-government microfinance providers, co-operatives comprising co-operative rural banks and TCCS make significant contributions.

In 1911 TCCS or SANASA were established and have been functioning ever since under the Federation of TCCS (FTCCS). In 1995, there was tabulation of 7992 primary TCCS having total membership of 726,000 (Kiriwandeniya, 1997). Primary societies function at the village level and the administrative members come from the village community. The primary functions of each TCCS are mobilizing local resources, savings and providing loans for income generating activities and consumption of poor people. Even though the primary societies have made an effort to incorporate a large proportion of the poor into its membership, the leadership at the primary society level still consists mainly of village level superior people and poor people have been continuously ignored (Attanayake, 1997). Moreover, the majority of societies, except a few, are weak due to a number of reasons such as government ignorance, poor leadership, etc (Kiriwandeniya, 1997). SANASA serves as a channel for a number of governments and internationally funded microcredit schemes, in addition to its own core activities. The SANASA movement has created a new SANASA Development Bank in 1997 which intends to develop as a full commercial bank in due course. This will strengthen the SANASA movement to become a sustainable rural credit institution and to raise the income levels of the poor through a sustainable approach (Kiriwandeniya, 1998). It has already started several group lending schemes as well as having entered into 'joint venture' with NGOs and Community Based Organizations (CBOs) to finance their poverty lending (ADB, 2000d) and to achieve sustainability.

Another cooperative institution is the Cooperative Rural Banks (CRBs) which are small institutions affiliated with Multi-Purpose Cooperative Societies (MPCSs) in 1999 (CBSL, 2000) and controlled by the Department of Cooperatives. CRBs are
effective mobilizers of savings but they are less effective in rural financial intermediation with their large client base (ADB, 2000d). But it couldn’t adopt a sustainable lending approach to the poor because of its affiliation with MPCS, whose approach to lending is tied to the politicization of attached CRBs.

The local NGOs especially Sarvodaya and SANASA were active in the pre conflict period but after the onset of intensive conflict, both of them have limited their activities. SANASA has withdrawn from most areas in the conflict zone. Sarvodaya is still involved in relief and rehabilitation work in those areas. But there is lack of data available on micro credit program in conflict zone. Anyhow it has been observed microfinance efforts in the conflict zones are being carried out in a piece-meal and ad hoc manner (Nayar, 2000).

From the above mentioned discussion it is obvious that non-government/private institutions play a larger role in the microfinance sector than that of the government institutions in Sri Lanka. Even though they perform well in this sector they have several weaknesses in their field. They lack networks among themselves as well as with the government institutions. Local NGOs tend to rely on donor fund or government fund to run their programs. Because of this nature they couldn’t function independently and most of the time they are indirectly or directly controlled by funding agencies. Furthermore, INGOs tend to depend mostly on local NGOs to implement their program. Because INGOs are weak in the knowledge of the local context of program implementing areas, they choose local organizations as their implementing arms. So the successes of those programs depend on the reliability of the local organizations. Further, INGOs are very keen in implementation rather than the evaluation of the program. Like the government institutions, most of the local and international NGOs are not ready to exchange information about the strength and weaknesses of their program with other microfinance institutions because they think that if they release information on the negative results of the project then their funding will be cut off. Because of these weaknesses most of the programs couldn’t reach maximum outreach and attain sustainability in the program. These conditions exaggerate
the necessity of further building institutional capacity of those microfinance institutions.

4.4.4 Traditional Money Savings Method

"Seettu" is a traditional money savings method in Sri Lanka that is practiced by the poor as well as rich people. The participants form groups (15-20 people) which contribute an agreed sum of money to a pool on a daily, weekly, bi-weekly or monthly basis (http://www.gdrc.org/icm). The pooled money is given to one member of the group at a time. The selection of the money receiver is done either by agreement or by drawing lots. The "Seettu" enable the poor to gain access to a lump sum of money which they would otherwise not be able to acquire. Generally women are more involved in this system than men. Currently in Jaffna several types of "Seettu" are available. However, basically all could be categorized into two major types.

- **Lottery seettu**
  Every week, two weeks or monthly the group chooses one name by drawing lots or through an agreed name order.

- **Discount seettu**
  In this type the person who needs money urgently takes money in a month given by giving some discount of the amount. If more than one needs money at a time the very urgent needy person will try to get money by discounting more money, thus competing with the other person. In this method, the last two persons in the groups receive money without giving any discount because the last two persons make a mutual understanding between them to avoid competition in money taking.

Even though this traditional savings system has some flexibility it is a less secure method and there is no guarantee to raise the level of members' savings. This "seettu" money is utilized for education, purchasing assets, purchasing jewellery, dowry, settling other loans, children's education and so forth. Before Jaffna was disturbed by the civil war the "seettu" savings system was practiced in each and
every nook and corner in various scales. Presently the “seettu” system is not being practiced as frequently compared to the last ten year period. Among the resettled people, they have yet not restarted their income generating activities properly and continue to suffer due to lack of income. Lack of trust, uncertain situations, and previous bitter experiences have prevented most people from practicing “seettu” on a large scale, though it is still being practiced on a small scale.

4.5 Microfinance Approaches
In Sri Lanka, there have been several microfinance approaches such as barefoot banking model, the Grameen model in rural areas, Grameen variant urban models and “credit plus” models (Nayar, 2000) practiced in various places.

4.5.1 Barefoot Banking Model
Generally the formal banking sector follows conventional banking procedures to provide loans to the poor. That means people go to the bank to get the loan. But the barefoot banking model takes the bank to the community in the form of a loan agent (eg: HNB’s -Hatton National Bank, Gami Pubudu Upadeshaka scheme). (The loan agent acts as an advisor to clients on financial and non financial issues and he or she directs and advises the poor on how to access non-financial services from other government and non-government agencies. The success of this model depends mostly on creating trust among people and establishing relationship banking, by encouraging people towards savings deposit (Nayar, 2000).

4.5.2 Grameen Model in Rural Areas
In this model village level catalyzers or social mobilizers encourage poor households to form themselves into groups, help each other and pool their labour in community based work, and thereafter undertake savings and credit activities within the group (eg: Samurdhi bank program). Once the basic groups of five to seven members have been established, they form village level primary
societies that are coordinated by village level associations. Then the village level associations are federated at the divisional or sub-district level. Sometimes, in the case of larger microfinance organizations the divisional level associations are federated at the district level. The primary societies serve as alternative collateral for loan repayment and are also responsible for loan provision and collection (Nayar, 2000).

4.5.3 Grameen Variant in the Conflict Zone
This model is mainly operated by UNHCR in conflict areas in Sri Lanka to build the capacity of conflict affected people to prepare them to meet their basic needs. The group size varies from 5 to 30 members. They have their own rules and regulations and function independently. Group meetings take place once a month, but group members have more frequent interaction. Groups are required to maintain reports including financial statements, loan portfolios, etc. The loan program is designed based on individual client’s needs, capacity to absorb and manage the loan, and ability to pay it back. Loans are given at a subsidized interest rate. They are first given to a group, which disburses it to its members. But the sustainability of this program is doubtful because of the lack of appropriate communication and coordination between agencies working in the conflict region (Nayar, 2000).

4.5.4 Urban Models
The Grameen model is more effective in rural areas and it couldn’t achieve considerable outreach in urban areas (Gunatilaka et al, 1999). This is because households in urban areas are less dense and people’s lives are more individualistic in nature than rural people. This results in a lack of social interaction among people which causes decreased effectiveness of the Grameen model. Some NGOs like Sewalanka are currently practicing an urban model on an experimental basis which uses group liability, but transactions are conducted on an individual basis by using door-to-door collectors and mobile banks for the collection of deposits, repayment and interest installments. So this model does
not require regular group meetings and thus reduces the service costs to the MFIs as well as reduces transaction costs to the poor (Nayar, 2000).

4.5.5 The “Credit Plus” Model
This model is mostly utilized for the enterprising poor in Sri Lanka to provide non financial services in addition to credit service. For example, the Sarvodaya Economic Enterprises Development Services (SEEDS) provides “credit plus” microfinance services to the enterprising poor. SEEDs encourages clients to move away from subsistence agriculture to enterprise development. It seems to encourage the agro based industry including manufacturing of value added production and processing, etc. At the initial stage of this model, the SEEDs loan portfolio consisted of 80 per cent agricultural loans, but more than twenty years later, non-cultivation loans amount to 70 per cent of its loan portfolio. The non financial service includes technology transfer, management training, transport service, etc (Nayar, 2000).

4.6 Government Intervention
The Sri Lankan government interventions in microfinance sector have caused both positive and negative impacts in the development of the sector (Nayar, 2000). Details will be given in the following sections.

4.6.1 Contradiction and Overlaps
The Sri Lankan government has multiple roles in the microfinance sector which has led to some contradictions in the policy environment and overlaps in its execution. The government regulates the financial sector through the Central Bank and at the same time the Central Bank itself is also involved in lending to poverty alleviation programs through a variety of schemes. Moreover, two state owned banks currently have at least 60 per cent of the formal financial market while maintaining a noticeable presence in providing financial services in rural areas (Nayar, 2000:20).
4.6.2 Ambivalent Nature
The government approach in microfinance activities has been ambivalent. On the one hand, the Sri Lankan government has identified NGOs involvement in the microfinance sector as an essential part in the Sri Lankan poverty alleviation program. Because of that, the government established the National Development Trust Fund (NDTF) in 1991 to such NGOs and required their partners to mobilize savings from clients and to use those savings in their credit programs. At the same time the government prosecuted non-partner groups (eg: Sarvodaya) for doing the same thing (Nayar, 2000).

4.6.3 Restricting the Growth of Microfinance Sector
The legal structures regulating Sri Lanka’s microfinance sector have restricted the growth of this industry in two ways. First they have imposed restrictions on the intermediation of savings. NGOs have been restricted to do savings mobilization from clients even though NGOs are major microfinance providers in Sri Lanka. This result is that most of the MFIs in Sri Lanka lacking financial sustainability. Secondly, the legislative framework has failed to resolve serious issues relating to financial prudence and the security of savings deposits in the sector (Nayar, 2000).

4.6.4 Flexibility Towards INGOs
In the case of INGOs, there is no legal structure governing their operation in microfinance. INGOs have been permitted to provide financial support for local NGO partners. They need only to sign a memorandum of understanding with the Ministry of Finance and Planning to commence operations in Sri Lanka, but they are not legally bound to do so. They are also allowed to receive funds from foreign donors without any restrictions, controls or supervision by the government (Nayar, 2000).
4.6.5 Limited Activities by State Owned Banks

Even though CBSL (Central Bank of Sri Lanka) plays a major role in the financial control, the microfinance sector remains outside the purview of the Central Bank, if not by law, at least by practice (Nayar, 2000). The Central Bank activities include monitoring of the larger banking institutions and setting monetary policies but it has no interest in the microfinance sector and at the same time, it lacks the capacity to regulate it.

Furthermore, commercial banks and development banks are subject to regulation by the Central Bank. As in the Central Bank's case, the intermediation costs of the commercial banks in the microfinance sector are prohibitive. Because microfinance lending requires highly interactive relationships between the institution and clients, this requires a large number of field staff at high costs. Moreover, repayment is also very low due to various factors. Most micro level agricultural activities do not generate adequate income. Agricultural and micro enterprises find it difficult to exist in an open market policy environment. They are unable to compete with import goods that are cheaper than local products.

Furthermore, poor people have familiarized themselves with government subsidy and welfare programs and these have developed a strong culture of credit repayment default among the poor. Loan forgiveness policies by successive governments have encouraged these trends. Because of this tendency, state owned banks have drastically reduced their advances in this market. Even if the situation of the state banks remain the same, the successive government may not pressure state banks to finance some priority development projects. Because of those constraints, state owned bank activities have been limited in the microfinance sector.
4.7 Issues and Problems of Capacity Building and Sustainability of Microfinance Program Organized by Institutions

The microfinance sector in Sri Lanka lacks the capacity to reach maximum outreach and sustainability in its programs. Most of the programs are not viable in the long term due to lack of capacity. There are however only a few good sources of quality technical training including strategic planning, efficient finance intermediation etc. provided by NGOs and INGOs. Even though almost all microfinance providers in Sri Lanka need capacity building there are few training staff and other resources to provide specialized training. The available training is also not ideal or suitable for the local context of Sri Lanka. Most of the training modules have been prepared based on Western experiences. Because of this most MFIs develop their own training program, and thus leads to duplication and cost escalation. Furthermore, high staff turnover in the competitive field of trained personnel can result in fatigue, lack of smooth transition and under-investment (Nayar, 2000). There is also lack of linkages of MFIs with formal financial sector. If MFIs have strong linkages with those formal institutions they could avoid the continuous dependency on donor funds. And at the same MFIs should build their capacity to influence the donor agencies to ensure the appropriate and sustainable delivery of funds and other microfinance services. MFIs could build their capacity in this way. There is also the lack of a management information system and financial information system to ensure the growth of successful MFIs (ibid). Furthermore, there is a lack of transparency among various MFIs in their function. To avoid this, there is a need to form a microfinance network among those institutions. These weaknesses in the MFIs could be addressed by paying attention to the capacity building needs of those institutions that could affect program sustainability in the long run.

It is difficult to determine the sustainability of MFIs because there is still a lack of information and data available on this aspect. MFIs in Sri Lanka are reluctant to show greater transparency and disclose their microfinance activities (Nayar, 2000). This is partly due to the fact that most NGOs are mainly dependent on
donor funds so that they are not willing to reveal their weaknesses which could cause donors to shift their financial support. Financial sustainability is a major problem among MFIs in Sri Lanka. The need for positive changes in the financial regulatory environment has been stressed. The establishment of an appropriate mechanism for regulation, supervision and depositor security is essential (ibid). Small defaults can affect the credibility of the industry. Depositor security may also be at risk in the areas susceptible to natural or man-made disasters.

Nayar (2000) argues that there is a need for donors to work out an effective strategy for the sustainable financing of MFIs that is designed to move MFI partners out of dependence over time. Furthermore she said that this sector also needs to design a mechanism that enforces proper financial accounting and annual audits of MFIs to ensure accountability, transparency and protection of depositors.

As stated earlier, there is also a lack of coordination among various microfinance practitioners in this sector and that also affects sustainability of MFIs. There is also no common body for regulation and supervision of the microfinance industry in Sri Lanka. The formation of a stakeholder network has already been suggested which should include various government and private MFIs, academics and technical assistance providers, donors, etc (Nayar, 2000).

Finally, there is a lack of linkages between MFIs and commercial and development banks. There are a few examples for this linkage such as the microfinance activities of HNB with the help of about 15 NGOs (Nayar, 2000). The state owned banks and RRDBs involved in the central bank's microfinance program have also partnered NGOs in rural areas, including SANASA and some grassroots organizations. Banks should be encouraged to select NGO partners for wholesaling relationships in order to contribute to microfinance activities that establish them as viable, socially conscious investors (ibid). In Sri Lanka such
5.1 Introduction
This chapter discusses the microcredit capacity building activities and the social and economic impacts of the CAB-J project. It provides a comprehensive description of capacity building activities practiced in each phase of the project. The information provided in this section was compiled through formal interviews, informal discussions, personal observations during field visits, extensive literature review, and reports and publications available from CBOs and the CARE international office in Jaffna. Also included are the survey data results based on a baseline survey conducted by CARE International, in the Jaffna community before commencing the CAB-J project. The analysis is based primarily on qualitative data rather than quantitative data due to lack of availability of the latter.

5.2 Background Information on the Jaffna Peninsula and CAB-J Project
This section provides some background information on the Jaffna Peninsula including its geographical location, administrative structure, and the socio-economic condition of the Jaffna people before and after the on-set of conflict. Most of the information provided in this section about past and present situations in Jaffna has been adapted or extracted from the Jaffna Plan (1998).

5.2.1 Geographical Location
The Jaffna Peninsula is situated in the northern part of Sri Lanka (See Map 5.1& 5.2). It covers the entire Jaffna District and is temporarily attached to Pachilapalli AGA Division of the Kilinochchi District which is located adjacent to the Jaffna District. There are small and large islands around the Peninsula. The total area of the Peninsula is 1,129.9 sq.km including 45.7 sq.km covered by lagoons.
MAP 5.1: Map of Sri Lanka

Source: http://www.sundaytimes.lk/
Geographically, Jaffna Peninsula is divided into 4 sub-regions such as islands, Vadamarachchi, Thenmarachchi and Pachilapalli, and Valikamam.

5.2.2 Population
The population in the 1981 census was 749,788 and it was estimated that the population in 1991 and 1995 would increase to 844,000 and 933,000 respectively by natural increase (Jaffna Plan, 1998). But due to the intensified civil war, the present population is 470,156 as of 1997, which is about one half of the projected population (ibid). Several factors influenced this such as migration out of the district but within Sri Lanka, net out - migration from the country, higher percentage of abnormal deaths due to war, delayed marriage due to lack of youths, and so forth.

5.2.3 Administrative Structure
The Jaffna Peninsula consists entirely of the Jaffna District with 14 administrative divisions and one administrative division of the Kilinochchi District. The Government Agent (GA) of the Jaffna District acts as an executive officer and the government coordinator for entire the Peninsula. The state administration functions through four hierarchies - central, provincial, district, and division. The central and provincial governments are responsible for planning, budgeting, and monitoring and the district level is responsible for back stopping, co-ordination and implementation. The divisional level is responsible for implementation and providing services to the public. Local government institutions in Jaffna include the Jaffna Municipal Council, 3 Urban Councils and 12 Pradeshya Sabhas. The local government institutions come under the supervision of the Commissioner of Local Government (CLG).

Civil society organizations include village level organizations such as Rural Development Societies, Co-operative societies, Farmers' Organizations, etc. They have been involved in identification, formulation, implementation and
monitoring of people-oriented development activities. In this context, local and international NGOs have become important partners.

5.2.4 Socio-Economic Situation
The socio-economic conditions of the Jaffna Peninsula depend mainly on industries, agriculture, livestock and fisheries. Since the onset of intensive conflict in 1983, local production and supply of food items have been decreasing drastically. Industrial production has collapsed completely, instead, the number of cottage level or small scale industries and self employment activities have been increasing since 1997. The service sector has been under-developed. The performance of the financial sector is still very poor. The following sections describe the socio-economic situation of the Jaffna community in detail.

5.2.4.1 Social Structure
The present socio-economic condition of the Jaffna Peninsula differs from that of the past. For many centuries, the social structure has been based on the concepts of ‘caste’, ‘class’, ‘kinship’, ‘elite’ and professional occupational categories. But the ethnic conflict has affected the social structure and network and close family affiliations have been devastated or disturbed. The civil war had caused destruction of many lives, property, and several displacements for the people. Many village communities have been dislocated and forced to live in new environments. As a result, they lost their community life and their means of livelihood. Moreover, a considerable proportion of people, especially educated people and youths, have migrated out of country. This has resulted in an unbalanced sex ratio with slightly more females, lack of persons with leadership quality and so forth. As a result, this migration has linked the people of Jaffna with the international community.

This entire situation has caused the people to deviate away from their traditional social networks and social bonds, and close family affiliations are gradually
disappearing throughout the Jaffna community. This could trigger conflict further, resulting in the need to rebuild trust and strong bonds among the people.

The following section describes how conflict specifically affected various groups (elements) in Jaffna society.

5.2.4.2 Impact of Conflict on Different Elements in Jaffna

The ethnic conflict has affected different levels of people and created different impacts on them. Many families have lost their resources and were displaced from their permanent places. Due to a lack of investment, they are unable to start any income generation activities in their new places. Even after returning to their own places many don't have resources that would enable them to initiate a new life and instead they depend mainly on government aid. Due to the war a portion of the Jaffna population, especially displaced people, are without any livelihood.

Because of the conflict many families have migrated abroad or to other parts of the country for employment or security purposes. In addition to this, many male members have died or gone missing due to the war. This has increased the number of female-headed households that require special attention, especially those families which have been affected by the war and still live under the poverty line.

Moreover, many youths had migrated from Jaffna due to a high unemployment rate and insecurity within the environment. The economy of Jaffna has been crippled by war causing poor employment generation in the last two decades. In addition, many professionals, skilled labourers and elites have moved away from Jaffna. This situation has thus created a large vacuum in various technological fields.

The families who were self-employed could not continue their activities after displacement, causing a loss or reduction of income. Children from low-income
families have been most adversely affected both physically and mentally. Children of those families could not get adequate meals or could not pursue their school education. This situation will definitely have a negative impact on creating a healthy and educated generation in the present and in the future.

5.2.4.3 Social Sector
5.2.4.3.1 Health
The health services of Jaffna used to be similar to those in the rest of the country. But since the commencement of war in 1983, health services in Jaffna have deteriorated. Deterioration of health service buildings, lack of availability of medicine, lack of preventive health programs, and migration of health service professionals from Jaffna have resulted in increased rates of morbidity and mortality, especially among vulnerable groups of the population. Furthermore, these groups are not able to eat well balanced meal which results in children and the elderly suffering from malnutrition and increased susceptibility to various communicable diseases. In addition, a considerable proportion of people have become mentally and physically handicapped due to the war. However, data are scarce on these aspects.

In 1983 there were 49 medical institutions in the Jaffna district with 2461 beds and today there are 37 institutions with 1659 beds (Jaffna Plan, 1998). This is a telling fact about the situation of health services in Jaffna. NGOs have played a significant role in filling some of the vacuum in health services. Health services were provided by NGOs like the Sri Lankan Red Cross Society, HUDEC, MSF and UNICEF during the period when National Health Services were unable to cope up with the situation.

5.2.4.3.2 Housing
Most of the Jaffna people live in their own homes. This is one of the cultural attitudes of the Jaffna population. Living in a rented home is not popular among Jaffna inhabitants. Many of them prefer to live in their own houses even though
they do not have many basic facilities. Most of the houses have been built of concrete with tiled roofing materials. In some villages, people have semi-permanent housing made of wood and sand bricks with roofing tiles or other locally available materials.

Before the onset of war in 1983, most of houses were already constructed, but after that most of the people have shown reluctance to invest money in the construction of new housing due to the prevailing uncertain situation. Furthermore many families migrated abroad and to other parts of country and left their houses empty and many have not yet returned. The majority of internally displaced people whose houses had been damaged or located in high security zone occupy those vacant houses.

5.2.4.3.3 Education
Jaffna has the same school system as the rest of the country. School service provision is a government function. There are only five private schools out of 492 schools in Jaffna (Jaffna Plan, 1998). Tertiary education such as university and technical education is also state funded.

After the onset of the intensive war in 1983, school education had been disturbed drastically. At the end of 1997, only 409 schools were operating out of 490 schools. School buildings, furniture and equipment were heavily damaged. Pupil population has reduced drastically. The number of school pupils was only 103,150 at the end of 1997, a huge decline from 209,802 in 1990 (ibid). Some children have moved out from Jaffna with their families and they have not yet returned. Some pupils are unable to attend school due to poverty. Instead of schooling they go to work as labourers along with their parents. Likewise the number of teachers has also been reduced as they have moved out of Jaffna. Even though Jaffna has placed a very high priority on education, there is still a threat of deterioration of the education of current and future generation. There is therefore an urgent need to rebuild it.
5.2.4.3.4 Employment/ Income

The main source of income in Jaffna is derived from agriculture, fisheries and industries. Most of the migrated Jaffna population are living abroad. Those in abroad send money to their families or relatives who are living in Jaffna. The outbreak of war has disrupted the development of all sectors. Fisheries is one of the most affected sectors and thousands of fishing families were displaced. Due to lack of inputs and marketing facilities, farmers cannot get much profit from agriculture. Many industrial sectors have ceased to function, so that many people have lost their jobs and are still struggling to find new jobs. As a result of the slowdown of economic activities in Jaffna, the unemployment rate is high and the skilled workforce has migrated from Jaffna. Because of this declining economy, the vulnerable groups of the population are suffering more than the rest of the population. So, remedial measures should be taken to uplift the income generation available to those groups. At this juncture, microfinance is considered as one of the poverty alleviation tools to uplift the income and standard of living of poor people.

The above discussion gives a brief overview of the conditions and factors affecting the CAB-J project implemented by CARE International. The next section deals with the CAB-J project which aims to alleviate poverty and create financial access for the poor for starting income generation activities.

5.3 CAB-J Project Activities and Related Capacity Building

5.3.1 Project Background

In 1999, while people were being resettled back in Jaffna following a massive displacement of about 500,000 people, CARE International conducted a research study in the Jaffna peninsula and concluded that microfinance facilities in Jaffna are highly demanded and an unmet need. As a result of this study, CARE International designed a project to improve the capacity building of some selected community based organizations and to improve the peoples’ savings through community based organizations which would ultimately improve their
income. This project is called the CAB-J project; CAB for Capacity Building and J for Jaffna. It is being implemented to meet the microfinance demands of Jaffna people.

The CAB-J project has been designed to address two major problems. First, the urban poor and rural people in Jaffna, a considerable per cent of the Jaffna population, have had very limited access to financial services for a long period. This project fills the demand for such services and explores the potential of CBOs to deliver these types of services. Second, the potential of CBOs to provide financial services is appropriate but their present capacity is insufficient. Those CBOs need to build their skills and capacity in order to mobilize savings and manage funds which will lead them to provide efficient financial services to people. So this project aims to expand the potential of CBOs by enabling them to mobilize local funds and to provide satisfactory financial services to the poor people of Jaffna peninsula as well as to empower the participants towards effective participation in financial services.

The goal of the CAB-J project is to contribute to reducing the vulnerability of poor households in the Jaffna area of Sri Lanka. The project hopes to do this by improving the access of vulnerable and poor households in Jaffna to financial services. The expected outputs of the project are: 1) capacity-building of 10 savings and credit groups, and 10 co-operative societies to provide demand-based financial services 2) enhanced capability of CBOs to access financial resources. To achieve these outputs and desired impacts and outcomes of the project, the CAB-J undertook several project activities and mobilized resources needed by the project. Furthermore to achieve sustainability and build the capacity of the CBOs the project involved several capacity-building activities in each phase or stage of the project. The next section will describe different project activities and related capacity building in each stage of the project. For this purpose I have divided the CAB-J project into four phases:

5.3.2 Project Designing Phase
The CAB-J is a two year pilot project. Before designing the project CARE International, Jaffna, did a diagnosis process which not only assessed problems (needs), but also assessed the opportunities (assets), including the potential partners for CARE to work with and strengthen in the CAB-J project. The CAB-J project was designed based on the needs assessment and 20 CBOs were selected as partner organizations for this project. The project was intended to build the local capacity of CBOs in microfinance. Furthermore in the post-conflict context of Jaffna, the CAB-J project tended to adopt several strategies to achieve sustainability and build local capacity which has been devastated by the long-lasting war. The CAB-J project tended to be more flexible in terms of adopting a suitable microfinance method/ approach based on the existing environment. Because the CAB-J was started as pilot project, the project is flexible enough during this trial period in adopting new strategies or altering the original strategy to meet their objectives rather than practicing one rigid method. For example they have incorporated the “seettu” system, a traditional kind of ROSCA, in their credit and savings program even though this component was not in the original project design. They did this because people are doing this informally and are interested in this method. One CBO called Sudar Oli Savings and Credit Groups has already started “seettu” system in their savings and credit program.

Further, at the initial stage, the CAB-J team let each CBO decide by themselves the affordable interest rate for the loan based on the economic condition of the group members. The project emphasized savings mobilization to each CBO in order to achieve the sustainability of the program. The project focused on building trust among people, which is a major problem in Jaffna, by having frequent meetings, training programs, and maintaining personal contacts. The project also intended to build community networks which were disturbed by war
by involving local institutions, especially the University of Jaffna, and local co-operative societies at different stages of the project.

5.3.3 Implementation Phase
This phase included several project activities and will be described in the following sections.

5.3.3.1 Recruit Project Staff and Training
Three young, male field staff and one female coordinator were selected to implement the project. The three field staff were graduates of the School of Business Management in the University of Jaffna. They didn't have previous experience in microfinance but were successful in their interview with CARE officers. After their recruitment they were given one month training related with microfinance issues especially in a post-conflict context. The project coordinator already has finance management background as she worked in a bank before. But later she was also sent abroad to attend one training program on microfinance issues. The three field staff under the guidance of the coordinator had to look after 20 CBOs which are far away from each other. All those staff were selected from the same community. So they devoted their time to uplifting their own community while working in conflict areas.

5.3.3.2 Selection of CBOs
The CAB-J team selected their 20 CBO partners all over the Jaffna peninsula. The CAB-J team defined the selection criteria. The focus was on the groups which had a “A vision for expansion and a mission for social development”. The selection criteria of CBOs was intended to cover all types within the Jaffna community such as agriculture, fishing, small scale industry, trading, etc., and all types of geographical locations consisting of both the islands and the mainland. About 1700 households were targeted to benefit from the project. So the selection of CBOs had to help reach this target figure. The selection was done in stages. The team expressed in the interview that the CBO selection was the
most tedious task at the initial stage. Since the people were displaced several times in the past, many had lost the community spirit for implementing and managing credit programs. The psychological impact of the war on NGOs and their local governance was another factor taken into consideration. Since the onset of conflict in Jaffna there emerged several movements, thus creating jealousies and strife between the youth members. So this caused trouble between families and community organizations dealing with power and control, thus losing community spirit and togetherness. These problems consumed more time in the CBO selection.

Ten existing co-operative societies were selected based on their past performance. In the formation of new groups an explanation was provided in the initial meeting about the purpose of group formation and its relationship with the CAB-J project. The CAB-J team faced some initial difficulties in gathering them as a group but in the process of selecting groups, the CAB-J formed five new groups. The CAB-J team had to make several visits to form these groups. The five existing welfare organizations marginally involved in financial services were selected for their vision in expansion and they had a commitment to their communities. So the CAB-J team didn’t have much difficulty in the formation of these groups.

The CBO office holders including CBO leaders were selected by the members of the groups. Because the members of the groups know each other very well, they selected the leaders and other office bearers based on their participation in various community activities and enthusiasm in the past. This way, the leaders were able to motivate the groups to save and lend.

After the initial enthusiasm declined there was a drop in attendance of meetings and training even though they continued the savings component. In those cases the CAB-J team had to make personal visits to individual homes, clarified their problems and convinced them again. The team expressed that it was important
to maintain personal contacts with clients for some period. The selected CBOs are categorized into three groups (See Table 5.1) and the geographical distribution of those CBOs is highlighted in map 1.1. The following sections describe the three categories of CBOs.

1. Existing CBOs Already Involved in Financial Services.
Out of twenty selected CBOs, ten CBOs come under this category. These CBOs were selected from Thrift and Credit Cooperative Societies (TCCSs). In Jaffna about 810 TCCS (Jaffna Plan, 1998) had been functioning for more than three decades until the massive displacement of Jaffna peninsula in 1996. After this displacement, most of the TCCSs were crippled and not in a position to continue their financial services. Even though only a few numbers of TCCSs are still functioning, CARE International selected ten of them to be a part of this micro credit project.

2. Existing CBOs Marginally Involved in Financial Services
The CBOs of this category are only involved in welfare activities particularly in their functioning area. Five CBOs in this category have been selected for this project purpose.

3. Newly Formed CBOs.
Under this category, CARE International, Jaffna formed five new CBOs. These CBOs were established in the communities where no CBOs were presently operating and where the financial need was very high.
<table>
<thead>
<tr>
<th>CBO’s Name</th>
<th>DS Division</th>
<th>GS Division</th>
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<tbody>
<tr>
<td><strong>Existing CBOs with financial services</strong></td>
<td></td>
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</tr>
<tr>
<td>Thoddilady TCCS</td>
<td>Vali-West (Chankanai)</td>
<td>J/181</td>
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<tr>
<td>Pannalai WTCCS</td>
<td>Vali-North (Tellippalai)</td>
<td>J/224</td>
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<tr>
<td>Neervely North WTCCS</td>
<td>Vali-East (Kopay)</td>
<td>J/269</td>
</tr>
<tr>
<td>Alvai Nackeeran TCCS</td>
<td>Vadamaradchi-North (Point Pedro)</td>
<td>J/400</td>
</tr>
<tr>
<td>Navaly Muruhanantha WTCCS</td>
<td>Vali-Southwest (Sandilipay)</td>
<td>J/135</td>
</tr>
<tr>
<td>Pandateruppu WTCCS</td>
<td>Vali-Southwest (Sandilipay)</td>
<td>J/146</td>
</tr>
<tr>
<td>Uduppiddy WTCCS</td>
<td>Vadamaradchi-Southwest (Karaveddy)</td>
<td>J/154</td>
</tr>
<tr>
<td>Ambihainagar FCS</td>
<td>Islands-South (Velanai)</td>
<td>J/18, J/19</td>
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<tr>
<td>Farmer’s Co-op Society</td>
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<td>Karainagar</td>
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<tr>
<td>Araly Ulolasiddy Vinayahar TCCS</td>
<td>Vali-West (Chankanai)</td>
<td>J/166, J/167</td>
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<tr>
<td><strong>Existing CBOs marginally engaged in financial services</strong></td>
<td></td>
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<tr>
<td>Tellippalai East Sahothara</td>
<td>Vali-North (Tellippalai)</td>
<td>J/227</td>
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<tr>
<td>Pahirvu Vazhvuz Kazhaham</td>
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<tr>
<td>Eavinai Kalaimahal Community centre</td>
<td>Vali-South (Uduvil)</td>
<td>J/209</td>
</tr>
<tr>
<td>Maariamman S&amp;C group</td>
<td>Vadamaradchi-North (Point Pedro)</td>
<td>J/399, J/401</td>
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<tr>
<td>Neeraviyady WRDS</td>
<td>Nallur</td>
<td>J/101</td>
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<tr>
<td>Inuvil RDS</td>
<td>Nallur</td>
<td>J/115</td>
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<tr>
<td><strong>Newly formed CBOs</strong></td>
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<tr>
<td>Urelu Valarpirlai S7C group</td>
<td>Vali-East (Kopay)</td>
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<td>Puliyanoodal Fin. Assistance group</td>
<td>Islands-North (Kayts)</td>
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<tr>
<td>Munai Sudaroli S&amp;C group</td>
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<td>J/401, J/403</td>
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<tr>
<td>Kurunagar S&amp;C group</td>
<td>Jaffna</td>
<td>J/68</td>
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<tr>
<td>Kuddiyapulam S&amp;C group</td>
<td>Vali-North (Tellippalai)</td>
<td>J/244</td>
</tr>
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</table>
5.3.3.3 Selection of Beneficiaries
The project only aimed at poor people just below or above the poverty line and did not target the poorest of the poor. This was because the poorest people struggle to meet their basic needs. Only after satisfying their basic requirements will they think about savings. So if the CAB-J project includes this category of people, the sustainability of the program will be affected in the future. The project team worked with three different types of groups: male only, female only, and mixed groups. Co-operatives are largely mixed groups with dominant male membership. But this project encouraged greater participation of women in the co-operative societies. Because of that the project team selected five womens' cooperative societies out of ten co-operative societies. The savings and credit groups, both existing and newly formed, have mostly female members. So this encouraged women to be active savers and borrowers and to take leadership roles. Different working groups enabled the project team to identify the best microfinance delivery channel. The team identified women as good savers and thus tried to include more female in both the mixed and male member only groups. For example in one of the CBOs called Gurunagar Fisheries Cooperative Society with only male members, the CAB-J team also emphasized the need to accommodate women members.

5.3.3.4 Conducting Baseline Survey and Assessment of CBO Capacity
A baseline survey was conducted in all CBOs by CARE International Jaffna. The survey collected data on the living conditions, financial capabilities and management of the individual members. Along with that, an assessment of the CBO was done to evaluate the existing institution's capacity and capability in managing finance. The University of Jaffna has been involved in the baseline survey process including the development of the questionnaire and conducting the survey. Fifteen students selected from Jaffna University were involved in a two-day workshop which included a model field test of the survey instrument. Necessary modifications on the questionnaire were made based on the workshop discussion. From the result of the baseline survey and CBO
assessment, the CAB-J team determined the interventions, methods and adaptations to be included in the training model.

5.3.3.5 Training of CBOs

For this purpose a training curriculum was prepared based on the assessment of CBO capacity and the results derived from the baseline survey. The training model is designed to suit three categories of CBO members based on a three-tier approach to the training needed by the groups. Group 1 is considered as the highest level. This group had the highest capabilities in financial management and group cohesion. The training model for this group included exploring the possibilities of the group to become self-sufficient and regular, acting like an informal savings bank and enhancing the groups’ ability to entertain non-member borrowing:

Group 2 is considered as the middle level. This group had some degree of understanding of financial management. The training module of this group included advanced book-keeping training and financial management, exploring feasibilities for the linkages with regular financial institutions like banks and expanding their vision by increasing membership through higher loan amounts.

Group 3 is considered as the lowest level. This group needed all the basic inputs in financial management, accounting, interest rate setting and calculation, basic understanding of money, inflation and loan portfolio management. The training module included basic accounting principles, savings mobilization, understanding peer pressure, feasible income generating activities, group cohesion etc.

The training sessions were held at the branch societies of the TCCS or CBO building and the groups were free to choose the time and days to ensure maximum participation. The CAB-J team had to work with several CBOs, so they couldn’t set a fixed schedule.
But the CAB-J didn’t incorporate the technical skills training in their training module which were essential for new entrepreneurs. Moreover, the project included CARE’s “do no harm policy” so as not to burden a person who is not prepared to use credit wisely and likely to suffer under the repayment program. So this policy helped the team to minimize unintended negative impacts. Some CBOs were more vulnerable to loan default due to the prevailing uncertain situation. The CBOs from fishing communities suffered under the government restriction for deep sea fishing, which was not stable to begin with. The government lifted this restriction for some time and then re-imposed it. Because of this ambivalent policy posture, the fishing community suffered a lot. In response, the CAB-J team gave them special training on how to manage the liquidity of the group. But there was a trend in this community to stop engaging in any economic activities when fishing restrictions were imposed. During this period the people would withdraw their savings to survive. To overcome this situation the CAB-J team has put forward a proposal to the executive committee to put aside at least 10% of the monthly savings to meet such emergency situations. The CAB-J could have further aided this fishing community by training its members in diversified farming and non-farm activities, so that they would not become totally dependent on their catch earnings.

5.3.3.6 Resource/ Savings Mobilization
The capital for loan provision was derived from local savings mobilization and some seed funds from CARE. At the initial stage of the project, savings mobilization was low because the long lasting war disturbed the income generation activities of the people. They couldn’t get adequate income and thus, they couldn’t save more money. The savings amount of each CBO is flexible but the minimum amount should be Rs50/= per month. Savings mobilization was not sufficient to meet the needs of the members because there was high demand for microfinance loans at the time. The newly formed CBOs had low performance in savings mobilization when compared with the existing CBOs. Following a needs assessment of CBOs, a seed fund was given to them but such funds were not to
be given automatically. Rather, such grants were given in stages, increasing in each subsequent stage based on the CBO's performance. The first stage seed fund had been disbursed to some of the groups who are performing well and meeting the expected standard. The performance was judged by the increase in the members' savings, number of loans given in a month, and the repayment rate. But the CAB-J team had to deviate from this procedure in one CBO located in a more vulnerable area. Even though the CBO performance was low the CAB-J team provided seed funds to encourage them to get involved in the program. The step-by-step grants were an integral part of the training and capacity building process. CARE closely monitored the use of grants by clients.

The seed fund was also very small size (Rs 30000/= or $518 CAD). The project coordinator revealed that they were unable to get an adequate amount of funds from the head office of CARE which was located in the capital city of Colombo in Sri Lanka. Furthermore, the CARE project staff had only one vehicle to visit various places in the entire district. This also limited their activities because some CBOs were located in remote areas where there was no access to public transportation. So it was a difficult task to cover 20 CBOs scattered all over the Jaffna peninsula by three field staff with one vehicle.

5.3.3.7 Loan Provision
The loan provision was done on a priority basis because loan capital was small and many members requested loan at a time. So they couldn't meet all members' needs at once. Loan applicants had to wait for long time to get the money and the loan amount was also small ranging from Rs 2000/= (CAN$ 34) to Rs 5000/= (CAN$ 85). All loans were given for production purposes. Persons applying for agricultural loans were given priority because agricultural needs are seasonal. Loans were provided based on group lending procedures with two members should sign as guarantors to a client. The loan recipients were required to be official members of the group and regularly present at meetings and training sessions.
Furthermore, the members of each CBO come from the same area or village. Every member knows each other. The CBO leader also knows each other's family. This close familiarity helps prevent clients from making any loan defaults. Each CBO faced a common problem in involving displaced people living in the area into their savings and credit groups. Because the host village people didn't know much about those displaced people, they lack trust in them. In those situations the CAB-J team intervened and facilitated the involvement of displaced people in the groups.

5.3.3.8 Ongoing Support and Networking
The level of support provided by CAB-J was linked to the individual needs of the various CBOs. Each CBO had to have regular contact with a project officer for the full training period. As the capacity of the CBO developed, the number of visits and meetings had been scaled down. At this juncture the project would begin to explore linking CBOs with each other and with banks such as cooperative banks or commercial banks. Furthermore, it was also intended to assist CBOs to widen their range of services including provision of loan for non members, insurance schemes and non financial services. But during my research study period, carried out at the end of first year, the project team hadn't fulfilled the last two intended tasks but they had plans to start that process based on the performance of CBO.

The CBO called Ambihainagar Fisheries Cooperative Society (FCS) already had an account in a commercial bank before they became a partner organization in CAB-J project. The savings collected from the members were being deposited in the bank but it was not being used for loan provision. They were afraid to withdraw and provide loan among their members because there was lack of financial management capabilities. After becoming involved with CAB-J training program they were able to provide loans from the deposited money.
The savers in another CBO called Gurunagar Savings and Credit Group (SCG) came under a newly formed group that wanted recognition. The CAB-J team was trying to legalize the society by registering them as an NGO under the Fisheries Ordinance Act.

In another CBO called Neeraviyady Women Rural Development Society (WRDS) some of the members got together and became actively involved in income generation activities such as supplying meals on orders and producing "mixture", a kind of snack popular in Jaffna. The CAB-J project has planned to link them with other groups to overcome the marketing problems faced by others who are involved in the same occupation. Because the WRDS members lived near the downtown area where the demand is high, they would be in a position to open a small boutique where they could sell their produce and others’ as well.

5.3.4 Monitoring Phase

5.3.4.1 Performance Assessment at Regular Intervals

The CAB-J team practiced on-going monitoring along with the implementation process. Regular meetings were scheduled by CAB-J team and took place with the office bearers of the CBO to assess the progress. Assessment included recording and management of savings fund and loan portfolio and repayments. Every month they had to submit a progress report to the CAB-J team. Furthermore, CBOs were encouraged to engage in self-monitoring of their CBO performance. So each CBO would be in a position to monitor and evaluate their activities by themselves. The regular meetings with officers of each CBO and the submission of a monthly progress report enabled the CAB-J team to monitor the project closely. Every month each CBO would arrange a general meeting and the CAB-J team would also participate in that meeting. In addition, officers of each CBO had to meet more often among themselves. The project officers couldn’t have much personal contacts with clients due to limited time and resources.
5.3.5 Evaluation Phase

In addition to the ongoing monitoring and assessment of the project CARE intended to do two evaluations, a mid-term evaluation and final evaluation. Each evaluation was intended to be done by two evaluators. CARE would evaluate the progress of each CBO and an independent evaluator - the University of Jaffna - was also engaged to assess the project and its impact. So the project could be evaluated from two different perspectives and thus helped to avoid any biases in the evaluation result. The project impact was compared with the results of a baseline survey which was carried out by CARE before starting the project. The lessons learned from this pilot project would be then applied to the next planning cycle.

The next section will analyze and discuss the socio-economic impacts of the CAB-J project.

5.4 CAB-J Microcredit Project Impacts

5.4.1 Socio-Economic Impacts

The poor participate in microcredit programs with the expectation that microcredit services will help reduce their poverty by increasing their income and sustaining self-employment activities (Khandker, 1998). The impact of the microcredit program on economic factors like income and employment, on a sustained basis can be measured directly (ibid: 37). But the impacts or benefits of the program can also be measured indirectly by measuring the changes in socioeconomic outcomes (ibid). I have measured the CAB-J microcredit program by using both direct measures such as income and employment aspects, and indirect measures such as children’s schooling, housing conditions, purchasing power of assets, household expenditures, ability to save, borrowing capacity and social participation, and women’s empowerment. At this juncture it is more appropriate to revisit the problem statement, the details of the survey results and the goal of the CAB-J project. This will enable the reader to see how
my evaluation measures have been linked with the problem statement of this research study and the goal of the CAB-J project.

Revisiting the Problem Statement of the Study
The research problem statement of this study is: how can microfinance services run by international aid agencies can contribute to community capacity building in post conflict areas like Jaffna? Here the phrase "capacity building" refers to the strengthening of social and economic structures of the community. In such a way, the evaluation of the project needs to take into account both direct and indirect socio economic measures, as mentioned in Section 5.4.1. Although each of the impacts is on the outcome of the CAB-J program, some are either directly or indirectly related with CAB-J program. As I mentioned in section 5.4.1, income and employment were directly impacted by the program and these kinds of impacts influenced various other factors in the lives of the recipients such as education, housing, health, food habits, etc. To fulfill the task of evaluating the socio-economic impacts of the CAB-J project, an interview guideline was designed which consisted of a variety of socio-economic questions (see Appendix 1). The entire interview process focused mainly on the project impact after the commencement of the CAB-J program. Initially the loan recipients were asked questions directly linked with microcredit such as employment activities undertaken with the loan; income improvement, etc. They were then asked about other consequent changes in their day to day life due to these improvements.

Revisiting the Goal of the CAB-J Project
The goal of the CAB-J project is to contribute to reducing the vulnerability of urban poor and rural households in the Jaffna area of Sri Lanka. This is also linked to different aspects of social and economic development in the area. The implementation of the CAB-J project is expected to provide several benefits for the affected population of Jaffna. The expected benefits of CAB-J are,
1) Improving access to financial services for 1700 households in Jaffna through empowering the socio-economic condition of vulnerable groups.

2) Improving the capacity of twenty CBOs to manage microfinance.

3) Empowering the socio-economic conditions of women.

4) Creating a stronger and more cohesive civil society.

5) Creating a better understanding of the gender dynamics involved in the delivery of microfinance.

6) Creating a better understanding of the coping strategies and the benefits of the microfinance services in the lives of the poor in Jaffna.

7) Highlighting the characteristics and features that can be replicated in areas similar to the situation of Jaffna.

To achieve the goals of the project, it targeted only the people just above or below the poverty line as beneficiaries and did not focus on the poorest people. This is part of the strategy toward program sustainability as the poorest of the poor are believed to be deserving of outright grants, not loans. The provision of loans is defined only for production purposes such as farming, fishing or other self-employment activities. To ensure the right provision of loans for the right clients, each CBO has been tasked to define their own loan provision criteria based on the encouragement of production loans to eliminate loan use for consumption purpose.

The following sections will discuss details of the socioeconomic changes that have resulted from the CAB-J microcredit program.

5.4.1.1 Income

Income improvement is one of the direct measures in the assessment of the microcredit program. Among the beneficiaries of CAB-J project, 69 per cent of households reported a moderate monthly income increase. The average monthly income ranges from Rs2500 to 3000 from all sources. But based on the baseline
survey, the average total monthly income from all sources before the project implementation was Rs1950.

Even though the microcredit program raised monthly household incomes, the real impact is small. This is because the CAB-J project is a two year pilot project and the assessment was done at the end of the first year. Therefore, this may be too early to assess the impact of the project on household income. In addition, the majority of the households involved in income generating activities are engaged especially in farming, fishing, small trades, etc. They could not receive maximum income from their farming endeavors because of lack of marketing facilities, low availability of inputs, and lack of technical know how on value-added farm products. Furthermore, due to the prevailing security situation in Jaffna, the fishing communities are restrained from deep sea and night fishing, affecting them much more in comparison to other communities. They are only allowed to fish in the day time approximately one kilometer from the shore. Due to this kind of restriction they are unable to attain enough income from fishing and have thus fallen below the poverty line.

This study reveals that there is no change in the monthly income of 31 per cent of the households. The main reason for this condition is that these households spent a major portion of the microcredit money to meet their household needs instead of investing in income generating activities. This group of people does not receive enough income to fulfill their basic needs and they therefore could not think about income generating activities until meeting their basic needs. Moreover, some households reported that the amount of credit money is small, and ranges from Rs2000 to Rs5000 which is not enough to start up any self employment activities to generate more income. Some households are still living in displaced areas and they are unable to start up large scale activities. Instead, they have become involved in small scale low income generating activities, so that they couldn’t get significant increases in their income levels.
5.4.1.2 Employment

Employment is another direct measure used to assess the impact of microcredit in a society. The CAB-J microcredit program has increased employment opportunities through facilitating self employment activities. Among the credit program beneficiaries, 82 percent of households reported a positive impact of the program on employment, and the remaining households (18%) revealed no impact on their occupational opportunities. The positive impact includes enabling loans to continue the existing occupation (49%), expanding the existing occupation (22%), and starting new income generating activities (11%). This reveals that the majority of households used the microcredit money to continue their existing occupation rather than expanding it or starting new income generation activities. Many factors influence this. The microcredit beneficiaries state that the credit amount is small, so they could not get a significant income increase from their occupation and it ultimately affected the potential of expanding current and future income generating activities. As discussed in Section 5.4.1.1, several factors influence employment expansion or the ability to initiate new activities. The households that reported no impact in their occupation utilized the credit money for non-income generating activities such as consumption, settling other outstanding loans, or other purposes. Their displaced life experience in the Jaffna Peninsula and the small size of loans, as discussed in Section 5.4.1.1, also played a negative role in decision-making for loan usage.

The micro credit beneficiaries utilized the credit money for a variety of employment activities including farming (41% -consisting of Agriculture-27% and Livestock-14%), small household level business (25%), fishing (16%), and the remaining 18 percent of households used it for mixed purposes consisting of settling outstanding loans, consumption, home gardening and other non income generating activities. This indicates that about 82 percent of beneficiaries are engaged in income generating activities, which is higher than the percentage (70%) derived from the baseline survey conducted by CARE International, Jaffna before the commencement of the project. Further, this survey has also reported
different income generating activities based on the numbers of families, as shown in Figure 5.1.

![Figure 5.1: Families Engaged in Income Generating Activities](image)

This figure also indicates a higher percentage of households involved in farming and less percentage of households involved in fishing. Even though fishing generates higher income than other activities, a lower number of people are involved in fishing due to prevailing security issues and fishing restrictions imposed by Sri Lankan Government (see Sec 5.4.1.1).

5.4.1.3 Education / Children's Schooling

Impact on education is one of the indirect socio-economic changes used to measure the benefits of micro credit programs. According to the baseline survey among the loan beneficiaries, 39 percent of households revealed that the micro
credit loan has a positive impact on their children's education. The parents were able to meet the children's school needs such as purchasing stationery supplies, clothing, and meeting transportation needs (e.g., buying a bicycle for their children to go to school). About 4.5 percent of households had no school age children. However, 57 percent of households said that the micro credit provision did not have much impact on education because their children have already been going to school even before this credit program began. In the Jaffna community both poor and wealthy people accord a high importance to education. The rural poor also send their children to school and meet the school expenses by getting loans or selling assets. But after the introduction of the micro credit program, they used the loan money from this credit program for their children's education expenses.

In the post conflict context of Jaffna, the education of children from the fishing community has been severely affected in comparison to other communities. However, during this post conflict period Jaffna has returned to normalcy. However, the fishing community still faces difficulties in returning back to fishing. Night time deep sea fishing continues to be prohibited in Jaffna peninsula. Displaced fishing communities are unable to return back to their home villages since their villages have yet to be rehabilitated and reconstructed properly. This situation has a negative impact on the schooling of their children and on income generation. It leads to some families not sending their children to school and asking them instead to engage in income generating activities. After the introduction of the CAB-J program it was observed that there was little improvement in the income of fishing communities. During informal discussions they expressed that if this credit program continues into the future without any interruption, they will be able to send their children back and keep them in school. The same opinion was expressed by other members in different CBOs as well. For example, some members from TCCS had revealed that their children were able to continue their education because of the financial assistance from this credit program.
5.4.1.4 Housing Conditions

According to the baseline survey results, a little more than one third of the respondents were living in rented or friend's/relative's houses. Out of these, about 95 percent of households were living in the houses of friends and relatives without paying monthly rent fees. Others were living in rented houses. But the majority of households surveyed owned houses. The materials for roofing utilized were tiles (48%), asbestos (18%), and galvanized sheets (5%). But one third of the houses used cadjan as roofing materials. The houses of 67 percent used cement for flooring and the remaining used cow dung. The houses of 66 percent used cement for the walls and others used tats, clay or wood. About 62 percent of houses had latrines and 30 percent house did not have latrines. This baseline survey data also supports the findings of the above mentioned interviews among loanees that reflected the fact that a greater percentage of houses were permanent and did not have urgent repair works.

The interview result among households revealed both a positive impact (32%) and no impact (68%) on the analysis of the impact of micro credit provision on housing conditions. The positive impact reflects an improvement of housing structures and facilities as a result of using this credit program. It included major and minor repairing such as improvements to the roof and floor, installing new latrines, repairing pipe lines, etc. But the greater majority of households (68%) expressed no impact. Out of the survey respondents, 11 percent of households were found living in temporary houses constructed by using locally available materials such as clay, wood, cadjan (coconut leaf), and cow dung. They needed to construct a semi-permanent or permanent house but they did not have much money to put up a new structure. The remaining 57 percent of households did not do any improvement work because their houses did not need urgent repair. In addition to this, a considerable percentage (nearly 20 %) of those families live in rented houses or their relative's houses because their houses were damaged by war or were located in an area inaccessible to the public due to a high security zone or mine field. Due to the two decade-long armed conflict, most of the upper
class and upper middle class people have migrated to other parts of Sri Lanka or abroad and their houses were left vacant. These houses are now occupied mostly by internally displaced people, many of whom are credit program beneficiaries.

5.4.1.5 Purchase of Assets
Among the credit beneficiaries, 41 percent of households reported an increase in purchasing power after the introduction of the micro credit program. Out of those positive respondents, 14 percent of households increased their purchasing power, buying jewellery for dowry and other household requirements such as bicycles, sewing machines, etc. The remaining percent of households (27%) increased their purchasing power up to the level that enabled them to acquire livestock like cows, goats and poultry.

The rest of the loan beneficiaries (59 %) reported that they did not experience any increase in purchasing power even though they have benefited from credit program in other ways. There were a variety of reasons that supported this trend. First, some households hesitated in buying assets due to the prevailing uncertain situation in the post conflict context of Jaffna. Secondly, some households did not receive enough income to spend on asset purchase while meeting other household expenses since the micro credit amount was too small at the early stage of the program. Thirdly, some survey respondents already had assets like bicycles, sewing machines, agricultural instruments, etc. and at the same time they gave priority to their basic expenses until they reach a certain income level.

5.4.1.6 Household Expenditures
Interviews among credit beneficiaries revealed that 75 percent of household respondents have had improvements in their monthly expenses and 25 percent of households reported that there was no improvement in their monthly expenses. It was also reported that the average total expenditure per month per family was Rs6150/= (CAN$ 104) ranging from Rs1875 (CAN$ 32) to Rs10665
(CAN$ 181). But it was difficult to get the data for expenses for each and every need because beneficiaries could not separate the expenses based on their different needs. They said that they spent a major portion of income on food. Out of the respondents reporting positive effects, nearly 5 percent of families said that they have changed their food eating patterns after being introduced to this program. Earlier they consumed more vegetables rather than meat, fish and other non-vegetable food items which are more expensive. But after the program they were able to buy more non-vegetable food items. After the introduction of the microcredit program, the average monthly expenditure was higher when compared with the average monthly expenditure (Rs5662/=) derived from the baseline survey.

5.4.1.7 Savings Trend
After introducing the CAB-J microcredit program, the savings rate among people has increased. Interviews among households revealed that 89 percent of households deposited money in CBOs and 11 percent of households were unable to save money after introducing the CAB-J project. Among those giving positive survey answers, 82 percent of households said that they could not save money before the program and rest of the households (18%) were able to save money before and after the project. This drastic change in savings trend was due to the incremental increase in household income due to this microcredit program. And at the same time, savings were a compulsory component for getting loans in the program. The people involved in this study previously hesitated to go to the bank to deposit their small amount of money. Banks were also located far from their village and involved paperwork to complete transactions. In contrast, the CBOs were located in their village and did not involve paperwork to deposit savings or to attain loans. They then felt more comfortable to gain access through CBOs than through other formal institutions.
5.4.1.8 Borrowing Capacity
The research study showed that 30 percent of households had reported an improvement in their borrowing capacity. Respondents said that after their involvement in this program, they were able to receive more income and save a small amount of money. Most of the participants contributed through social and welfare activities and thus a strong social bond developed among them. Self-confidence and trust developed among themselves and between different community members. This improved sense of well-being increased their confidence and borrowing capacity.

Some 36 percent of the households had no problem in borrowing money in the period before and after the micro credit program, and the rest of the households (34%) reported no improvement in their borrowing capacity. The negative respondents noted several reasons for this, such as inability to provide collateral, high interest rates, and inability to repay their previous loans. But most of the respondents reported collateral problems. In addition, few households reported that the grassroots organizations where they belong did not have enough money to give loans to their members. Therefore they were not able to obtain loans in the required time. It was also expressed that they were not able to get any returns on their investment using the loans, which are small to begin with. Thus, their living conditions remained unchanged and ultimately this led to no improvement in trust level or borrowing capacity.

5.4.1.9 Social Participation
Among the respondents, 55 percent reported that they had participated in social activities and 45 percent reported no participation in social activities. Out of the respondents giving positive answers 87 percent of households reported that they had participated in social activities after their involvement in the micro credit program and the remaining 13 percent of households reported that they had participated in the period before and after the involvement of the program. The majority of households (nearly 75%) who participated in social activities were
members of one or more community voluntary organization. About 55 percentage of survey respondents participated in religious organizations (12.5%), TCCS (8.3%), WRDS (12.5%), 'seettu' (4.2%), farmers and fisheries organizations (4.2%), multipurpose co-operative Society (MPCS) (16.7%), other NGOs (4.2%) and community development centers (12.5%). Nearly 25 percent of households who participated in social voluntary activities are not members of any voluntary organizations. The baseline survey result revealed that about 35 percent of people who were 15 years or older in the sample participated in voluntary community organization's activities. This reflects the trend that after introducing the micro credit program a greater percentage of people had shown interest in social activities because as their earnings increased, they became empowered to participate in social welfare activities. These social activities also led to a build up of trust, self-reliance and social networks within the Jaffna community. Moreover, Jaffna had a strong tradition of co-operative societies since the early 1900s (Jaffna Plan, 1998) and this was also disturbed by the civil war. The CAB-J project, by selecting TCCS as CBOs in the program, attempts to build on the existing strength of those societies and at the same time increase their capacity to provide microfinance services to their own communities.

The CAB-J project also explores the possibility of linking CBOs with co-operative banks or commercial banks. If possible the project will link the twenty savings and credit groups in clusters. But those activities focused on strengthening and building the capacity of individual CBOs had not been started as the project was still in its early stage at the time field work for this study was conducted.

Furthermore, this project involved local institutions such as the University of Jaffna in the strengthening of CBOs. The University of Jaffna had already been involved in the baseline survey and workshops related with these issues during the pre-implementation period. The involvement of local institutions in this program has promoted greater societal cohesion and thus would help to build social networks and assist in the rebuilding of Jaffna civil society.
5.4.1.10 Women's Empowerment

According to the baseline survey results, 56 percent of the sample group were female. It also revealed that 68 percent of the households interviewed were headed by males and 32 percent of the households were headed by females. The selected twenty for the purposes of the project included mostly female members and nine have both male and female members. Only one CBO had only male members. Regarding the overall performance of both sexes in the micro credit program, women's involvement was higher than male members. The female members who participated are considered more motivated to save money in comparison to the male members in the program. This was an attitude observed among most poor families in Jaffna during the study period. It should also be noted that most of these women have already been involved in traditional saving system called "seettu". By becoming involved in both kinds of saving systems (credit program & "seettu") most of the women were able to save more money which enabled them to independently cover household expenditures like purchasing food items and other home needs. This leads towards a lower level of dependence on their husbands for their daily expenses. As a result of this increased savings, a higher percentage of women members have become involved in starting up home-based income generating activities such as sewing clothes, preparing food and selling them, etc. Some elderly women were able to engage in roadside selling of vegetables and food items produced in the households which enabled them to earn money for their medical expenses. After their involvement with this credit program most of the women were also able to participate in social activities carried out by the CBOs including attending monthly meetings, and training programs conducted by CARE in relation to microfinance and other concerns.

Male deaths and migration have led to an increased number of female-headed and female-maintained households. In addition, the dowry system and fewer men of marriageable age have also delayed many women's marriages while some have remained single (Jaffna Plan, 1998). Middle and upper class women were
able to compete with men in various aspects like in education, employment etc. But in rural areas where people are involved in farming, fishing or other self employment activities like pottery, and carpentry, their earning and educational capacity has been constrained by the shift in social structure and women are not able to have equal opportunities with men (Jaffna Plan, 1998). More attention should then be given to the empowerment of women in lower social categories. The CAB-J program focused on poor rural women by promoting the opportunity for them to work out of their homes and become involved in social and production roles in addition to their traditional reproductive roles.

The next chapter six will discuss the various strength and weaknesses of the project and the challenges of capacity building identified in the project implementation period.
CHAPTER 6
Analysis/ Discussion: The Challenges of Capacity Building for Microcredit Project in Post Conflict Reconstruction

The previous chapter has analysed the CAB-J project impacts and various capacity building activities adopted in the micro credit program at each phase of the project from start-up phase to phase out stage. The CAB-J project has several strengths and weaknesses in its project design. It also has experienced several challenges during the project period. So this chapter is going to discuss various strengths and weaknesses of the project and various challenges of capacity building identified in the project implementation period.

6.1 Project Design
6.1.1 Strengths and Weakness
Before designing the project CARE did a diagnosis to assess problems (needs) and opportunities (assets), and to identify potential partners. So the CAB-J project was designed based on local needs. This project approach was expected to lead to positive outcomes.

The CARE adopted the "Savings led Credit" approach. The CAB-J project in which savings mobilization is a compulsory component in the project. This approach enables the poor people to change their status from 'always debtors' to savers. This approach is intended to lead to the sustainability of the program in the long term. Subsidy-based micro credit programs find it more difficult to attain financial sustainability compared to programs based on local resource mobilization. But in the post-conflict context of Jaffna, the prevailing uncertain situation made the people hesitant to put their savings in CBOs or they were unable to save due to inadequate income. This raises the question "Is the savings-led credit" approach suitable for a post-conflict context until permanent peace is reached in Jaffna?" At this point the project would have enough, well trained human resources to win the peoples' minds. But the CAB-J project only
employed one coordinator and three field staff to look after 20 CBOs with approximately 1000 members. Besides the field staff didn't have any previous experience with microcredit and they were only given one month training in microfinance.

The project is intended to build local community capacity in microfinance. This is essential especially in a post-conflict context like Jaffna because of the prevailing uncertain situation and repeated violence. This situation makes people experience temporary displacements for a short period. If the local community capacity is built in microfinance, the program would be able to continue providing financial services to their community in the transition because all group members are from the same community.

The project is tended to be flexible. During this period, the project implementers tried to practice “learning by doing” and adopt new methods based on their field lessons. So during its two-year period their objectives were not rigid and could be altered. This slow-start approach is particularly ideal for a post-conflict context like Jaffna.

The project team conducted a base line survey and CBO capacity assessment among CBOs after the completion of CBO selection. Based on the results of those studies the project team designed the training module. This is a better approach than using training modules irrelevant to the local context. Training modules should be designed based on the local context especially in a post-conflict environment. However, the training modules were still inadequate as the project did not provide any technical training on developing small enterprises even though there is a high demand for it among the beneficiaries.

The project is intended to build the trust and community network in Jaffna in the post-conflict context, as these elements had been devastated by the long lasting war. For this purpose the CAB-J held frequent meetings and training programs to
create avenues for social interaction and community development. The project incorporated local institutions like the University of Jaffna and co-operative societies in project activities, thus enabling the creation of more dense social networks in the Jaffna community.

The project had been designed in a way to include on-going monitoring during the project implementation period. For this purpose it practiced participatory monitoring and evaluation methods, where self-monitoring was done internally by each CBO. The project team arranged regular meetings with the CBO’s officers, members of the savings and credit groups and received monthly progress report from each CBO. This enabled the project implementers to keep track of the progress of the project. But the field officers couldn’t maintain much close contacts with individual clients due to lack of time and lack of staff.

In the evaluation phase the project had been designed to do two evaluations: mid evaluation and final evaluation. Each evaluation would be done by two evaluators: CARE would act as internal evaluator and independent evaluator as an external evaluator. This evaluation procedure would help avoid any biased results. When the CAB-J project is evaluated from the perspective of different stakeholders, to the community would learn more lessons gained from the project that could be used in the next project cycle.

The next section will describe various challenges encountered in the capacity building of CBOs in microfinance.

6.2 Challenges Encountered in Capacity Building of CBOs in Microfinance

The discussion of various challenges has been categorized under two topics: challenges at the level of intermediary organization (CARE International, Sri Lanka), and challenges at the level of the partner organization (CBO).
6.2.1 Challenges at the level of Intermediary Organization

In the CAB-J project, CARE International - Sri Lanka acted as an intermediary INGO. It experienced many challenges in the capacity building of CBOs.

Inadequate Staff

The limited number of field staff were not able to maintain close contact with the loan beneficiaries. The civil war in Jaffna had disturbed social capital very extensively and caused many constraints in the implementation part of this program. To implement the program successfully, it required a lot of human force to create a better understanding of the program and to convince the people that the program would be beneficial. For a certain period, until the members become familiar with the program, the project team has to maintain close contact and close monitoring with clients. Thus, more staff is needed to implement this program.

Lack of experience in microfinance

The field staff did not have previous experience in the microfinance sector except for one month training after their appointment. Lack of well-trained personnel is the main problem in post-conflict areas like Jaffna. The prolonged war caused more professionals to move away from the Jaffna peninsula. Bringing in trained personnel from the outside would cost more. So the local personnel training in microfinance is more cost effective and it is also a more time consuming process. At the same time trained personnel from the same community are expected to work more enthusiastically to uplift their own community thus enabling the project to achieve desired outcomes.

Lack of Funding

The CAB-J project is a savings and credit program with savings mobilization as a compulsory component. This savings component is also incorporated into the capital and loan provision. But the lump sum savings pool of many CBOs was lower than the expected amount. The savings mobilization mainly depends on
the economic condition of the members and the number of members for each CBO. At this point, CARE International expected that each CBO should have at least 75 members. But only 10 CBOs out of 20, which have been functioning as TCCS before, had a membership of more than 75. Furthermore, the savings amount of five newly formed CBOs was very low when compared with the savings amount of the rest of the CBOs. The other two groups of CBOs have already been involved partially or fully in credit services, but the newly formed CBOs are newcomers to this field and it takes time for them to get used to this program. Most of the CBOs were able to provide a small amount of loans for very few members. The rest of the members were dissatisfied because they could not get their loans within their required time, such as farmers with seasonal capital needs ranging from Rs 2000/= (CAN$ 34) to Rs 5000/= (CAN$ 85).

At the initial stage, CARE provided Rs 30000/= (CAN$ 508) as a seed fund for each CBO but this fund was not adequate because the credit demand was high and members needed more money for their employment activities. The project couldn’t get more money even though the implementers should be in a position to convince the donor agencies to get more money for the project. There was no sustained effort on the part of the implementers to pursue more funding applications.

**Demand for “Credit plus” Approach**

The CAB-J project focused on farming, fishing and small trader communities. Each of these communities is in need of non-financial services, in addition to credit services. The farming community suffered due to lack of farming inputs, lack of marketing facilities and so forth. The fishing community could not attain reasonable income from fishing due to restrictions on deep sea and night time fishing imposed by the Sri Lankan government. As a result, they wanted to become involve in other types of occupation in addition to their traditional occupation, but they did not have much technical knowledge to pursue these. The fishing community also required non financial services like technical training,
management, etc. The home-based business people also required more technical training on value added for raw material production and other types of technical skills related to the cottage industry. Providing non financial services would further increase the cost of services and create acute difficulties in implementing the core program activities since the project is already suffering from lack of financial support.

Lack of Monitoring
Even though the CAB-J team did on-going monitoring and assessment during the project implementation period they could not do it intensively due to inadequate staff, lack of transportation facilities, lack of funds etc. They could not make frequent visits to each CBO to monitor their activities. This situation led many loan beneficiaries to utilize the loan for non income generating purposes. In a post conflict context like Jaffna, it is important to maintain close contact with clients to guide them in their decision making, as they are very susceptible to change their plans because of the existing uncertain and insecure situation.

Prevailing Uncertainty
The volatile political situation has led internal refugees to expect that at anytime they might be again displaced from their homes or lose their lives due to another break out in the war between rebel and government forces. Due to this continuing uncertainty, most of the people in Jaffna, who have already been displaced to other parts of the country, were reluctant to initiate any self employment activities on a large scale even though they have been involved in the savings and credit program. Doyle (1998) supported this trend that people in conflict-affected areas are more inclined to save rather than invest. Some people were also reluctant to get involved in savings activities due to the lack of infrastructure, land and building availability, marketing, etc. which prevented them from getting adequate income from their occupation. The existing situation has therefore heavily hindered the attainment of overall goals and desired outcomes of the CAB-J project.
Conflicting Opinion

In Jaffna there were many INGOs like FORUT, GTZ, and SCF which provide microfinance services to the poor. All these INGOs were carrying out subsidy based programs. They gave micro credit loans to beneficiaries under this category and the beneficiaries were being encouraged to start self employment activities and repay the loans on an installment basis. Unfortunately these INGOs programs’ did not encourage savings mobilization. The people or members of those programs were already familiar with these subsidy-based programs. In contrast, the CAB-J project was a sustainability-focused program with savings mobilization as a compulsory component, and a primary requirement to become eligible for a loan. It was found that the people preferred the subsidy program rather than the more sustainable program.

Unfulfillment of Urgent Needs

The CAB-J project specifically concentrated on the people just below or above the poverty line and did not focus on the poorest people. Even though the program focused on this category of people who have little earnings, it did not provide enough to meet their daily basic needs. Although there was a high demand for microfinance among the people, they needed some kind of subsidy in addition to micro credit to meet their basic requirements until they reach adequate income levels to meet both household needs and income generation needs while repaying loan. Because of this nature a considerable percentage of people (18 %) utilized this micro credit money for consumption or other non income generating purpose. This trend prevented the project from being able to achieve its desired outcome.
Impact of Informal Money Savings System

The micro credit program is practiced by CARE International and the CBOs to improve poor people’s savings, however, the people are still practicing the traditional method of savings called “seettu”. It had been observed that the “seettu” had some negative impact on the CAB-J project progress. The Jaffna people are already familiar with “seettu” and they thought that the “seettu” method was easier and more flexible than the savings and credit method practiced by CARE. They were able to get money as early as possible in the “seettu” program. Due to lack of funds within the CAB-J project people had to wait for a long time. Because of this trend, the CAB-J project has also started to incorporate this “seettu” system into their project as well. One CBO had already incorporated “seettu” system along with the savings and credit program.

6.2.2 Challenges at the level of Partner Organization

The CBOs act as partner community organizations in the CAB-J project. For this purpose 10 CBOs were selected from Co-operative societies called TCCS, 5 CBOs were selected from welfare organizations which have partially involved in credit services and 5 CBOs are newly formed CBOs. At this level the CAB-J project experienced many challenges in the capacity building process in microfinance.

Purposive and Biased Selection of Beneficiaries

Some TCCS were doing purposive selection to avoid the very poor and were selecting the people who they believed would be able to repay loans. CBO leaders felt that the poorest of the poor would not be able to repay their loans and it would cripple their credit program. One TCCS leader stated that he only accepted his relatives and friends as TCCS members and it was because of this reason that the TCCS was functioning well. Because of this trend the poor in that particular village were not able to receive loans and thus remained poor. So there is a need to train the CBO leaders to understand the concept of the project.
Lack of Trust
The civil war has disturbed the social structure and destroyed the infrastructure network in Jaffna, causing frequent displacement and relocation of the people to other villages or cities. But the people of the host village or city would not recognize the displaced people since they do not know or mix very much with each other. This trend prevented the displaced people from becoming involved in this micro credit program. This also reflects a lack of trust among the people. In addition to this, the emergence of various Tamil militant groups among the Jaffna community has also assisted in the destruction of the existing social network while creating new militant opposition groups. Even though the displaced people, host villagers and militants live together they have different opinions regarding the war. This trend eroded social trust and affected the beneficiary selection of newly formed CBOs and the selection of loan recipients as well. This has also led to a lack of cooperation among those people in decision making and has contributed to difficulties in many group activities.

Lack of financial literacy
The frequent displacements of people in the conflict period caused many people, including CBO officers and members in TCCS and welfare organizations to live outside of Jaffna or in new resettlement areas. So in the post-conflict context, these CBOs faced difficulties in continuing their functions due to new adjustments and lack of financial literacy of people in their midst. Even though TCCS members have adequate knowledge of financing and credit provision, they also faced difficulties in the expansion of their services like creating linkages with formal financial institutions. The other two types of CBOs needed considerable training services. The members of newly formed CBOs had poor literacy in financing, planning, management, etc., and needed more help than members in the other two types of CBOs.
Previous Bad Experiences
Some TCCS members had previous bad or negative experiences in similar credit programs. In those TCCS, some people received loans but before settling the loan, they were displaced and had to live in another district. They had not returned and repaid the loan. Because of this loan default the rest of the members could not obtain loans in the mean time because the TCCS federation would not approve new loans until all previous loans were repaid. As a result, the members were frustrated and had negative opinions of CBOs.

Lack of Interest
The people who were involved in illegal employment activities, such as illegal distillation of liquor, theft etc., which were more common in the post conflict context than in the pre conflict phase, were not interested in becoming engaged in this program. At the same time other CBO members were also reluctant to enroll the above-mentioned groups of people into this program. After getting the loan, there was a strong likelihood that those engaged in illicit activities would not repay the loan. Furthermore, some people who were already engaged in CBOs had a lack of interest or awareness and exerted little effort in this program. They were not attending CBO meetings or training classes regularly but were very keen to receive loans.

Uncertain Weather and Need for Compensation Loan
Farming families are affected by uncertain weather more than people in other types of occupations. Due to unexpected drought or heavy rainfall farming families may not derive adequate income from their occupation, causing difficulties in repaying their loan. Among the CAB-J project beneficiaries, 27 percent of households utilized micro credit money for agriculture purposes. Out of them, 33 percent of households reported that they could not get adequate income due to bad weather like a lack of rainfall and drought. So they were struggling to repay the loan and had to seek another private lender to settle this
loan. They revealed that CBO should provide some special kind of credit services like a compensation loan to recover the lost capital.

Lack of Outward Linkages
Due to the prevailing political instability the Sri Lankan government was hesitant to invest money in post-conflict areas. Because of this, the formal financial institutions like state banks were reluctant to incorporate CBOs in post-conflict areas in their microcredit program. Furthermore, non-governmental financial institutions like private banks, local microcredit NGOs like Sarvodaya and SANASA had also withdrawn or reduced their activities in this area. But for the long term viability of the program it is necessary to link CBOs with those kinds of formal financial institutions. The lack of outward linkages would affect the viability of CBOs as well as the program after the completion of the project.

The above analysis of the empirical research findings discussed the impacts of the CAB-J project (Chapter 5) and the project's strengths and weaknesses and various challenges (Chapter 6) experienced in the microfinance capacity building during the project implementation in Jaffna's post conflict context. The next chapter will offer some conclusions and make further recommendations for the project.
CHAPTER 7
Conclusion and Recommendation

This chapter provides a summary of the study, important lessons that emerged from the experiences of the CAB-J project, some strategies, recommendations for national level policy making, and suggestions for future studies.

7.1 Summary of the Study
The Jaffna Peninsula had been facing intensive civil war since 1983. Since 1996 Jaffna has been under control of the Sri Lankan government and since then it could be considered a post-conflict area particularly in light of the 2002 permanent ceasefire and ongoing peace talks. The thirteen year long civil war has devastated the economy and the social capital of the Jaffna community. There is therefore an urgent need to reconstruct and redevelop the Jaffna community, particularly among the urban poor and the rural people who cover about 80% of the present population. It is very essential to uplift their standard of living through the strengthening of their economy and social capital. As one of the strategies to overcome this problem, CARE-International, Jaffna, has implemented the two-year pilot CAB-J project for the purpose of building the capacity of Community Based Organizations in microfinance, ensuring the financial access of the poor. It also aimed to increase the income generating activities of the poor and build the local capacity of the Jaffna community for economic and social empowerment.

This research was designed in a way to address the problem of how microfinance services run by international aid agencies like CARE International can contribute to building local community capacity in a post-conflict area such as Jaffna. Here I refer to the phrase 'local community capacity' to mean the strengthening of the economic and social capital of the community. For this purpose, the social and economic impacts of CAB-J were analyzed and the
challenges and constraints faced during project implementation period in the post-conflict were also identified and discussed.

7.2 Emerging Lessons from the Study of CAB-J Project

The lessons emerging from the study of the CAB-J project in Jaffna are described below.

**Microfinance could be successfully implemented in a post-conflict context**

From the experiences of the CAB-J project, microfinance projects could be implemented successfully in a post-conflict context even though several obstacles and challenges exist. In addition to this, microfinance programs work well in areas where microfinance already exists rather than in areas where there are no microfinance organizations. From the experience of the CAB-J project the CBOs selected from TCCS performed better than the other CBOs consisting of newly formed CBOs and CBOs selected from welfare organizations.

**Microfinance is a poverty alleviation tool in post-conflict reconstruction**

Microfinance could be used as a poverty alleviation tool when compared with relief assistance programs in terms of helping families to rebuild their livelihoods in post-conflict areas like Jaffna. Furthermore it could become part of a comprehensive development program after permanent peace and political solutions have been achieved in those areas. The CAB-J project had created positive impacts on the socio-economic development of the Jaffna community which had severely destroyed by the civil war. External factors, such as market and infrastructure improvements etc. which may affect the community’s socio-economic aspects were not analyzed due to time limitation. However the results derived from the analyses of the CAB-J project revealed that more than half of the loan beneficiaries expressed moderate positive impacts on their employment and income after becoming involved in the CAB-J project. Furthermore, it also enabled the certain percentage of loan beneficiaries to attain favorable changes in education, housing conditions and the purchase of assets. They were able to
increase their household expenditures and this led to changes in their food patterns, as they were able to consume more fish, meat and other non vegetable food. After getting involved in this savings and credit program the savings trend, borrowing capacity and social participation of the people have improved. Moreover, the majority of the project participants are women, thus enabling them to engage in self-employment activities and other forms of social participation. Finally it can also lead to the empowerment of women which is a strategic goal for the Jaffna community, especially among poor people. The long lasting war has caused many deaths, leaving a considerable percentage of widowed women or female-headed households due to male out-migration for security purpose. These trends make poor women struggle harder to support their families than middle or upper class women.

High Demand for Non Financial Services in addition to Financial Services in Post Conflict Context
In the Jaffna post conflict context the people receiving loan require non financial services such as training programs, marketing, and input provision. This will enable them to select good self-employment activities and get more income from their occupations, among other benefits.

High demand for human resource development in microfinance
From the CAB-J project experience, it was shown that more staff well-versed in building community social capital is needed in this sector, particularly in the post-conflict context because of lack of trust among people. Some people are reluctant to invest money in employment activities due to uncertain conditions. Others do not have a clear opinion about the program or have used production loans for consumption purposes. To eliminate such drawbacks the program requires more staff to be engaged at the field level. There is a need for the project staff to maintain close contacts with the clients.
The CAB-J Project requires adequate funding support
The CAB-J project suffers from inadequate funding and small amounts of seed funds given to each CBO, even though there was high demand for micro credit. The high demand for non financial services would also increase the cost of the program. The CAB-J project was able to obtain only a limited amount of funding from the CARE Head office in Colombo, the capital of Sri Lanka. This reflects the fact that microfinance donors find that a post-conflict environment is unstable for development until a permanent solution to the war problem is found. The question therefore remains for donor agencies: is their reluctance to invest more money in Jaffna partly hindering current efforts to peace-building in the area?

It is important to overcome clients' dependency mentality
Microfinance implementation in a post conflict context needs special attention in overcoming clients' dependency mentality. The CAB-J project experienced huge challenges in overcoming the clients' dependency mentality in Jaffna due to the long lasting war that disturbed the social structures, and trust among the Jaffna community. The prevailing uncertainty had made the people reluctant to join or to show interest in the program. To counter those negative trends, more field level staff are needed to allow more time to educate the people and gain their trust.

Learning by doing is ideal for a post-conflict context
Practicing the “learning by doing” process is an appropriate strategy for microfinance in the post conflict context. During the CAB-J project implementation period the implementers would be able to understand the project operating context, adjust operations, practices, etc. Flexible approaches in microfinance implementation in the post conflict context would enable the development of strategies suitable for the local context. For example, the CAB-J team has been incorporating traditional methods of money saving into the savings and credit programs. Moreover, the need for flexibility also suggests that a single microfinance approach is not suitable for all places and that microfinance
approach should be developed based on the local cultural context and demand of the local people.

Capacity building in microfinance is a time consuming process in a post-conflict context
In conflict or post-conflict areas like Jaffna, economic and social development efforts have been disturbed by the war. Due to the lack of human resources, capacity building in microfinance would therefore require a long period of time to successfully establish its foundations. During this time, donor funding is necessary to continue the program’s human resource development and organizational capacity-building efforts.

There is still demand for grant or other subsidy in addition to micro credit
Due to inadequate funds available at the initial stage of the program, clients could not be involved in large-scale income generating activities, hence, they were not able to attain the adequate amount of income for both housing and food expenditures and livelihood activities while repaying their loan. Therefore, there was a demand for other types of assistance at least for a short period of time until their livelihood activities become established. Furthermore, as the community is still experiencing repeated violence, this also triggers the need for relief assistance at least during the conflict period.

Changes in Government Policy and Regulatory Environment is Important in the Long Run
The restructuring of government policy and its regulatory environment is important in both the short run and in the long run. Currently the Sri Lankan government is conducting many microfinance programs, although there is strong hesitation to implement those programs in Jaffna. Many non-governmental organizations like SEWA LANKA and private banks also follow this trend. But in the long run microfinance programs that are being implemented in Jaffna will suffer problems of sustainability because of the lack of adequate outward
linkages. To overcome this problem, a favorable government policy and regulatory environment in a post-conflict area like Jaffna is essential and the government should encourage donor funding agencies and other private institutions to invest their money in Jaffna. Moreover, local people should be encouraged to participate in policy assessment exercises, such as policies that restrict or prohibit fishing in coastal communities.

**Permanent Resolution for the Conflict Problem is Essential in the Jaffna Context**

The CAB-J project experiences reflect the understanding that until a permanent political resolution is reached with regard to the conflict in Jaffna, it would be difficult to reach the desired outcome of the project. Most of the constraints and challenges of the CAB-J project relate either directly or indirectly with the political instability of the Jaffna area. It is then essential to reach political stability in Jaffna to achieve the maximum success of the program as well as long term sustainability.

The above mentioned lessons derived from the experience of the CAB-J project could be utilized to alter the existing strategy within the microfinance sector in post-conflict areas like Jaffna. The next section will describe a few strategies that could be adapted in the existing CAB-J program.

### 7.3 Strategies

The CAB-J project has already adopted many strategies to direct the program in a sustainable way. These are: 1) targeting only the people just below or above the poverty line and not those considered the poorest people. 2) starting slowly and setting future strategies in microfinance, 3) adopting a group lending approach, 4) introducing a savings component in addition to credit, 5) more flexibility in setting interest rates for the loan, based on the economic situation of the members. The flexibility in interest rate setting is important at least in the
initial stage of the program in a post conflict context, even though they must be incorporated within some specific components in the existing program.

The program should offer more training to the clients in post-conflict environments than that offered in a normal context, thus enabling the participants to identify suitable self-employment activities. The CAB-J program should include non-financial service provisions. This will increase the program costs but initially this type of service, such as technical training, input provision and other types of training could be provided by utilizing local institutions like the University of Jaffna's Agricultural Department and other relevant local institutions on an in-kind basis.

Due to the prevailing situation people are reluctant to invest their money. To eliminate this trend the implementers should arrange frequent meetings and at the same time special components should be included during the violent conflict periods. These include blending relief assistance into existing credit and savings programs without disturbing the original program (Doyle, 1998). During the violent periods the program should be able to give special loans for affected clients to recover the physical capital destroyed by the violent conflict. Relief assistance could be given in the form of material aid or grants. These kinds of special opportunities encourage the clients to get involved in the microcredit program and they could be required to make the regular loan repayments of previous loans continuously. The program implementers should be flexible during this period, in that they should not compel the clients to repay their old loans before receiving the special loans. In Jaffna many INGOs are conducting relief assistance programs. Among them, some organizations like CARE, SCF, and UNHCR are carrying out microfinance as well as relief programs. They could then blend the two programs.

Further, each CBOs should be linked with state-owned financial institutions like banks. Necessary measures should be taken in this aspect by program
implementers. The government and non-governmental financial institutions should select CBOs as part of their microfinance programs. To contribute to this, CARE International, Jaffna should initiate a dialogue with government and non-governmental program implementers.

7.4 Recommendations
This research suggests the following recommendations for further national or regional levels of policy-making and for further implementation of the microcredit project.

- Along with credit and savings the beneficiaries should be given grants or subsidies for some periods. This means welfare and relief programs and micro credit programs could be carried out in parallel until beneficiaries are able to generate adequate income from their self-employment activities. This type of assistance should be available during violent periods or bad weather times without disturbing the original program.

- The urban poor and rural people need both financial and non-financial services like marketing, input availability, technical training and so forth. Therefore a "credit plus" approach is more suitable than a "credit only" approach.

- In Jaffna, many INGOs are carrying out microcredit programs which included subsidy based and sustainability based approaches. The establishment of a microfinance network structure among INGOs is therefore important. This will enable them to gather commonalities and different experiences from each program and develop an integrated strategy in microfinance for Jaffna community. It would also help avoid program overlaps and replication in the implementation of microcredit projects.
• Jaffna is located in a post-conflict area and it has yet to enter into a permanent political solution dealing with this issue. In such a situation, more people tend to save money rather than invest in self employment. Therefore, intensive monitoring and maintenance of close contacts with clients is necessary. This requires adequate, well-trained staff to be involved in the program at least for a short period until people are fully involved in the program or project.

• After the pilot project period, each Community Based Organization should be able to function independently. For this purpose it should develop linkages with other formal financial institutions. At this point the state banks should select Community Based Organizations as their local partners in their micro finance projects or programs. In that way the current government policy should be more flexible or modified.

• A permanent and stable political environment should be created to achieve the maximum success of any type of development program or project in Jaffna.

7.5 Suggested Future Studies
The following future studies are suggested in the microfinance sector to further the development of microfinance in the Jaffna Peninsula as well as other parts of the country which face a similar situation.

Other microfinance programs carried out by INGOs in Jaffna should be studied while facilitating a process of gathering commonalities and constraints faced by the various microfinance programs in post-conflict Jaffna. This enables the microfinance providers to develop an integrated strategy within the microfinance community in Jaffna.
After completing the pilot project period, the project should be assessed to account for the number of beneficiaries who continued successfully after the project period and measure the degree of expansion of their employment based on scale, number of employees, etc.

The traditional money saving system (seettu) and its various forms should be studied in depth as it would help to adopt new strategies or assist in improving the existing strategies within micro credit program.

7.6 Conclusion

This study concludes that microfinance is an important tool for socio-economic development in post-conflict areas like Jaffna. Even though the CAB-J micro credit project produced positive impacts, it is difficult to make final conclusions, and further study is needed. This was also due to the fact that the CAB-J project is a two year pilot project and my research study was carried out at the end of the first year. The actual impacts should be assessed in regards to the long term effect and sustainability of the program. Generally many of the micro credit programs practiced in several countries around the world provide successful histories in the short period, and face several problems in achieving sustainability in the long term. Fernando (1999) suggested that the most sensible way to measure the success of micro credit programs may be to take account of the number of beneficiaries who remain successfully in business for some time after the project period and also are able to expand and diversify their business while continuing repayments. External factors, such as market and infrastructure improvements etc. which may affect the community's socio-economic aspects were not analyzed due to time limitation. Due to the lack of data, I was unable to reach conclusions similar to Fenando’s account.

But from the previous history of microcredit programs in Jaffna, it was obvious that microfinance programs like Thrift and Credits Cooperative Societies had
been successful until the commencement of the intensive conflict and consequent displacement which collapsed its functioning capabilities. Due to this reality, the CAB-J project was designed in a way to build the capacities of the Community Based Organizations with regard to financial management skills of the partner organizations and to have sustainable and transparent functions throughout the conflict situation.

From this research study I would conclude that the CAB-J microcredit could be used as a tool in alleviating poverty in the Jaffna context by strengthening the socio-economic structures of the Jaffna community which have been devastated by the long lasting civil war. However, the maximum success and outreach of the program require a permanent, stable political environment in the Jaffna Peninsula. Moreover, some special components such as incorporating non-financial services, blending the microcredit program with relief assistance, increasing human resources in microcredit, and pouring more funds into the program should be incorporated into the existing programs to enhance its outreach. Furthermore the attempt toward the capacity building of Community Based Organizations in microfinance is a long term process but one that will enable the people to jump-start income generating activities on a large scale once the Jaffna Peninsula reaches a permanent political resolution to the internal conflict problem.


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Appendix 1: General Interview Guidelines for Loan Recipients study on Microfinance and Post-Conflict Reconstruction: Organizational Capacity-Building of a CARE International Microcredit Project in Jaffna, Sri Lanka

1. 1) Name of interviewer:  
2) D.S division of Interview place:  
3) Date:  

2. Household details

<table>
<thead>
<tr>
<th>Name</th>
<th>Relationship</th>
<th>Age</th>
<th>Marital status</th>
<th>sex</th>
<th>Years of education</th>
<th>Occupation</th>
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3. The utilization of microcredit money for
   - Farming (agriculture / livestock)
   - Fishing
   - other self employment activities (detail)
   - non income generation activities (detail)

4. Does the CAB – J microcredit make any impact on the occupation? 
   Yes / No
   If yes, what kind of impact?
   - continuing the occupation
   - expansion of the occupation
   - starting a new occupation
   - others
   If no, what are the reasons for that?

5. Do you have any impact on income after the involvement with the CAB – J microcredit program? Yes / No
   If yes, degree of impact on income
   - High
   - moderate
   - low
   If no, what are the reasons for that?

6. Do you have any impact on your children education after the involvement with the CAB – J microcredit program? Yes / No
   If yes, - list the positive impacts after the program
   - list the problems which are solved in education after the involvement in this program
   If no, what are the reasons for that?

7. Housing condition (observation)
   - temporary/ permanent
   - own / rented / share with relatives / share with friends

8. Do you have any improvement on housing condition after the involvement with the CAB – J microcredit program? Yes / No
   If yes, kind of improvement  
   - building of permanent house
   - repairing the present house
   - move to rented house from shared house with relatives or friends
   If no, what are the reasons for that?
9. Does the CAB – J microcredit project make positive changes on your purchasing power? Yes / No
   If yes, kind of positive changes on purchasing power
     - Purchasing of production tools/
     - Purchasing of household items
     - Purchasing of livestock
     - others
   If no, what are the reasons for that?

10. Is there any increase in your monthly expenses after getting involved in the CAB – J micro credit program? Yes / No
     If yes, what is your monthly expenditure?
     If no, what are the reasons for that?

11. How does the CAB – J project impact on your saving trend?
     - after the involvement with the project, able to increase the savings at different degrees – high / moderate / low / no impact.
     If no impact on savings, what are the reasons for that?

12. What is the improvement in the borrowing capacity after getting involved in the microcredit program?
     - borrowing capacity increased after the involvement with program
     - borrowing capacity does not show any improvement after the involvement with program
     If there is no improvement, list the problems in borrowing capacity before & after the involvement of program
     If the borrowing capacity does not improve even after the involvement of program, what are the reasons for that.

13. What is the impact of CAB – J micro credit project on social participation in community volunteer organization?
     -after the involvement of program social participation increased / not increased.
     If involved give some detail of that

     | Social organization | activities | Reason for participation |
     |---------------------|------------|--------------------------|
     |                     |            |                          |

     List the reasons, if there is no improvement in social participation even after the involvement of program.

14. What is your opinion on the existing CAB – J project program?
15. Do you have any suggestions for further improvement of the program?
    If yes, list them.
Appendix 2:

A) Interview guideline for CAB-J Project Staffs

1) Could you explain briefly about the CAB – J project?
2) Why & how did the CARE International choose this project to Jaffna peninsula?
3) Can you tell me the overall performance of CBOs?
4) What are the problems you faced during the project implementation period?
5) What are the challenges you experienced in the capacity building process at grassroot level?
6) What are the challenges you experienced in the capacity building of CBOs in microfinance at institutional level?
7) What are the strengths and weaknesses in the original project design?
8) What are the war implications in Jaffna community?
9) What are the government implications on Jaffna microfinance program?
10) What are the strategies should be adopted in the future microfinance program?
11) Can you tell me the group members' performance during meetings and training programs (Gender wise)?
12) Does this CAB – J project have any special objectives in gender (specially women) development?

B) Interview guideline for CBO leaders

1) As a CBO leader, could you explain your responsibility & duties in this CAB – J project?
2) Can you tell me the overall performance of the CBO regarding number of members, savings mobilization and credit provision and repayment?
3) Can you tell me the group members' opinion about this program?
4) What are the challenges/ problems facing in providing microcredit services to clients at community/ members level?
5) What are the challenges experienced in building the capacity of CBO in microfinance?
6) Can you list the selection criteria of your CBO to be a loan recipient?
7) Does your CBO have any restrictions on usage of loan money? If so, how do you ensure the clients use the loan money for the particular purpose?

8) What are the war implications on the microcredit program and community?

9) After the introduction of this program, do you feel any improvement in socio-economical sector of your CBO members/ community?

10) Can you tell me your opinion about the CAB-J microcredit project?

11) Do you want make any suggestions to improve the program in future?
Appendix 3: The Name list of Interview respondents and Date of Interview

<table>
<thead>
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<th>Name of Respondent</th>
<th>Date</th>
<th>Name of Respondent</th>
<th>Date</th>
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Appendix 4: The Name List of Key informants for the interview

A) CBO Leaders

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B) CAB – J Project Staff

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<td>Kalai (Field Staff)</td>
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<td>Deni (Field Staff)</td>
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<td>Ramanan (Field Staff)</td>
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