From Aid to Enterprise: BRAC's Evolution from Relief to Sustainable Financial Services in Sri Lanka

Contents

Preface

This report was largely written in January 2014, covering the activities of BRAC in Sri Lanka, a development organization based in Bangladesh, starting from the wake of the 2004 Indian Ocean tsunami through 2013. Later in 2014, when the transformation process described here was close to completion, the Sri Lanka central bank enacted reforms to consolidate the finance sector, including a significant increase in capitalization requirements for financial entities. As a result, BRAC International decided to exit Sri Lanka, approving the sale of its 59.3% stake in BRAC Lanka Finance PLC to its partner in the joint venture, Commercial Leasing and Finance PLC, a part of Lanka Orix Leasing Company, for USD 4.7 million. The nine-year presence of BRAC in Sri Lanka thus came to an end, completing the journey from aid to enterprise.

Executive Summary

BRAC sent a relief team to Sri Lanka in early 2005 in the immediate aftermath of the Asian tsunami, one of the most significant natural disasters in recorded history. Since then, BRAC's Sri Lanka operations went through significant transformations, evolving to meet the needs of poor communities. The following paper documents the rare trajectory of BRAC's operations in Sri Lanka, evolving from a philanthropically funded relief operation to a commercial financial services company serving the poor.

Table 1 BRAC Sri Lanka Microfinance Operations at a Glance

BRAC Sri Lanka Microfinance Operations at a Glance	
Clients:	Economically active women from 18 - 60 years only
Loan Provision Through:	Village Organizations (VOs) clusters of 15 -45 women, with sub-groups of 5 women each
Collateral:	Not Required
Total Borrowers:	67,816 borrowers as of April 203
Total Portfolio Size:	9.9 million USD as of April 2013
Average Loan Size:	USD 261
Loans Range:	USD 80- 750
Duration of Loans:	1 Year
Interest Rate:	15% Flat

Despite the challenges of starting up in the aftermath of a disaster, in a country already plagued by decades of civil war, BRAC scaled up quickly to become a key player in microfinance in Sri Lanka. In part, this was due to an established microfinance methodology that BRAC transplanted from Bangladesh, and the support of early philanthropic assistance that allowed BRAC to reach poorer populations and move at a gradual and measured pace towards sustainability. BRAC's success in Sri Lanka is also testament to the economic resilience of Sri Lanka's women, given that its entire portfolio and 87% of its staff in Sri Lanka is comprised of women.

As its tsunami-affected clients grew more resilient and less reliant on philanthropic assistance, so did BRAC's own operations in Sri Lanka. As it grew sustainably, BRAC encountered a new set of challenges that impacted its ability to serve the financial needs of clients, and that threatened its growth and very ability to execute its pro-poor mission. A difficult policy environment characterized by ambiguous and changing regulations of Sri Lanka's microfinance sector created a situation wherein BRAC could not obtain access to the capital it required to grow commensurately with the needs of borrowers.

In light of these pressures, BRAC, referred to by the Economist (2010) as the largest, and "one of the most businesslike" NGOs in the world, made a bold and unorthodox move for a development sector NGO. To bypass the ambiguities of the microfinance sector, BRAC formally entered the private sector through a partnership with a local commercial enterprise, Lanka Orix Leasing Company (LOLC), to acquire an existing for-profit financial services company in Sri Lanka. It subsequently sold its stake in this joint venture, thus completing its nine-year journey in Sri Lanka.

BRAC's evolution in Sri Lanka is an atypical story, with insights for the humanitarian and disaster relief communities as well as development and microfinance practitioners. The transformation process, at once strategic on the part of BRAC, as well as adaptive to local contexts, was orchestrated in close partnership with LOLC, a conglomerate financial services company with a strong 30-year track record in Sri Lanka as a provider of leasing, insurance and microcredit products. There is much to learn from BRAC's story in Sri Lanka and the agreement between BRAC and LOLC, with implications for microfinance expansion strategies and pro-poor financial inclusion through commercial means.

"When BRAC entered Sri Lanka, best practices in microfinance were not strong. Unsustainability was not uncommon in the sector. Operating models were running at high costs, and portfolio quality was low. BRAC's entry set an example for the industry. It used to be that microfinance organizations in Sri Lanka would think that if the poor can't pay, they can't pay. Now they have stepped up their methodology, seeing that microfinance is not a charitable act, but a sustainable tool to lift people out of poverty."

Anura Athapattu
Microfinance Consultant &
Chairman/ CEO
Development Facilitators Pvt Ltd

Why is BRAC's Experience in Sri Lanka Noteworthy?

BRAC Sri Lanka represents a compelling case of an organization maneuvering to meet the needs of its clients and navigating an often convoluted and cumbersome regulatory framework in doing so. Several milestones and challenges characterized BRAC's experience in Sri Lanka from 2005 to 2014:

- **Rapid growth in a post-disaster, and post-conflict environment**
  Although new to the country following the 2004 tsunami, BRAC was credited with being the fastest growing microfinance initiative in Sri Lanka during the years 2007 to 2009 (GTZ, Banking with the Poor Network) with operations primarily in tsunami affected regions. These years also witnessed additional constraints on expansion, and movement in the east of the country, due to an ongoing ethnic conflict in the North and Eastern regions. Despite these challenges, BRAC's microfinance portfolio scaled up to serve over 112,000 members and 73,000 active borrowers with a loan portfolio of over USD 11.2 million at its peak in 2011.

- **Established operations in the East during wartime**

Despite an ongoing ethnic conflict, BRAC expanded branches in the East. Its established presence there prior to the end of the war allowed BRAC Sri Lanka to make a contribution to war torn communities and their financing needs early on.

- **Best practices for the microfinance sector**
  During its early years of operation, BRAC was credited in the microfinance sector for its rapid growth. At the time of BRAC's entry into Sri Lanka, the bulk of microcredit programs were being funded largely by donors or subsidized through government banks and programs. (GTZ, Banking with the Poor Network, 12). During BRAC's initial years of operation in Sri Lanka, sector-wide PAR (portfolio at risk) at 30 day levels were routinely in the double digits.[1] BRAC set a new standard for PAR 30, starting at roughly 5% and eventually reaching less than 1%. Across the microfinance industry in Sri Lanka, PAR 30 rates dropped in the years since BRAC's entry into the sector as BRAC modeled a methodology and organizational culture with strong portfolio results.
- **Sector capacity building**
  BRAC Sri Lanka took an open philosophy to sharing its methodology and expertise. BRAC invested in strengthening the capacity of partner NGOs in the field by inviting other NGO staff to its trainings and through handing over BRAC working areas with existing programming and resources to local small NGO partners.
- **Significant constraints on growth**
  Even with significant funding constraints starting in 2010-2011 onwards, BRAC remained at the leading edge of microfinance delivery, serving the second largest number of clients in the unregulated microfinance segment as of mid-2013, with the lowest PAR at the 30 day mark, and with more demand for loans than it could service.
- **Banking by women, for women with a community development focus**
  Built into BRAC's mandate is a strong focus on local community development and empowerment of women. All borrowers and roughly 87% of BRAC staff in Sri Lanka are women. For low-income women borrowers particularly in rural areas, BRAC is a viable source of credit to develop their entrepreneurial efforts, and it is often more comfortable for them to approach female credit officers for their financing needs. For female employees, who may otherwise be working in retail or manufacturing sectors, employment at BRAC is often a more professional career path than otherwise available, offering greater mobility, and opportunities to advance. BRAC's expansion and success is testament to the community development, entrepreneurial and professional competencies of a predominantly women-driven staff and an entirely women-comprised borrower community.
- **An International NGO Entering the Private Sector Through an Acquisition**
  BRAC Sri Lanka became the first foreign NGO to enter the financial sector in Sri Lanka, through the acquisition of a registered finance company. This move completed a significant and challenging transformation process from that of a non-profit organization functioning in the unregulated microfinance sector, into that of a for-profit entity in the well regulated financial services space. No other foreign entity has yet undertaken such a transformation in Sri Lanka.

[1] MIX Market Records, Sri Lanka MFI reporting (http://www.mixmarket.org/mfi/country/Sri%20Lanka)

- **Exit From the Market**
  In 2014, BRAC completed the sale of its remaining stake in BRAC Lanka Finance PLC to a subsidiary of LOLC Group, a local private enterprise, thus completing the transition from aid to enterprise.

Introduction: From Bangladesh to Sri Lanka

BRAC's Beginnings

Founded in 1972 in Bangladesh, in a remote rural village as a limited relief operation, BRAC is now considered the largest development organization in the world, and one of few based in the Global South. It has unprecedented scale, reaching an estimated 135 million people worldwide, with over 120,000 employees and operations currently in 11 countries, including in Asia (Afghanistan, Bangladesh, Pakistan, Philippines and Myanmar), Africa (Liberia, Sierra Leone, South Sudan, Tanzania, and Uganda), and the Caribbean (Haiti).

In Bangladesh and increasingly in other locations, BRAC's holistic development approach has expanded from its early roots in relief and rehabilitation to cover a broad spectrum of development activities, including microfinance, education, healthcare, legal services, agriculture and community and women's empowerment.

After 30 years of operations in Bangladesh, and shortly after its first international expansion to Afghanistan in 2002, BRAC's entry into Sri Lanka was not a pre-meditated strategic move. BRAC's arrival in Sri Lanka was precipitated by a large-scale humanitarian crisis, and BRAC's desire to share its expertise and respond to a neighbor's time of need.

> *"There are examples around the world of microfinance institutions transforming into companies. What is different about BRAC in Sri Lanka is the unique path to get to that point and the way it was done, through acquiring a for-profit company. "*
>
> S. N. Kairy
> Group CFO,
> BRAC & BRAC International

> *"In our lifetime this was a huge disaster, and Sri Lanka was a war-torn country too. We wanted to respond as a neighbor. In Sri Lanka we could do something, and share our relevant expertise in disaster recovery and emergency response in Bangladesh."*
>
> Sagarika Indu,
> Country Representative,
> BRAC Sri Lanka

Entry into Sri Lanka: A Neighbor's Response

The 2004 South Asian tsunami claimed an estimated total of 230,000 lives and countless livelihoods in multiple countries in South Asia and Africa. The days and months following the tsunami made clear that outside of Indonesia, which felt the effects of both the quake and the resulting tsunami, Sri Lanka was the country most adversely affected.[2] Over 35,000 individuals lost their lives, over 800,000 individuals were displaced, and official estimates projected over 150,000 individual livelihoods lost. Ninety percent of those affected lost productive assets including their dwellings. Micro

[2] BRAC sent a technical assistance team to work with an Indonesian microfinance organization in Aceh for several years to aid in

and small businesses (including fisheries, tourism, textiles, coir and carpentry) were most adversely affected. (Srinivasan, 08). Most of the damage was concentrated in Northern and Eastern provinces of the country, regions already ravaged by a then 20-year ethnic conflict.

As an organization with over three decades of experience responding to frequent cyclones and flooding in Bangladesh, and with tremendous experience seeding livelihood generation and economic growth out of these poverty and disaster relief contexts, BRAC felt compelled to offer assistance in the aftermath of this extraordinarily devastating event.

> *"Disaster is a big democratic process of nature. It creates an emergency for all. After it is over, those who were better off, those with support systems, find a way forward. Those already in tough positions before a disaster have difficulty surviving once it passes. After BRAC's immediate tsunami response, there was a need to develop economic sustainability for these individuals in the long term. BRAC has this experience. "*
>
> Sagarika Indu,
> Country Representative,
> BRAC Sri Lanka

BRAC's initial tsunami relief interventions in Sri Lanka were geared towards recovery and rehabilitation efforts, including the cleaning and disinfesting of contaminated water wells, constructing latrines to prevent health hazards, and replacing lost and damaged school materials of tsunami affected school children.[3] In May of 2005, BRAC registered itself in Sri Lanka as a non-governmental organization (NGO) to expedite its work and run development programs in the fields of social services, livelihood and capacity development (Srinivasan, 34). In the months that followed, BRAC began to organize tsunami affected individuals into clusters and began delivering microcredit loans.

> *"At BRAC, our objective is not to create a surplus for investors, or to perpetually use donor funds. It is to sustainably serve poor people. We prefer to start with subsidy and donor funds, and then gradually move to sustainability. That movement has to be driven by clients and their own ability to borrow greater amounts in their own time."*
>
> S. N. Kairy
> Group CFO,
> BRAC & BRAC International

Within a year of operations, BRAC reached over 26,000 clients making it a significant microfinance player in Sri Lanka. This milestone was attributed, by local microfinance experts such as Anura Athapattu, Microfinance Consultant and Chairman/ CEO of Development Facilitators to "well established management practices, systems, and a ready methodology largely replicated from Bangladesh."[4]

BRAC leadership, including its CFO, S. N. Kairy, attribute those early successes to BRAC's ability in Sri Lanka to pursue its preferred avenue of entry into microfinance in order to reach the poorest. Having started up with subsidies from donors including Oxfam, BRAC had an

[3] Interview with Sagarika Indu, Country Representative, BRAC Sri Lanka, June 2013.
[4] Interview with Anura Athapattu, Microfinance Consultant & Chairman/ CEO Development Facilitators Pvt Ltd, June 2013.

opportunity to serve poorer populations with the smaller loan sizes they desired, rather than feel the pressure of reaching sustainability more quickly by serving the moderate poor with higher loan sizes.

According to Kairy, “Sri Lanka is successful because we started with grant funding. This is the best way to set up, as it allows you to really reach the poor, and then allows a path for sustainability to emerge. If there is no grant, then in effect, you are serving a higher income portion of the population, perhaps the moderate poor. But to eventually get to a place of sustainability while serving the poorest, an organization needs some level of subsidy at the start.”

Another factor that influenced success, according to Kairy, was a cultural context that BRAC understood well. “There were a lot of cultural similarities between Bangladesh and Sri Lanka. The family networks and roles are very similar. We work through women borrowers, but in countries like Bangladesh and Sri Lanka, it is often a family unit that is contributing to paying the loan back. Family members are jointly responsible for paying the loan, and the family is itself a layer of social collateral.”

In much the same way BRAC’s entry into Sri Lanka was not premeditated, neither was BRAC’s rapid rise as a key microfinance player in Sri Lanka. “We were not envisioning coming into Sri Lanka at the level that we operate now,” says Sagarika Indu, current BRAC Sri Lanka Country Representative. She adds, “But it is BRAC’s nature that we always respond to the needs of the people.”

An Exit for BRAC in Sri Lanka

In June 2013, BRAC partnered with Lanka Orix Leasing Group (LOLC), a longstanding provider of leasing and insurance and other financial products with its own microfinance practice (LOLC Micro Investment Ltd), to acquire a majority stake in a regulated financial services company called Nanda Investment and Finance PLC (NIFL). The acquisition of Nanda, a household name in Sri Lanka with significant brand recognition, represented a new chapter for BRAC in Sri Lanka. The new entity was now part of the regulated private sector, with the capacity to accept deposits and raise debt financing from international sources, two key prior constraints to its access to capital and growth trajectory. In 2014, in response to new changes to the Sri Lankan central bank’s capitalization requirements, the board of BRAC International sold its stake 59.33% stake in the jointly held company, BRAC Lanka Finance PLC, to Commercial Leasing and Finance PLC, a subsidiary of its partner, LOLC. The sale was completed in September 2014.

Evolution of BRAC in Sri Lanka, Accomplishments and Impact

BRAC's evolution in Sri Lanka, characterized by innovation and course correcting along the way, has largely been the product of two interdependent factors. Firstly, BRAC's trajectory has been significantly affected by a shifting and often adverse regulatory environment as Sri Lanka moved from post-disaster, to post-war, to economic growth. Secondly, BRAC's charted course has been affected by its attempts to keep pace with the evolving needs of its low-income clients in this rapidly changing environment.

BRAC Starts to Offer Microfinance in Sri Lanka

Beginning in 2006, as the need for immediate disaster relief and rehabilitation efforts subsided, BRAC moved towards providing micro loans and facilitating economic development at the community level. BRAC categorized the affected communities of women by need, through extensive surveying and mapping exercises.

BRAC took a phased approach to entering the sustainable microfinance sector. Its first steps in this direction were to provide in-kind grants, typically productive assets such as sewing machines or coir (rope) spinning looms to tsunami-affected women. Eventually, BRAC began to provide zero-interest loans to select clients, followed by reduced interest loans, at interest rates of 6-8%, (Srinivasan, 23) much below commercial rates. Over time BRAC formalized its process of offering microloans along the lines of its established methodology, initially lending to tsunami victims in clusters of roughly 10 women. Gradually, interest rates were increased to commercial rates by 2007 and borrower clusters were organized into formal Village Organization (VOs), sometimes as large as 40-45 members each. As its lending activity grew, BRAC began to emphasize capacity building efforts both for low-income borrower communities and for partner NGOs alike.

Capacity Building for Low-Income Women Led Households

Starting in 2007, the Sustainable Livelihood Development Programme advanced by BRAC was primarily geared at strengthening the capacity of the worst tsunami-affected communities in close proximity to BRAC branches. Select clients, mostly women headed households, widows, and those without other NGO assistance were selected to receive loans and grants from BRAC in conjunction with training on poultry and livestock rearing, agriculture and enterprise development. Women were trained in basic business planning, assessing the market, locating wholesale options, handling day to day book-keeping and interacting with customers (BRAC Sri Lanka Annual Report, 2009).

Capacity Building for Partner NGOs

To seed the development of the broader NGO sector, BRAC's Capacity Development Programme, was geared towards strengthening local NGOs, including area development organizations, social services and welfare provision organizations. BRAC invited partner NGO staff to its own staff trainings, began to train Master Trainers, and deliver workshops to address the capacity shortfalls of partner NGOs in the areas of organizational development, team management, operational systems management BRAC simultaneously handed over BRAC working areas with existing activities (Avellaneda, 25) and resources to partner NGOs (BRAC Sri Lanka Annual Report, 2009).

The First Transformation

By the end of 2006, several tsunami-related disaster relief programs were wrapping up in Sri Lanka, and related funding began to dwindle. Beneficiaries of these programs were turning to BRAC for their financing needs. As demand for microfinance loans increased, it became increasingly clear to BRAC that the operating structure of an international NGO was not sustainable, and not ideally suited to develop a profit-generating microfinance institution. By the end of 2006, due to these circumstances, and due to restrictions posed by the Sri Lankan government on the borrowing activities of international NGOs, BRAC went through its first structural transformation. It established a non-profit Guarantee Company with the same mission and vision of the previous NGO, and was henceforth known as BRAC Lanka (Guarantee) Ltd.

Scaling Up

In the years 2006 and 2007, BRAC began rapidly scaling up its microfinance program, expanding its client base beyond the initial tsunami victims. By 2007, the company had evolved to a fully-fledged microfinance operation, and a near replication of BRAC's microcredit model in Bangladesh (De Silva, Ranasinghe, 2). In the years that followed, from 2007 to 2011, despite operating in an ambiguous and unregulated sector, BRAC scaled its operations to a portfolio of over USD 11.2 million, serving 74,000 borrowers at its peak in 2011. BRAC has a presence in seven provinces in Sri Lanka, with lending operations covering the south, east and western provinces through 87 branches and over 6,295 Village Organizations as of mid-2013.

BRAC Borrower Criteria
▪ **Poor economically active women aged 18-60** ▪ **Living within 5 km of one of 87 Branch locations for at least 5 years** ▪ **Not served by other microfinance organizations** ▪ **Priority to female headed households and widows with children** ▪ **For first time borrowers, family income of not more than 15,000 Sri Lankan Rupees (USD 115) per month[5]**

As BRAC expanded its operations, so too did many of its borrowers. Subsequent loan cycles from BRAC helped many women move past the debilitating impacts of a tsunami, in some cases out of subsistence earning, into economic activity and micro-enterprises.

[5] Interview with Sagarika Indu, June 2013, BRAC Lanka (Guarantee) Limited, 2012 Annual Report

No Matter What, We Will Rebuild: Mangalika's Story

When Mangalika came to BRAC, her family had lost their home, their business, their vehicle and most of their possessions in the tsunami. She recalls, "Eight feet of water came into the house. The only things left were the clothes we were wearing. We were lucky to escape with our lives."[6]

Mangalika with her husband and youngest child

Mangalika and her husband, K.G. Sirisena, had always been an entrepreneurial couple. Her husband had a job as the area representative Singer Electronics repairman. While this brought them a steady income, they aspired to build something of their own. Together in 2000, as a young couple with three children, they built a home-based business servicing Singer branded and other electronic appliances. Her husband handled the repairs while she maintained the books, processed orders and marketed their efforts. In a few years, it was evident that their hard work was paying off. By late 2004, they employed 12 individuals on a part-time basis and were clearing a profit of roughly $750 a month.

When the tsunami struck in December of 2004, Mangalika's home-based and uninsured business housed several appliances in the middle of repairs. This resulted in multiple claims from customers for compensation for items lost. Business was slow to pick up after the tsunami. Mangalika's husband continued a day shift at the Singer Service Center and repaired mostly refrigerators damaged in the tsunami at night. Mangalika worked to rebuild the back-end operations. However, business remained slow. With the exception of heftier appliances like refrigerators, most electronics damaged in the tsunami were lost, or damaged beyond repair. Fewer repairs were expected over the longer term as well, as many tsunami relief NGOs were offering in-kind grants of brand new

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[6] Details obtained from interviews with Ms. Mangalika in June, 2013 and August, 2013.

appliances and productive assets to tsunami victims.

An employee repairs an ice cream vending cart

Mangalika's first loan of 10,000 LKR (roughly $80) from BRAC was taken out to buy spare parts for repairs as business started to pick up in 2007. In 2013, she is on her eighth loan from BRAC, for an amount of over $600. Over the years, Mangalika has used loans from BRAC to acquire spare parts such as motors, compressors and fans. The capital has also been used to purchase power tools and equipment to replace lost assets and to once again expand operations.

Along the way, Mangalika and her husband have had to rely on local moneylenders to cover the balance of their capital needs. These sources lend at roughly 10% per month. BRAC's loans at 15% per annum are the cheapest source of money available to Mangalika and her business. The business now employs six apprentices and has moved to a new location. Mangalika estimates her net profit at around $380 a month. She and her husband have purchased a 2 seater car to replace the one they lost, and also purchased a three wheel (auto rickshaw) which they run on hire, to serve as another source of income. "With what we make, we are once again able to manage all our family expenditures and maintain a good lifestyle," says Mangalika. She adds "We were determined to re-build what we had, no matter what. BRAC's loans allowed us to do that."

Mangalika with her husband and 3 sons in front of the family's new Repair Center

Organizational Structure, Benefits and Challenges

BRAC's operations in Sri Lanka, in line with BRAC's overall approach and methodology, maintain a relatively flat organizational structure. From the level of credit officers who interact on a daily basis with borrowers, to the highest-level staff, care is taken to minimize extraneous levels of command, and to keep the line of reporting as short and streamlined as possible. BRAC's success is attributed in part to this flat organizational structure, which allows for quick learning and adaptation to the needs of clients and the portfolio at large.[7]

BRAC's Sri Lanka headquarters in Colombo handles key centralized functions serving the communications, human resources, information technology, and logistics needs of all branches. BRAC's field operations are managed by three regional managers, to whom 15 area managers and one branch manager per branch report. Each branch employs roughly four to five credit officers, who work directly with the borrower groups or VOs, attending multiple collection meetings daily. BRAC's total staff is roughly 625 members strong, inclusive of staff at headquarters and across the branches.

"There were over 20 people from Bangladesh working in Sri Lanka at one point. Then in 2011 the Sri Lankan government started cancelling their visas as they went to renew. This presented a huge threat to the organization, but also an opportunity and a challenge to immediately develop local people and transfer responsibilities to local leadership. It worked. Within 3 months, things were well settled. "

S. N. Kairy
Group CFO,
BRAC & BRAC International

In line with BRAC's mandate of promoting the economic and social development of women, roughly 87% of its staff is female. An emphasis on hiring and developing women in the areas where BRAC operates is a key driver of its success, given that BRAC in Sri Lanka lends only to women borrowers, who are often more likely to approach and be comfortable interacting on a weekly basis with female staff and credit officers.

While the benefits of hiring mostly women are evident, BRAC's staff retention rates and operational efficiency are duly affected by this choice. A significantly higher proportion of female staff requires the organization to maintain a higher number of staff than what is thought to be operationally efficient. This is due to eventualities such as maternity leave, the need for time off for personal reasons and other considerations that impact women disproportionately. For instance, the nature of BRAC's branch and fieldwork demands a good deal of travel from young female recruits. While there are no obvious limits on a woman's mobility in Sri Lanka, significant travel for young and especially unmarried women is not a cultural norm, and often contributes to the drop out of otherwise high performing female staff members.

[7] Interview with Anura Athapattu, Microfinance Consultant, Development Facilitators International, June 2013.

BRAC Portfolio Review and Indicators

As of April 2013, the total portfolio of BRAC in Sri Lanka was over 1.2 Billion Sri Lankan rupees (LKR) or roughly USD 9.3 million.[8] Its Portfolio at Risk at the 30 day mark was merely .63%, among the best in Sri Lanka. The portfolio was disbursed among 67,816 active borrowers, out of 87 branches.

The largest sub-segment of loans, roughly 38%, was provided for agriculture-related enterprises. A close second, 35% of the portfolio was disbursed for trade-related enterprises, for instance operating small shops and door-to-door sales of goods. Roughly 26% of loans were for women conducting what are considered manufacturing enterprises, for instance, tailoring, small scale manufacturing of household goods, or handicrafts.

BRAC Sri Lanka Portfolio at a Glance	
Total Borrowers:	67,816 borrowers as of April 2013
Total Portfolio Size:	9.3 million USD as of April 2013
Average Loan Size:	261 USD
Loans Range:	75- $750 USD
PAR > 30 days:	.63%

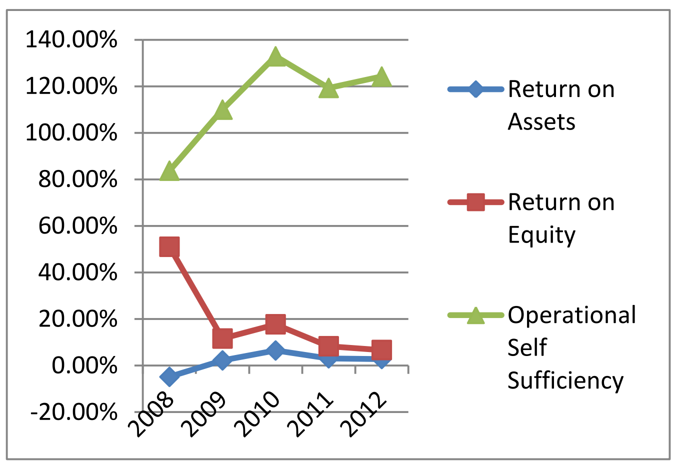
The current portfolio is primarily funded by equity advanced by (BRAC Bangladesh and BRAC International) of roughly USD 3.5 million, and retained earnings of USD 1 million. About 18% of the portfolio, or a total of roughly USD 1.8 million is financed by debt from two domestic microfinance wholesale funding partners, namely Stromme Microfinance Asia and Etimos. As of 2013, 3.5 % of the portfolio was comprised of donor funds in the form of a grant from BRAC USA and Whole Planet Foundation.

Overall Financial Performance Indicators

By all accounts, even with significant constraints to the growth of the portfolio over past years, BRAC Sri Lanka's financial performance indicators are strong.

BRAC's return on Equity and Assets stabilized in the years 2009 to 2012. Operational self-sufficiency of over 100%, indicating recovery of cost of operations with generated income, was reached in 2009, and despite recent constraints to the growth of the portfolio, the self-sufficiency percentage has

Table 2 : Performance Indicators ROE, ROA and OSS Over Time



8 Figures provided by BRAC Sri Lanka, July 2013. (1,223,101,858, LKR translating to 9,290,583.USD at a conversion rate of 131.65 LKR to the Dollar)

continued to grow.

Table 3 Overall Financial Performance Indicators[9]

Overall Financial Indicators	Fiscal Year	2006	2007	2008	2009	2010	2011	2012
	Return on Assets	-24.89%	-15.62%	-4.90%	2.17%	6.43%	3.08%	2.78%
	Return on Equity	2934.80%	286.59%	51.02%	11.58%	17.7%	8.27%	6.66%
	Operational Self Sufficiency	21.25 %	46.57%	83.71%	109.95%	132.86%	119.28%	124.17%

Portfolio Growth

BRAC's loan portfolio grew steadily from 2007 to 2011, and then began to contract as a result of capital constraints. Portfolio growth was also affected by the relinquishing of savings deposits. BRAC was compelled to return deposits to borrowers as a result of several government mandates instructing microfinance institutions to stop accepting deposits.

Table 4: Gross Loan Portfolio and Deposit Growth in USD

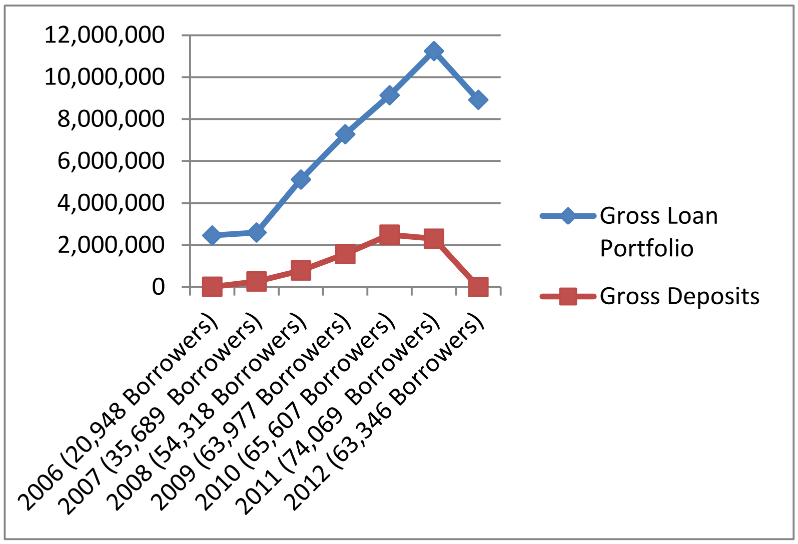


Table 5: Portfolio Growth Indicators Over Time[10]

Portfolio Growth Versus Deposits	Fiscal Year	2006	2007	2008	2009	2010	2011	2012
	Gross Loan Portfolio USD	2,454,153	2,594,335	5,117,639	7,277,828	9,134,708	11,241,729	8,914,962
	Gross Deposits	9,948	262,400	786,136	1,570,266	2,491,375	2,298,428	0
	Number of Borrowers	20,948	35,689	54,318	63,977	65,607	74,069	63,346

[9] Data from Mix Market: http://www.mixmarket.org/mfi/brac-lka/report
[10] Mix Market: http://www.mixmarket.org/mfi/brac-lka/report

Risk Indicators

BRAC Sri Lanka has maintained low portfolio risk, setting a standard for Portfolio at Risk performance at 30 days past due (PAR 30), below the national industry median[11] over the course of its operations in Sri Lanka.

Table 6: BRAC PAR > 30 Compared to National Median of Self Reporting MFIs Over Time

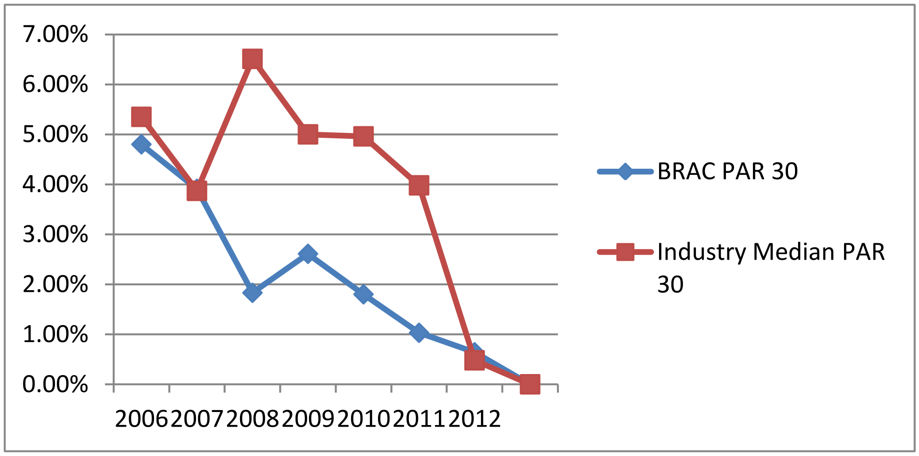


Table 7: BRAC PAR >30 Compared to National Median of Self Reporting MFIs[12]

Portfolio % At Risk > 30 days	Fiscal Year	2006	2007	2008	2009	2010	2011	2012
	BRAC	4.8%	3.91%	1.83%	2.61%	1.8%	1.03%	.64%
	Industry Average	5.35%	3.87%	6.51%	5.0%	4.96%	3.98%	.48%
	Reporting MFIs[13]	Median of 14 reporting MFIs	16 reporting MFIs	20 reporting MFIs	22 reporting MFIs	20 reporting MFIs	17 reporting MFIs	Median of only 2 MFIs reporting one of which is BRAC

[11] National microfinance industry medians for PAR>30 were derived from MIX Market data, which is a compilation of MFIs (who may vary year on year) voluntarily reporting. In actuality, industry levels are likely higher. BRAC data is factored into each median.

[12] Based on data of reporting MFIs on MIX. Particular MFIs vary year to year. http://www.mixmarket.org/mfi/brac-lka/report

[13] Varying MFIs voluntarily reporting each year. BRAC data is factored into each median.

Building a Tailoring Business from the Ground Up- Prashanthy's Story

When the Tsunami struck in 2004, Prashanthy was a newly married young woman in her early twenties. She had learned to sew from her husband, a professional tailor who was working abroad at the time. The tsunami damaged Prashanthy's sewing machine but not her spirit to renew and rebuild. With her husband out the country, she had to figure out how to get back on her feet, and earn an income again.

Prashanthy, photographed by GTZ, a BRAC partner in 2008, around the time of her second loan. Photo Courtesy of GTZ.

Prashanthy's first loan of roughly USD 150 from BRAC allowed her to get her sewing machine repaired. She was able to have the machine fitted with an electric motor, which allowed her to increase her productivity considerably. As a result, her modest home-based tailoring business started to add new clients and new designs. Within two years, Prashanthy was able to secure another loan from BRAC, which she used to start supplying tailored clothes to local shops. [14]

In 2013, Prashanthy is on her 5th loan from BRAC, this time roughly USD $350. Her husband has returned from abroad, and now works in a garment factory by day, and helps Prashanthy with her home-based tailoring business in the evenings. Together they make roughly USD 250 a month. They have hopes of expanding their business to a small shop and hiring a few workers. According to Prashanthy, what is holding her back is access to capital to expand.

Prashanthy in 2013, at her home-based work station

In addition to growing her business Prashanthy is firmly focused on her home life. She now has a daughter and dreams of the day she can add on to and improve her home. Undeterred as she was after the tsunami, Prashanthy states " In a family both a husband and a wife should share the costs," and plans to move forward while making her daughter's care and education a priority.

[14] Details obtained from an interview with Ms. Prashanthy in 2013 and from http://www.microfinance.lk/publications/GTZ%20PROMIS_Clients_final_small.pdf.

Social Impact Review and Outcomes

The most pronounced efforts to measure and evaluate the social impact of BRAC's efforts in Sri Lanka, in accordance with the impact criteria of funding partners, was during the early years of BRAC's operations when activities were primarily grant funded. Several evaluations of impact were carried out during these years.

The lion's share of initial grant funding for BRAC operations came by way of two projects, both supported by Oxfam Novib, a longtime trusted partner of BRAC in Bangladesh . Covering a timeframe of May 2005 through November 2008, Oxfam Novib's total contribution to BRAC's microfinance approached USD 5 million.[15] Expected outcomes of the Oxfam funded program included:

- Poverty alleviation
- Assisting rural poor to improve their lives through sustainable capacity development
- Empowering poor women, especially in rural areas
- Enhancing the capacity of project participants as well as development partners

Mid-program and post-program evaluations conducted in 2006 and 2008 found that BRAC was successful across these measures and that the micro-enterprises funded through BRAC's loans contributed significantly to family income. In many cases the microbusinesses funded by BRAC were the main source of income for the borrower's family. Often times, the borrowers' families did not have formally employed members, thus making employment in the micro business the main source of household income (De Silva, Ranasinghe, 29).

The evaluation determined that a key empowerment-related outcome of BRAC's microfinance program was the shift in the dependence of women borrowers on informal sources of capital (pawning jewelry, friends and family, shopkeepers who were either suppliers or sales channels for micro-businesses, and lastly, money lenders) to a more structured product. This shift brought with it a level of security, a guarantee of access to capital as long as borrowers repaid loans on time, and a measure of confidence among borrowers in the continuity and even expansion of their micro-businesses. Oxfam Novib evaluations of BRAC cited this as a major empowerment-related outcome among women borrowers (De Silva, Ranasinghe, 22). As early as 2006, impact evaluations concluded that village organizations were instrumental in enhancing women's empowerment by increasing their participation in decision-making regarding access to and use of resources (Avellaneda, 14).

[15] The first project was from 16th May 2005 to May 2007 with a total budget of US$ 4,729,787 of which Oxfam Novib provided US$ 4,229,787. Another phase from Oct 2007 to Sept 2008 commenced where Euro 575,000 was provided by Oxfam Novib. (De Silva, Ranasinghe, 2009).

Microfinance in Sri Lanka

A Growing and Unregulated Sector

At the time of BRAC's entry into Sri Lanka, the bulk of microcredit programs in the country were funded and subsidized through government banks and programs, or charitable endeavors. Microfinance initiatives were largely characterized by portfolios of poor quality, high cost operational structures and little operational efficiency. BRAC helped define industry standards in Sri Lanka setting its own Portfolio at Risk at 30 (PAR 30) days at no more than 5.35% (its highest level during its first year in 2006) and below 2% after 2009. In comparison, in 2009 based on data from 51 self-reporting MFIs, PAR 30 figures varied from 43% to 0% for these institutions, and only 18 institutions reported PAR 30 less than 5%. An estimated approximate average of PAR 30 days for the sector in 2009 was 16%.[16]

The microfinance sector in Sri Lanka has matured and professionalized in the past years, with several organizations improving their operations and portfolio quality. The sector consists of a variety of players. Serving the lower end of the microcredit spectrum are several cooperatives structures, including co-operative rural banks, and cooperative societies organized for various purposes. These initiatives have been regulated by the Department of Co-operative Development (South Asian Microfinance Network).

A significant portion of microfinance players in Sri Lanka, including BRAC until mid-2013, fell into an unregulated classification of microcredit institutions, where the lack of a clear regulatory framework greatly constrained their activities, and their ability to raise funds to grow their portfolios. These MFIs were either stand-alone initiatives such as Lak Jaya[17], or were the microfinance initiatives of larger local or international NGOs, such as Berendina[18] or Sewa Finance, the latter an initiative of the Sri Lankan NGO SewaLanka

The Microfinance Regulatory Vacuum, and the Pressure on MFIs

The idea of a Microfinance Act to govern the activities of various microcredit institutions in Sri Lanka was first surfaced in the early 2000s.. Prolonged delays in its finalizing, coupled with intermediate directives from the government curbing the activities of microfinance institutions (MFIs)over recent years, have waned confidence in the microfinance sector that clear, concise legislation favorable to MFI operations will be introduced.

Meanwhile, microfinance institutions operated in a relativeregulatory vacuum characterized by ambiguities and restrictions. These include restrictions on accessing foreign sources of funding, on the ability to mobilize deposits and savings of borrowers, and restrictions on visas for foreign owned MFIs, all of which place significant constraints on the growth potential of microfinance institutions in the country.

In the absence of clear and supportive regulatory frameworks, microfinance initiatives in Sri Lanka wereattempting to move themselves into existing regulatory frameworks - those governing cooperatives, and commercial financial institutions.

[16] Lanka Microfinance Practitioner's Association (LMFPA) Member Profile, 2010, as reported by South Asian Microfinance Network, http://www.samn.eu/?q=srilanka.
[17] Lak Jaya is one of several other international MFI initiatives of ASA International http://asa-international.com/srilanka/

Foundation[19]. A 2010 legal study commissioned on the microfinance sector jointly conducted by the German Development Aid Organization GTZ and the Lanka Microfinance Association identified the absence of a proper legal and regulatory framework concerning microfinance institutions as the largest impediment of the MFI sector in Sri Lanka.[20]

In addition to regulated cooperatives and unregulated microcredit institutions, several private sector commercial banks, such as Hatton National Bank, Commercial Bank and several finance and leasing companies including Lanka Orix Leasing Company, were in the process of rolling out microfinance offerings in low-income communities. These entities are regulated by the Central Bank of Sri Lanka (GTZ, Banking with the Poor Network, 7-10).

With several types of institutions in the microfinance space, and given the limitations of microfinance products in their size and duration, it was a common occurrence for borrowers to take loans from multiple lenders. Concerns of over-indebtedness and portfolio quality characterized the Sri Lankan microfinance landscape.[21]

"In Sri Lanka the PPP adjusted per capita income is about 3 times what it is in Bangladesh, yet the average loan size that BRAC has been able to offer, given its constraints, is smaller than what it is in Bangladesh. It's therefore not surprising that borrowers in Sri Lanka have several accounts and microfinance loans to meet their needs."

Shameran Abed
Associate Director Microfinanace
BRAC

Post-War Progress and a Changing Funding Environment

While demand for microfinance in Sri Lanka grows, an increasingly challenging funding environment prevails for many of the initiatives attempting to serve the poor. The official classification of Sri Lanka as a post-war middle-income country[22] in 2010 has resulted in a rapid outflow of development grant funds towards other countries and priorities. This trend, coupled with the gradual decline of philanthropic funding associated with tsunami relief, has dramatically affected the operations of heavily donor-driven NGOs and microfinance operations highly dependent on international donors. Funds for on-lending to

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18 Berendina Microfinance Institute is funded by the Netherlands based Berendina Stichting Trust http://www.berendina.org/about_us_berendina_stichting.php

19 http://www.sevalanka.org/

20 Legal Study on the Microfinance Sector, 2010. GTZ ProMis in Collaboration with The Lanka Microfinance Association http://www.microfinance.lk/publications/legal_Study.pdf. Various practitioners in microfinance express the need for a more supportive regulatory environment in a Ministry of Finance and Planning and GTZ publication, Key Principles of Microfinance, Explained by Microfinance Practitioners and Promoters http://www.microfinance.lk/publications/1265107188.pdf

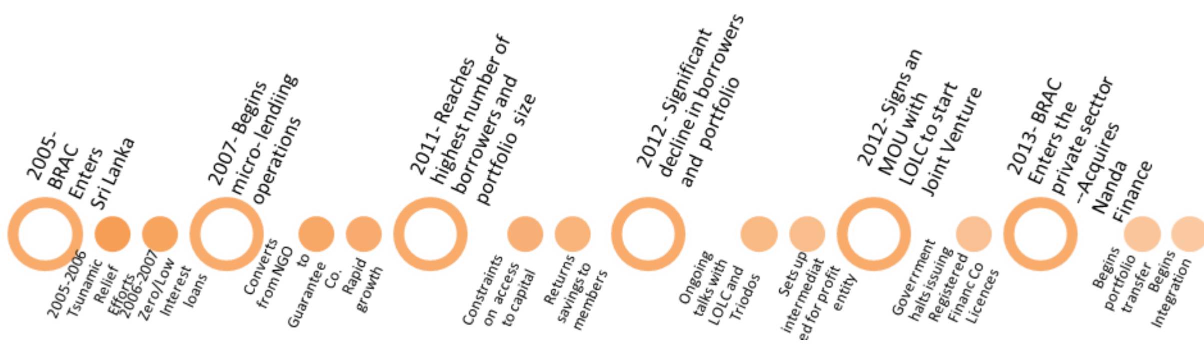
21 See http://www.samn.eu/?q=srilanka for a overview of the Sri Lankan Microfinance Sector by South Asia Micro Entrepreneurs Network

22 Sri Lanka was classified a "Middle Income Emerging Market" by The International Monetary Fund (IMF) graduating Sri Lanka from the list of Poverty Reduction and Growth Trust (PRGT) eligible countries on 11 January 2010. http://www.island.lk/index.php?page_cat=article-details&page=article-details&code_title=91104

borrowers, and for technical assistance and capacity building efforts in the microfinance sector, are moving away from microfinance initiatives into, for instance, small and medium enterprise financing.[23]

BRAC's Sri Lanka operations, having reached sustainability early on, included only a minor portion of grant-funded activities and lending, and therefore were not significantly affected by the retreat of development grant funders. Nonetheless, BRAC experienced a significant decline in its portfolio, forfeiting its position as the largest microfinance provider in the country in 2012 to Berendina Microfinance Institution.

Figure 1 BRAC Sri Lanka Significant Milestones



BRAC Responds to a Challenging Environment

> *"Unless we offer a whole suite of products, we cannot expect clients to stick with us. There is a huge need for savings and in the last few years of operations in Sri Lanka, this was not an option we could provide. "*
>
> Shameran Abed
> Associate Director Microfinance
> BRAC

BRAC's microfinance operations in Sri Lanka retained much of the same methodology and character defined originally in Bangladesh, including its lending structure with loans disbursed through Village Organizations, its staff structure and training, and the methodology and processes related to loan

[23] Interview with Roshini Ferando, former Senior Microfinance Specialist, GTZ, currently Adviser, Access to Finance GIZ, June 2013.

underwriting, portfolio management and expansion efforts. However, with regards to product offerings in Sri Lanka, there were key differences between BRAC Sri Lanka and other BRAC operations. These differences were largely shaped by the funding constraints faced by BRAC in Sri Lanka and a shifting and undefined microfinance regulatory environment. BRAC's staple product had been modified over time in response to government mandates and the changing macroeconomic context of Sri Lanka.

BRAC's Product Evolution in Sri Lanka

One Loan Product

In Sri Lanka, only one loan product was currently offered, and only to women, as opposed to Bangladesh and now several other country operations, where multiple loan and savings products are offered, to men and women. The lack of product diversification was not for a lack of demand by clients, nor due to a lack of desire on the part of BRAC to innovate new product offerings. With limited sources of funding, BRAC took a conscious decision to develop competencies around extending one core product, for which there was ready demand.

Modified Savings Components, and Loan Tenures

As of 2013, BRAC lent loan amounts from 11,000 to 100,000 rupees (USD 85 to 765) to be repaid over a period of 44 weeks, at an interest rate of 15% flat. In 2009, the same product was offered at 20% interest, payable over the course of 48 weeks. The product also incorporated a mandatory loan security savings component of 5% of the loan value, and BRAC encouraged additional voluntary savings by the member of 10 rupees (US 7 cents) or more, per week.

In the period between 2009 and 2011, several factors contributed to the loan product being revised in the following ways; (1) Interest rates to borrowers were lowered (2) Shorter terms of repayment were instituted, and (3) Savings requirements were reduced and eventually eliminated. The following factors precipitated these changes:

- The prime lending rate declined in 2010 to 9% from a high of over 20% in 2009.[24] BRAC's mission-driven wholesale funders, BRAC clients and staff resoundingly supported a reduction in BRAC's interest rate offered to borrowers. In response, BRAC reduced its interest rate charged to borrowers from 20% to 15% per annum. At the time, BRAC was borrowing funds from wholesale lenders at rates of 9-11%, therefore a reduction in interest rates offered to borrowers effectively accomplished a passing-on of BRAC's savings to its clients.
- In 2011, at the directive of the Central Bank, BRAC eliminated weekly volunteer savings. To counterbalance the effects of a near simultaneous interest rate reduction and the relinquishing of voluntary savings back to members, BRAC decreased the term duration of loans from 48 to 44 weeks, and increased the mandatory savings component, from 5% of the loan value, to 10%.
- In December of 2011, a Bill titled the Finance and Business Act outlined that companies outside of registered finance companies could not associate themselves with "savings" or mobilizing

[24] The prime lending rate has since crept back up, to 12.8% as of May 2013. http://www.tradingeconomics.com/sri-lanka/bank-lending-rate

deposits. On December 15, 2011, BRAC began to refund borrowers' 10% loan security savings to its members, by adjusting outstanding loan balances, further diminishing its capital base.

Evidence of a Problem

As BRAC's portfolio growth was increasingly constrained, and its core product underwent changes as a result of regulatory directives, demand for microfinance in the country began to grow. As the nation emerged from a post-disaster and post-war context, signs of economic recovery began to show. Low-income borrowers were increasingly seeking financing for various needs. New borrowers were approaching BRAC VOs, and existing borrowers were returning to BRAC requesting increased loan amounts as their microbusinesses and financing needs expanded. Amidst these pressures, clear evidence of BRAC's funding constraints began to surface. [25]

- **Borrower Numbers Declined**
  BRAC's portfolio over the years 2011-2013 illustrates the effects of capital constraints. BRAC experienced a significant dip in the number of members, from 74,000 members in 2011 to roughly 63,000 in 2012. Up to that point, the annual member dropout rate experienced by BRAC was not more than 2%. The significant member decline was attributed to limited sources of funding for lending to returning and long-term members who were seeking higher loan volumes.

Table 8: Decline in Number of Borrowers Over Time

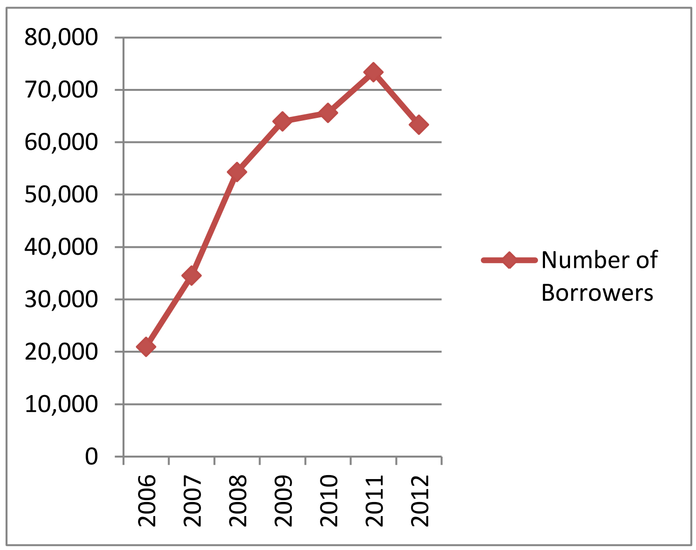
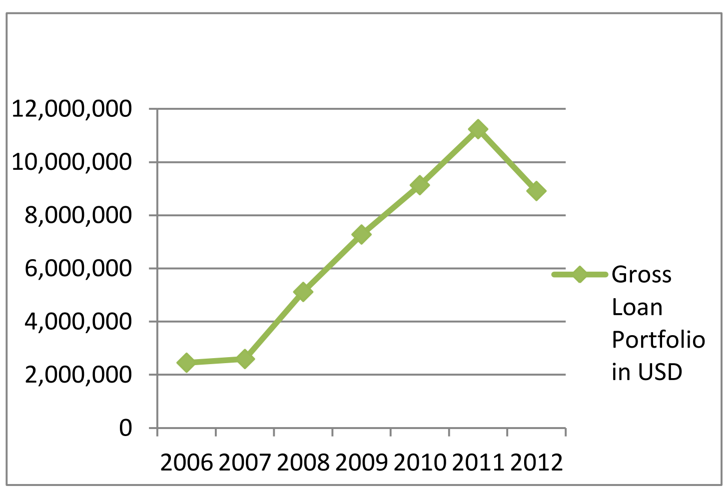


Table 9: Loan Portfolio Growth Over Time (in USD)



- **Delays in Processing Subsequent Loans**
  Since its early years of operations in Sri Lanka, BRAC was accustomed to processing subsequent loans for returning borrowers very quickly, within time frames as short as a week. In 2012, funding constraints started to push the turn-around

[25] Interview with Sagarika Indu, June 2013.

time for subsequent loans. Often branches had to delay the issuing of these loans by more than one or more weeks.

- **Loan Ceilings for Subsequent Loans**
  Temporary loan ceilings were put into place on a case-by-case basis for subsequent loans in several branches. For instance the upper limit for a second cycle loan was reduced from 45,000 rupees to 40,000 rupees (USD 345 to 305) in several branches.

"Of all of BRAC's microfinance lending in the 7 countries that we offer microfinance, BRAC Sri Lanka has the lowest average loan size over per capita income of all the countries. This is in large part due to the constraints on the portfolio."

Shameran Abed
Associate Director Microfinanace
BRAC

- **Loan Sizes and Offerings Failed to Keep Pace with Borrower Needs**
  The above factors disproportionately affected BRAC's returning clients who were seeking higher loan amounts, and a varied product offering, after having proven themselves to be reliable microfinance borrowers. It was becoming increasingly clear to BRAC that the borrowing needs of clients that BRAC had invested in, nurtured and cultivated over years were not being effectively met. Despite the fact that it would be operationally more effective for BRAC to retain these clients, rather than recruit new ones, disbursing the larger loan amounts required to serve returning clients was becoming increasingly difficult. As a result, returning borrowers increasingly began to turn to other sources for their financing needs, ranging from higher interest loans from other microfinance institutions, to commercial lenders offering microfinance products, and local moneylenders.

- **Temporary Halt in Admitting New Members**
  Although 24 new branches were opened in 2011, BRAC temporarily suspended admitting new members to existing branches that same year. It was able to resume admitting new members in 2012, because of a USD 500,000 grant from BRAC USA using philanthropic funding from the Whole Planet Foundation, earmarked for loan disbursements.

- **Decline in Capacity and Skills Building Efforts for Borrowers**
  BRAC's initial operations included substantial capacity building and skills development resources for members. For example, BRAC provided both general enterprise development training for borrowers in agriculture, trade and manufacturing related microbusinesses as well as more targeted skills building, such as training on how to interact with customers, locate wholesale options, and handle day-to-day accounting tasks. These capacity building and training components, previously bundled into BRAC's MFI offerings, have been largely eliminated due to funding constraints. By 2012, these components were available only when specifically supported by grant funding.

By the end of 2012, the above developments made clear to BRAC leadership that if the status quo remained, scaling up BRAC's portfolio in Sri Lanka, and indeed BRAC's very ability to assist low-income communities in line with its mission, would be in jeopardy.

An Emerging Solution: Entering the Private Sector

With the above constraints bearing down on the unregulated microfinance sector in Sri Lanka, BRAC and several other MFIs began to explore options to move themselves into better regulated sectors, on their own terms, through partnerships and new organizational structures. For larger microfinance operations such as BRAC, becoming a regulated deposit taking entity with secure funding streams and a clear path to growth, effectively meant edging into the private sector.

Partnering Local

The rapidly shifting, and simultaneously undefined regulatory environment surrounding microfinance in Sri Lanka was particularly problematic for foreign organizations lending in the country. Besides crippling restrictions on access to capital, BRAC was experiencing difficulty with obtaining visas for foreign staff to enter and reside in Sri Lanka due to ambiguities about which local departmental jurisdiction unregulated microfinance institutions fell under. These circumstances underscored for BRAC, the need for a local partner. With an eye towards moving into the formal finance sector, and with the immediate goal of relieving some of the visa related and operational constraints faced, BRAC began to explore the option of a joint venture (JV) with a strong local player, Lanka Orix Leasing Group (LOLC). Triodos Bank, an international microfinance wholesale funder and previous equity investor with BRAC, facilitated the development of this relationship.[26]

Critical Challenges Faced by MFIs Attempting to Enter the Private Sector

In the absence of a clear regulatory framework for microfinance players in Sri Lanka, those that attempt to move themselves out of ambiguity and into the formal private sector face significant challenges:

- The government has taken a decision that no new Registered Finance Company licenses will be issued, citing problems faced by existing licensed companies in maintaining their capital requirements. At best, under the current framework as of 2013, case-by-case approvals may be possible for new Registered Finance Company licenses.
- Secondly, capital requirements for attaining a Registered Finance Company license are significant (roughly USD 4 million), meaning that even if the government readily issued licenses, microfinance institutions would typically be hard pressed to pursue this path.

Lanka Orix Leasing Group (LOLC) and Lanka Orix Microcredit Ltd. (LOMC)

Lanka Orix Leasing Group (LOLC) is a conglomerate financial services company with a strong 30-year track record in Sri Lanka as a provider of leasing, insurance and microcredit products. Its growing microfinance activities were separated into a dedicated microfinance operation called Lanka Orix Microcredit Ltd. (LOMC) in 2009. Focused primarily on rural areas in Sri Lanka where it issues leasing

[26] In 2008 Triodos had invested in BRAC Africa Loan Fund (BALF) serving BRAC's microfinance operations in Uganda, Tanzania and South Sudan.

products to farmers and group loans to women, LOMC serves 143,174 clients of which 66% are female. Average loan amounts are EUR 624,[27] nearly 3 times as large as BRAC's average microloan.

Triodos Bank

BRAC had a longstanding relationship with Triodos Bank,[28] a leading lender with 30 years of experience and over EUR 6.8 billion under management investing in renewable energy, sustainable banking, and microfinance. The bank provides financial support for more than 6,000 sustainable enterprises in 40 countries worldwide. [29]

In addition to a longstanding relationship with BRAC, Triodos Bank had a working partnership with LOLC in Sri Lanka. Triodos Microfinance Fund, Triodos Fair Share Fund and Hivos-Triodos Fund had previously provided LOMC with a loan to enable its portfolio expansion. [30] Having had a successful partnership with both LOLC and BRAC, Triodos Bank was instrumental in connecting the two entities and facilitating initial conversations.

A Mutually Beneficial Alliance

At the time LOLC and BRAC connected, LOLC had been considering avenues to expand its microfinance practice and more effectively serve its rural customer base. As it sought to do so, the expertise and brand value associated with BRAC, a leading international microfinance player, was appealing to LOLC. As a long term local player in the financial services and microfinance markets, LOLC brought to bear an established reputation and a local dimension to the partnership, including relationships with lawyers, advisors, key influencers, access to the Central Bank and government agencies.

"BRAC was looking to transform its NGO operations into the mainstream in Sri Lanka, and was looking for a reliable local partner from the financial sector with in-depth knowledge of the SME and micro segments. BRAC choosing LOLC as its first partner in an international venture is a great honor to us."

Ravi Tissera
Director/CEO
LOLC Micro Credit Limited

Given these advantages, the joint venture considered was hoped to relieve some of the difficulties faced by BRAC on its own. It was envisioned that the new JV would petition the government for a Registered Finance Company License, allowing the entity the ability operate with the full flexibility of a debt-raising and deposit-taking institution, jointly run with the expertise of BRAC and LOLC.

In early 2012, after over a year of negotiations and internal moves on the part of BRAC to allow the creation of such a joint venture, a Memorandum of Understanding was signed between BRAC Lanka Guarantee, LOLC and Triodos Bank, stating the intent to move forward. As the parties began to make strides towards formalizing the relationship, the Sri Lankan government issued a directive indefinitely

[27] Per data reported by Triodos: http://www.triodos.co.uk/en/about-triodos/what-we-do/who-we-lend-to/results/?projectId=196024

[28] Triodos had invested in BRAC Africa Loan Fund (BALF) in 2008, which serves BRAC's microfinance operations in Uganda, Tanzania and South Sudan.

[29] http://www.triodos.co.uk/en/about-triodos/what-we-do/who-we-lend-to/results/?projectId=196024

[30] http://www.microcapital.org/microcapital-brief-lolc-micro-credit-ltd-lomc-receives-14m-from-symbiotics-and-three-triodos-funds-to-expand-microfinance-operations-in-sri-lanka/

suspending the issuance of new finance company licenses. With the granting of new finance company licenses indefinitely on hold, BRAC had to once again modify its approach to entering the formal financial sector.

Acquisition of a For-Profit Company

With the option of acquiring a new registered finance company license off the table, BRAC and LOLC began to look at existing finance companies to acquire. The joint acquisition of an existing financial services company with its full license privileges, including deposit- taking and debt raising capacities, would be the last remaining option available to BRAC and LOLC to operate together in a fully regulated space. Nanda Investments Finance Limited (NIFL) was such a company.

Nanda Investments Finance Limited

Considered a small-scale finance company, Nanda Investments was a profitable enterprise with a portfolio of roughly USD 2.18 million, net assets amounting to USD 4.15 million, and fixed assets and properties amounting to roughly USD 2.5 million.[31] NIFL was incorporated in 1961, and was licensed as a "Registered Finance Company" with full privileges granted by the Central Bank of Sri Lanka to carry out finance leasing operations and deposit taking functions. A household brand in Sri Lanka, the company has a history going back 50 years. Its late founder Mr. Sirisena Mallawarachchi informally known as "Nanda Mudalali" (mudalali being the local term for businessman) was the owner of Nanda Motors (Pvt) Limited, the local agent for a large number of passenger vehicle brands popular in Sri Lanka. Nanda Investments was established as a financing company to add value to the core car sales and leasing business. With the intention of reinforcing its identity as a finance company, with its privileged abilities to raise deposits, the company changed its name to Nanda Investments and Finance Limited in April 2011.[32]

Anatomy of a Joint Acquisition

In June of 2013, BRAC and LOLC jointly acquired 90% of the common stock of NIFL. BRAC acquired 56.6% and LOLC acquired 33.4 %, at a cost of USD 4.04 million, and USD 2.83 million respectively. Triodos Bank reserved the ability to acquire 10% of BRAC and LOLC's joint stake at a later date. Such a transaction would infuse additional capital into the new venture and will likely position Triodos, a known player with a track record funding the microfinance initiatives of regulated entities in Sri Lanka, as an ongoing source of debt financing to grow the portfolio.

New Operations

Called BRAC Lanka Finance PLC, the partners planned for the new entity to solely handle the microfinance portfolio transferred in from BRAC Lanka Guarantee for the first two years. It was envisioned that BRAC would spearhead all microfinance lending activities of the newly acquired entity with LOLC's support, but

> *"It is still early days for both parties. The board and the management is focused and the chemistry too is good. BRAC Lanka will need time to hit its stride. I have no doubt that this would turn out to be a great success."*
>
> Ravi Tissera
> Director/CEO
> LOLC Micro Credit Limited

[31] Memo from Tanwir Rahman to Stichting BRAC International Board, 6/22/2013.
[32] Due Diligence Report on Nanda Investments and Finance Limited, RSA Capital, BRAC ELP Investments Limited, 2013.

these plans changed when central bank capitalization requirements led BRAC to sell its stake to LOLC and exit the company entirely.

The plan was for BRAC's existing portfolio of nearly USD 9 million to be assumed by Nanda through a gradual transfer process. BRAC Lanka Guarantee will provide legal notifications to individual borrowers, informing them that the outstanding balances on their loans are now payable to NIFL. On a rolling basis, NIFL will then pay borrower-authorized outstanding loans to BRAC Lanka, effectively assuming the portfolio.[33] In practice, the portfolio transfer process was challenging. Due to allegations of fraud against other financial services companies in Sri Lanka,[34] additional safeguards, which require a clearance certificate from local authorities for the transfer of each branch's portfolio, have been implemented by the government.

The process of BRAC internally gearing up to acquire Nanda was a complicated one. Due to BRAC Lanka's unregulated status, which made it ineligible for loans, a separate for-profit subsidiary of BRAC International Holdings BV, registered in the Netherlands, called BRAC Lanka Investment (Private) Ltd. was set up to procure a loan and to conduct the acquisition.[35]

Integration and Expansion with a Partner

The planned expansion of a microfinance portfolio jointly run by BRAC and LOLC also involved a learning curve that would have required integrating BRAC and LOLC cultures. It was planned that day to day operations of the newly acquired Nanda, rebranded as BRAC Lanka Finance PLC, would be conducted through the infrastructure of BRACs existing 87 plus branches. BRAC's core methodology, staff and processes would steer the new entity's microfinance portfolio. While LOLC would not be operationally involved in day to day management of the portfolio, it would play a key role in new product roll out and decisions on strategy and growth.

No new loan products were envisioned during the first year, to allow BRAC and LOLC the opportunity to stabilize operations, and become accustomed to working together without the added pressure of new product roll out. Starting in year three, several new products, including small enterprise financing, several savings products, and equipment lease financing were envisioned.[36] It was anticipated that the company's new product roll out, overseen by the board, would be driven by BRAC with the consent and support of LOLC.

Highlighting the uncertainty of working in an environment with changing regulations, these plans were reconsidered with the sale of BRAC's stake, giving LOLC full operational control over the portfolio.

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[33] Interview with Tanwir Rahman, July 2013.

[34] The country has suffered several rounds of collapses of financial companies, often with concurrent allegations of corruption and fraud. The most recent instance is Central Investments and Finance Ltd. (CIFL) in late 2013. See http://www.sundaytimes.lk/130922/editorial/finance-companies-the-same-old-story-63318.html and http://www.sundaytimes.lk/131013/news/faults-and-frauds-of-a-failed-finance-firm-65628.html

[35] Interview with Tanwir Rahman, July 2013.

[36] Business Plan for Nanda Investments and Finance Limited, 2013.

Challenges and Lessons Learned in the Transformation Process

Ultimately, BRAC was successful in acquiring a private company, moving into the private sector, and then exiting the market. The move has not been without delays and challenges. The transformation process undertaken in Sri Lanka bears important lessons and implications for BRAC overall.

The Benefits of Partnering, and the Cultural Shift Required

Prior to the Sri Lanka transformation experience, BRAC had not engaged in a partnership at the level undertaken with LOLC. Indeed, the very idea of an international joint venture of this significance was new to BRAC, and the process of the partnership coming to fruition demanded a shift in BRAC's internal culture and customary practice.

While BRAC's operations in Bangladesh had previously engaged with many local partners to roll out both for-profit and not-for-profit initiatives in a number of sectors, BRAC's experience in Sri Lanka was a milestone on several counts. Never before had an international joint venture been pursued, where BRAC shared significant ownership of an initiative with a foreign entity. Additionally, previous partnerships and joint ventures have been pursued in various initiatives ancillary to BRAC's core microfinance activity in Bangladesh, for instance, pertaining to agriculture, research and development and other activities in support of BRAC's mission. In Sri Lanka, the joint venture would have driven BRAC's primary microfinance operations, affecting the full scope of BRAC's work in Sri Lanka.

> *" It is extremely difficult for a not for profit to transform into a for profit in any country, and in particular in Sri Lanka in a regulatory vacuum. It is a process that took us 1.5 years of work to think and sort through."*
>
> Tanwir Rahman
> Director Finance, BRAC and BRAC International

Plan and Structure for Growth from the Beginning

Once a decision to pursue a joint venture with LOLC was finalized, BRAC's organizational structure, that of a not-for-profit entity in an unregulated sector, gave rise to several challenges and delays in pursuing this path. BRAC Lanka Guarantee's legal structure and its Memoranda of Association placed limitations on the type of activities it could engage in, and allowed use of its assets.[37] For instance, as a non-profit, BRAC could only donate assets to a similar organization. Sale of its portfolio or the acquisition of a for profit entity, the course of action eventually pursued with Nanda, were both prohibited under BRAC's charter. To accomplish these transactions, BRAC was required to set up an intermediate for-profit entity called BRAC Investment Limited through which to direct activity and funds related to the acquisition.

The Sri Lanka experience illustrates the potential perils of starting MFI operations that are intended to eventually reach sustainability within a not-for-profit structure, and more so, in an unregulated environment. The lesson is that MFIs with a commitment to move away from philanthropic grant funding and towards sustainability, if successful, are likely to push against the limits of a not-for-profit

[37] Interview with Tanwir Rahman, July 2013.

set up. BRAC learned that a significant transformation process to commercialized microfinance operations is challenging, especially in a sector with shifting regulations, but possible..[38]

BRAC is now more mindful of planning carefully at the outset as it enters new countries in order to ensure agility and future room for growth.[39] In 2008 as a result of the experience in Sri Lanka, BRAC established two for-profit microfinance companies in Sierra Leone and Liberia. It has started to cleave out its MFI operations from its other non-profit operations in several countries, placing microfinance activity in for-profit entities, while allowing other charitable activities to continue in non-profit structures. Operations in Tanzania were split along these lines, as well. “Early planning along these lines will hopefully result in a greater range of options for growth, allow investment from diverse sources, and hopefully minimize bureaucratic constraints to the scale -up of operations,” says Tanwir Rahman, Director Finance, BRAC and BRAC International.

Uncharted Territory: Challenges and Opportunities

With the stifling barriers to access to capital removed as a result of having acquired a for-profit company with a registered finance company license, it seemed briefly that the shackles on BRAC’s growth in Sri Lanka were effectively removed. BRAC, through its new entity, would have beenable to borrow from domestic and international sources and mobilize the savings and deposits of members. As BRAC was growing its portfolio in a robust way prior to constraints on access to capital and savings, it stood to reason that with both of these constraints removed, given time, growth would resume.

However, the change in capital requirements that led to the sale of BRAC’s stake in the new joint venture changed the situation yet again – to a successful exit of BRAC from a market it has initially entered nine years earlier primarily to offer humanitarian aid in the wake of the tsunami.

Prior to the sale, when it still appeared BRAC would keep a stake in BRAC Lanka, BRAC’s Associate Director of Microfinance, Shameran Abed, said, “Sri Lanka has a very established financial sector, it has banks, it has leasing companies, housing finance companies and insurance companies. This begs several questions: does BRAC need to be in the commercial financial sector in the first place? What is going to make BRAC Lanka Finance Company different from the rest of the 47 or so financial services companies in the country?”

> *“Sri Lanka is a mature market and there will always be competition. It’s simply about who does it better. BRAC already has a large number of borrowers in Sri Lanka and name recognition. We are already ahead of the game in some ways. Success depends on how we manage these advantages, how we bring on new products, and how efficient we can be.”*
>
> Tanwir Rahman
> Director Finance, BRAC and BRAC International

He added, “I think the thing that will make us different is if we still have a rural focus, if we still have a relatively small ticket focus, and we add to our existing microfinance portfolio, a small and medium enterprise lending arm. We want to collect deposits but we

[38] Interview with Tanwir Rahman, July 2013.
[39] In 2013 BRAC in Uganda began its planning to transform into a regulated deposit taking entity.

want to collect deposits from poorer people outside of urban areas where there are not a lot of options. I think if we do that, that's what is going to make BRAC different, and doing so would address a real need in Sri Lanka."

Conclusion

Few organizations respond to a natural disaster with a view to sustainability. BRAC's experience in Sri Lanka is a story of an organization charting an unlikely course, and nimbly pivoting to address the needs of poor populations over an extended period. From 2005 to 2014, BRAC has transitioned from an aid organization utilizing foreign aid to provide emergency relief and rehabilitation, to becoming the largest microfinance institution in the country, to entering the for-profit financial services sector and finally engineering a sale and departure from the market. The path BRAC took, forming a partnership with a financial services company with its own microfinance portfolio and a strong local reputation, to then jointly acquiring a distressed for-profit financial services company and then selling its stake, makes BRAC's experience in Sri Lanka all the more notable.

The transformation process is perhaps one of BRACs best examples of adaptive planning in the face of rapidly changing macro-economic contexts characterized by disaster, war and post-war prosperity as well as a challenging policy environment. It is a story of iteration, adaptation and an organization stepping outside of its typical approaches, to make possible a long-term commitment to a pro-poor mission.

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