

Micro-financing towards Empowerment of Disadvantaged Groups in Nepal: Innovations and Practices



Prepared by
Micro Finance Department
Nepal Rastra Bank



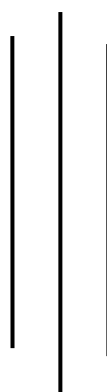
Sahakarya Project
Centre for International Studies and Cooperation (CECI)

March 2008

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Foreword



Despite the intensification of globalization and satisfactory growth of GDP in the world, poverty and inequality is still prevalent, particularly in the developing world, creating challenges and hindrances to growth. The impact of poverty on the development process was discussed in 1970s by the Eminent Economists Gunar Myrdal followed by Paul Steeren, Amartya Sen, Prof. M. Yunus; etc in their intensive research and writings on poverty nexus growth, with reference to developing countries of the world. Economists, social think-tanks and philosophers have realized the importance of microfinance in poverty reduction and have accorded it one of the highest rankings in poverty reduction methodologies. Recently the Nobel Peace Prize was awarded to the pioneer of micro-credit, recognizing its growing importance as one of the effective tools for poverty reduction and peace building.

For nearly four decades in Nepal various agencies have been active in microfinance with Nepal Rastra Bank, the central bank of Nepal, playing a pivotal role in policy-making decisions. A rapid upsurge in micro-finance programs has been witnessed in the last one and half decades. Within this period, Nepal introduced various microfinance programs with diversified methods and modalities including: public vs. private sector modality, project based modality, wholesale lending based modality, community and deprived sector based modality, etc. The programs such as PCRW, MCPW, GBBs, GBBRs etc. come under gender-based programs. Likewise, the programs namely PAPWT, TLDP, RMP, CGISP etc. come under project based micro credit programs. The activities of RSRF, RMDC, SKBB, etc are solely based on wholesale micro-credit modality. Likewise, the micro credit activities of SACCOs and FINGOs fall under the modality of community/rural based.

Despite the various programs conducted throughout the country along with micro-credit facilities, the incidence of rural poverty is still relatively high and there is also great disparity in the distribution of income among the different development regions of the country. This urges all stakeholders of micro finance institutions to work intensively on poverty reduction with their own modalities/philosophies without duplicating each others activities at the grassroots level. As we all know there is a dire need for seed money in the rural economy and this can be met only through collective efforts of all stakeholders involved in the microfinance sector. Additionally, self-reliance and good governance of MFIs also determines the sustainability of microfinance programs.

The outreach of MF activities has been just 0.7 million households, which is only 8.06 percent of the total population living below the poverty line in Nepal. This calls for all MFIs to work intensively on a poverty alleviation drive in the years to come via various microfinance activities along with a credit plus approach as NRB has already mentioned in its monetary policy of FY 2007/08.

This book was prepared as a country report on microfinance on the glorious eve of the *Second World Congress on Rural Finance* that was held jointly by APRACA and BAAC. However due to time constraints, this book could not be published before the World Congress took place in November 2007, and I am happy that the book is published now. This book has made an effort to explore comprehensively various facets of micro-finance activities with reference to poverty. Additionally it encompasses a review of microfinance activities, prudential policies related to microfinance, and also discusses the contribution of micro finance activities with reference to efforts on poverty reduction in Nepal. It throws light on how microfinance activities should be accelerated in the coming years to cater to the rural poor of a developing country like Nepal.

At this point, I must mention that APRACA has created a wonderful academic venture for encouraging the APRACA member countries to publish the book on microfinance. I believe, this will not only provide access to share experiences between countries but also cultivate the essence of Asian culture between South and South East Asian Countries via such academic exercises. I hope this book will be a worthy literary asset to share microfinance activities and learning among the APRACA members and others. Additionally, I hope the dissemination of such a book will serve as a guideline for all stakeholders, microfinance players, planners, researchers, social scientists, etc. of Asia and Pacific Region.

I would like to express my sincere thanks to Micro-finance Department's staff of Nepal Rastra Bank who endlessly put their efforts towards such a wonderful publication in a short period of time. I am particularly thankful to Mr. Sushil Ram Mathema, Executive Director of Micro Finance Department/NRB – the lead writer of this book for his untiring efforts and guidance to his fellow staff. My thanks are also due to Dr. Bama Dev Sigdel, Deputy Director and Mr. Amar Krishna Joshi, Asst. Director of MFD for their assistance in write ups, academic exercises and layout of this book and to other staff of MFD for their direct or indirect contribution and in support. Last but not the least, my thanks also goes to Centre for International Studies and Cooperation (CECI) Nepal for publishing this book.

March 2008



Bir Bikram Rayamajhi
Deputy Governor
Nepal Rastra Bank

Preface

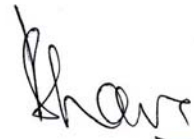
CECI has been working in more than 40 districts of Nepal for the last 20 years. Among various areas of interventions, promotion of rural finance is a key component of our community-based socio-economic development program. CECI's *Sahakarya* project has been working in five hill districts of mid- and far-western regions since 1997. Currently, the project is supporting 176 savings and credit cooperatives and five district unions of such cooperatives in their leadership development, managerial, technical and service delivery capacity development. CECI conducted research on "Effectiveness of microfinance in the Western Hills of Nepal" on the eve of celebrating "International Micro Credit Year 2005". The ensuing report has been published and circulated for wider use. Likewise, CECI has been supporting various organisations in publishing their research works. This book is one of such publications.



CECI feels proud to publish this book titled "Micro Financing towards Empowerment of Disadvantaged Groups in Nepal: Innovations and Practices" prepared by Microfinance Department of Nepal Rastra Bank. We are very hopeful that this book will be useful to all players of microfinance in Nepal.

We would like to thank Mr. Sushil Ram Mathema (Executive Director of Microfinance Department, Nepal Rastra Bank) for taking the initiative to publish this book, Nepal Rastra Bank for giving us this opportunity to publish this book and colleagues in CECI namely Dr. Prahlad Thapa, Ms. Muriel Mac-Seing and Ms. Karen Barkley for editing this book for publication.

March 2008

A handwritten signature in black ink, appearing to read 'Keshava Koirala'.

Keshava Koirala
Country Representative
CECI-Nepal

Acknowledgements

Micro Finance Department of Nepal Rastra Bank (NRB) extends its heartfelt thanks to APRACA and BAAC for coming up with a wonderful idea to prepare the country book on the august occasion of Second World Congress on Rural Finance that took place in Bangkok, Thailand from 30 October to 03 November, 2007.

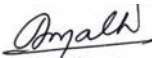


Although this book could not be published before the event took place, it is now published with the support from Centre for International Studies and Cooperation (CECI) Nepal. Every effort has been made in this book to cover each and every facet of the microfinance sector of Nepal. The first chapter discusses background information on the socio-demographic, economic and financial system of Nepal. The second chapter presents review of micro-finance policies and programs in Nepal. The Third chapter covers the topics of modalities of microfinance, poverty reduction strategies, planning, poverty and microfinance. Similarly, chapter four is concerned with the prudential regulatory framework, and the chapter five presents poverty vs. microfinance, on-going wholesale microfinance activities, outreach credit inducement of new innovative devices of microfinance such as remittance, crop insurance, foreign employment, etc. along with the critical elements of successes of microfinance in selected sectors. Existing pertinent issues and the future of microfinance have been minutely discussed in the last chapter.

NRB and APRACA have a good longstanding relationship of cooperation and understanding in academic endeavors and policy matters by active participation and consultation through seminars, discussions and publications since the establishment of APRACA. Against this backdrop APRACA along with BAAC is celebrating the *Second World Congress on Rural Finance*, Nepal Rastra Bank as the founder member of APRACA feels privileged to bring about this publication on micro finance, "**Micro-financing towards Empowerment of Disadvantaged Groups in Nepal: Innovations and Practices**". We would like to thank APRACA and BAAC for their guideline and encouragement to compile and write the book.

I am very hopeful that this book will be useful to academicians, economists, policy makers as well as researchers of Nepal and Asia and the Pacific. My heartfelt thanks go to Respectable Deputy Governor Mr. Bir Bikram Rayamajhi for his encouragement at every stage of writing this book. I would like to thank my staff members without whose support, this publication would not have come into such a good quality and shape. I would like to acknowledge Deputy Director/ MFD Dr. Bama Dev Sigdel for his potent contribution in academic inputs and organizing the substance of the book. I would also like to thank Assistant Director Mr. Amar Krishna Joshi for sharing his time in compilation of the various reports and layout designing of this book. My thanks are also due to other staff of Micro Finance Department for their direct/indirect support and involvement to bring out this book at the right time in such a beautiful form. My sincere thanks go to Dr. Prahlad Thapa, Ms. Muriel Mac-Seing and Ms. Karen Barkley of CECI for editing and CECI for publishing the book.

March 2008


Sushil Ram Mathema
Executive Director
Micro Finance Department
Nepal Rastra Bank

Acronyms

ADB/M	Asian Development Bank, Manila
ADB/N	Agricultural Development Bank/Nepal
BAFIA	Banking and Financial Institutions Act
CBS	Central Bureau of Statistics
CECI	Centre for International Studies and Cooperation
CGISP	Community Ground Water Irrigation Sector Project
CIDA	Canadian International Development Agency
CSD	Center for Self-help Development
DEPROSC	Development Project Service Centre
DOI	Department of Irrigation
DSCP	Deprived Sector Credit Program
FAO	Food and Agriculture organization
FDC	Foundation for development Cooperation
FINGOs	Financial Intermediary Non-governmental Organizations
FSRP	Financial Sector Reform Program
GBBRs	Grameen Bikas Bank Replicators
GBBs	Grameen Bikas Banks
GDP	Gross Domestic Product
IBP	Intensive Banking Program
IDP	institutional development program
IFAD	International Fund for Agricultural Development
MFD	Micro Finance Department
MFDB	Micro-finance Development Bank
MFIs	Micro Finance Institutions
MOAC	Ministry of Agriculture and Cooperatives
MOLD	Ministry of Local Development
NBL	Nepal Bank Ltd.
NCDB	National Cooperative Development Bank
NGOs	Non-governmental Organizations
NLSS	Nepal Living Standard Survey
NRB	Nepal Rastra Bank
PAPWT	Poverty Alleviation Project for Western Terai
PCRW	Production Credit for Rural Women
PO	Partner Organization
PSLP	Priority Sector Lending Program
RBB	Rastriya Banijya Bank
RMDC	Rural Micro-finance Development Centre
RMP	Rural Micro-finance Project
RUFIN	Rural Finance Nepal
SFCL	Small Farmers Cooperative Ltd.
SFDP	Small Farmers Development Program
SHGs	Self Help Groups
SKBBL	Sana Kisan Bikas Bank Ltd.
SPOs	Sub-Project Offices
STWs	Sallow Tube-wells
TLDP	Third Livestock Development Project
VDCs	Village Development Committees
WAR	Weighted Risk Assets
WB	World Bank
WDD	Women Development Division

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CHAPTER I BACKGROUND

1.1 General Overview

Situated in the lap of the Majestic Himalayas, Nepal is bordering on the two most newly emerging Asian economies of the World, India in the east, south and west and China in the north. It has three distinct physic-geographic regions, i.e., Terai (southern plain), Hill and Mountain. Administratively, the country is divided into five regions and 75 districts. Nepal has around 26 million people comprised of more than 100 caste/ethnic groups. Nepal presents glaring example of being in socio-cultural harmony and has maintained its pride to be an independent and sovereign state.

Despite the various planning efforts in the past, 77 percent of the people are still living in rural areas. Economic growth of the country has not been able to keep up with the population growth of 2.2 percent resulting in high levels of unemployment and poverty.

The total fertility rate currently stands at 3.6 per women and the life expectancy of a Nepali has remained at 62.8 years.

Agriculture is the mainstay of the economy constituting 80 percent of employment and 38 percent of the GDP. As a result of economic liberalization policies, the economy was about to take-off in the nineties (4.5% growth of GDP). However, due to low growth in the agriculture sector coupled with a seizure of growth in the non-agriculture sector due to armed conflict, the pace of growth slowed down to just 2.5 percent during the Tenth Five Year Plan Period (2002-07). As a result, still 31 percent of people are living in poverty.

1.2 Financial System

Nepal Rastra Bank (NRB) – the central bank of Nepal was established in 1956. The history of modern banking system in Nepal began in 1937 with the establishment of the Nepal Bank Limited (NBL) as the first commercial bank in Nepal. After the establishment of NRB, Nepal witnessed a systematic development of the financial system. After the adoption of liberalized economic policies during the 1980s, financial industries expanded rapidly in Nepal.

The Nepalese financial sector is composed of banking and non-banking sectors. The banking sector is comprised of NRB and commercial banks. The non-banking sector consists of development banks, micro credit development banks, finance companies, co-operative financial institutions, non-government organizations (NGOs) performing limited banking activities. Other financial institutions include insurance companies, employee's provision fund, citizen investment trust, postal saving offices and Nepal Stock Exchange.

A tremendous growth in the number of financial institutions in Nepal has been witnessed in the last two decades. At the beginning of the 1980s, when the financial sector was not liberalized, there were only two commercial banks, and two development banks performing banking activities in Nepal. But after the liberalization drive in 1980, there was a promising expansion of the financial sector in Nepal. By mid-January 2007, NRB licensed bank and non-bank financial institutions totaling 203 (Box 1). These financial institutions are under the regulation and

Box 1: Financial institutions

Commercial bank	19
Development banks	35
Financial companies	72
Micro credit development banks	11
Savings and credit cooperatives	19
Non-governmental organizations	47

supervision of the NRB. Besides these institutions, there are more than 3000 registered saving and credit cooperatives and as many as 10,000 NGOs involved in this sector.

	1980	1985	1990	1995	2000	2006	2007
Commercial Banks	2	5	5	10	13	18 ^{\$}	19
Development Banks	2	2	2	7	13	30	35
Finance Companies	-	-	-	20	46	70	72
Cooperatives*	-	-	-	8	35	19	19
Non-governmental Organizations*	-	-	-	6	13	47	47
Micro Credit Development Bank	-	-	-	-	-	-	11
Total	4	7	7	53	120	184	203

Includes micro-finance development banks & rural development banks.

* Licensed for limited banking activities only.

\$ Including ADB/N.

Source: Nepal Rastra Bank

The total assets/liabilities of the financial system experienced continuous growth over the last five and half years, signifying strong uplift in the financial business. It increased continuously at an average rate of 16 percent per annum during 2000 to 2005 and stood at Rs. 474.3 billion in mid-July 2005. Commercial banks comprised the largest stake of 86.7 percent followed by finance companies (6.4 %), development banks (4.9 %) and others (2.0 %). The total assets of commercial banks alone accounted for more than two third of the system's total assets. So, the Nepalese financial system is basically dominated by the banking system particularly the commercial banks. The data reveals that of the total investment of Nepalese financial sector, commercial bank's hold 90.5 percent of the total followed by finance companies (3.6 %), development banks (3.0 %), micro-credit banks (2.3 %) and others (0.6 %).

CHAPTER II PREVIEW OF MICRO FINANCE POLICIES AND PROGRAMS

2.1 Micro-finance Sector

Economic transformation of the poor and deprived rural population lies on the shift in rural economic activities from subsistence to commercial. The savings and investments of the rural population are low due to low earnings. To mitigate the saving investment gap in the rural economy, universal access to rural finance would be desirable. Despite the various endeavors, the outreach of financial institutions has covered only 30-35 percent of the population. It means that there are still 65-70 percent people relying on merchants, money lenders, traditional cooperatives, etc., for financing on socio-economic activities with high interest rates. In the absence of access to formal sources of credit, the poor of the rural areas continue to be subjected to exploitative terms (high interest, gift, premiums, free labor, bonded labor, etc.) feeding the perpetual cycle of indebtedness and poverty.

Micro-finance is coined as the financial service rendered to the deprived group of the people and small entrepreneurs to help them in developing self-employment opportunities and various income generating activities. The small size of the loan, regular savings, small-scale entrepreneurs, diversified utilization and simple and flexible terms and conditions are the determining characteristics of its definition. Usually, micro-finance is a program that serves a large number of clients with reference to women/deprived people and works at a grassroots level with financial sustainability. The main objective of a micro-finance program is to provide quality service to the largest number of the deprived populace.

Nepal has three decades of experience in Micro-finance. Although many programs have been implemented for poverty alleviation in Nepal, only micro-finance programs are seen as pro-poor and rural based. In Nepal, agriculture based cooperatives were initiated in the 1950s as a first step in micro-finance. Poverty alleviation rural development programs were initiated through the Small Farmers Development Programs (SFDP) on a pilot basis in 1975 by ADB/N. On the basis of the success of these programs, the SFDP was transferred into SFCLs (Small Farmers Cooperative Limited), which were managed by the farmers themselves. Later, other micro-finance development programs, such as Priority Sector Lending Program (PSLP), Intensive Banking Program (IBP), Production Credit for Rural Women (PCRW) and Rural Self-Reliant Fund (RSRF) were implemented.

In the 1990's, five development banks were established as a replication of the Bangladesh Grameen Bank model of micro-finance delivery. They aimed to serve about 400,000 clients. Later as a result of the promotion of private sector's participation in micro-finance, Nirdhan, CSD, Chhimek and other organizations came into existence. Some government's donor-funded directed programs (TLDP, PAPWT, CGISP, etc) have been implemented in Nepal in coordination with NRB. The common features of such programs were: (i) targeted to the specific sectors and people with low income, (ii) extend collateral free credit on group guarantee basis, (iii) program includes other support services along with credit, (iv) principal aim to alleviate poverty.

The 2002 Financial Sector Study by the World Bank revealed that the formal microfinance sector has had limited impact to date in providing financial services to the rural poor. Nevertheless, microfinance is recognized as a powerful instrument for poverty reduction/alleviation in Nepal. Of the estimated 20 million rural inhabitants, 31 percent are classified as poor and only about 700,000 (11% of poor) are served by formal microfinance institutions (MFIs). The overwhelming majority of the poor,

therefore have to look to the traditional informal sector viz; moneylenders, family members, friends, traders, landlords, rotating savings and credit associations for these services.

The development of the formal microfinance sector dates back to 1974, when the NRB directed that NBL and RBB lend at least 5 percent of their deposits under a " Priority Sector credit" Scheme. The target sectors under the scheme included agriculture, cottage industries and services. This requirement then was extended to all commercial banks and the guideline was raised to 12 percent of total deposits mobilized. The success of this approach, however, was less than anticipated and the loan portfolio actually extended to small farmers was quite limited. Presently, Nepal is implementing World Bank funded Financial Sector Reform Program (FSRP). As a part of the FSRP starting from the fiscal year 2002/03 for the next 5 years, the NRB has declared a phasing-out policy of the three decade-old Priority Sector credit program (12 percent requirement) of the commercial banks. According to this phasing out policy, commercial bank's credit to the priority sector will not be a mandatory by the end of FY 2006/07.

In parallel with government's efforts to establish a network of rural financial service providers in the early 1990's, the private sector as explained earlier also came forward to serve as financial service providers. These included formal cooperatives (savings and credit, and multi-purpose cooperatives), NGOs, savings and credit organizations and international non-governmental organizations. The World Bank estimates that they service about 300,000 clients with the largest providers being the registered cooperatives (150,000) and Centre for Self-Help Development (36,000). Other large providers are Nirdhan (32,000), the Support Activities for Poor Production of Nepal (SAPPROS) (13,000) and the Development Project Service Centre (DEPROSC) (14000). The nexus of the detailed microfinance practices prevailing in the country is given in the forthcoming chapter.

2.2 How Microfinance is Understood in Nepal

Microfinance is the provision of a broad range of financial services to poor and low-income households such as micro-savings, loans, payments/or money transfers and micro-insurance. Microfinance products in the country are micro-credit, medium & small enterprise credit, group savings, project loan and micro-insurance. Although the conventional definition of microfinance is to provide banking services to lower income people targeting the poor and the very poor, the institutional definition of micro-credit in Nepal is the following:

- Central Bank (NRB) in its regulation defines the loan up to Rs. 60,000 by Micro-finance Development Bank (MFDB) as micro-credit.
- Rural Self Reliance Fund (RSRF) recognizes loan up to Rs. 60,000 per borrower given to the deprived sector as micro-credit and a group loan up to Rs. 150,000 given to the members on joint liability for project loans.

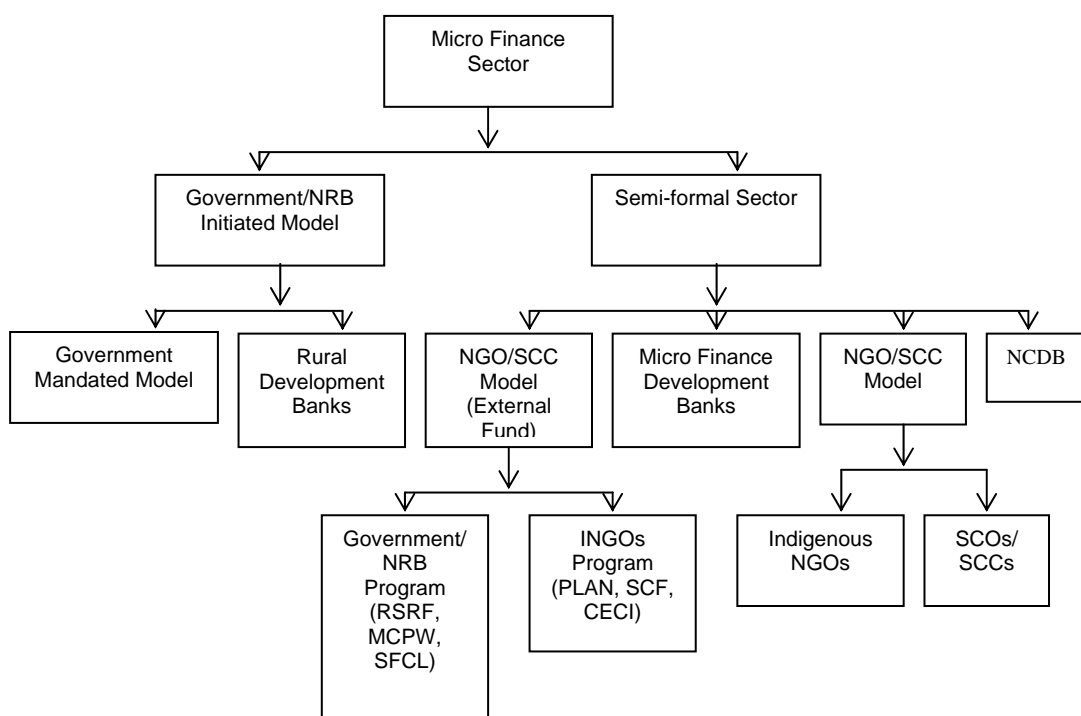
2.3 Modalities of Nepalese Micro-finance Sector

Micro-finance programs are set up and accelerated in Nepal with diversified methods and modalities. They are deprived vs private sector modality, gender based modality, project based modality, wholesale lending based modality, community vs deprived sector based modality, etc. The micro-credit programs such as PCRW, MCPW, GBBs Replicates, etc., fall under gender based programs while the programs as RMP, PAPWT, TLDP, CGISP, etc. comes under project based micro credit programs. The wholesale micro credit programs are RSRF, RMDC, etc. The micro credit activities of SACCOs and FINGOs come under the modality of community/deprived sector based.

The financial institutions operating under different models are functioning as a legal entity and have received Nepal Rastra Bank's approval for their operation. Some partner organizations (POs) of Rural Self-Reliance Fund (RSRF), operating in the rural and remote areas are registered with the Department of Cooperatives. Also, a number of NGOs involved in financial intermediation in the informal sector, village banks, self-help groups, etc., are also rendering micro finances services to the rural people. Some of these institutions are promoted and developed by Cooperatives, INGOs, and local people.

Nepalese micro-finance sector can be classified as formal and semi-formal. Formal sector model is initiated by government/NRB. The initiative so far includes the establishment of Rural Micro-finance Development Center (RMDC) and implementation of the programs as Jagriti (Women Empowerment Program), Bisheshwor with the Poor, Intensive Banking Program (IBP), Small Farmer Development Program (SFDP), and Production Credit for Rural Women (PCRW). The semi-formal model is initiated by NGOs, Cooperatives and Micro-finance banks (see, Fig.1).

Fig.1
Micro-finance Sector in Nepal



2.4 Poverty Measurements and Reduction Strategies

Nepal Living Standards Survey (NLSS II) 2004 estimates the level of poverty at 31 percent in 2003/04, a decline of 3.7 percent per year or 11 percent in aggregate compared to 42 percent in 1995/96. But during that period, the income inequality worsened with Gini coefficient increasing from 34.2 to 41 from 1995/96 to 2003/04. This indicates inequality in opportunities and access. Disparity in the urban and rural development was one of the reasons for the 12-year long armed-conflict in Nepal that ruined further the rural economy and life.

The rural poverty (34.6%) is more than three times higher than urban poverty (9.6%). The urban poverty declined from 22 percent to 10 percent while rural poverty declined in a slower rate from 43 percent to 35 percent. NLSS I and II data clearly indicate disparity in the poverty level by ecological belts, geographic and development regions. It is highest in the mountains followed by hills and lowest in the plain Terai (Table 2). Similarly, household poverty level is related to education, caste, family size and employment status of the household heads. As such, high poverty is pronounced among underprivileged people like Janjatis and Dalit (low caste) compared to higher caste like for Brahmin and Chhetry. The incidence of poverty is highest in the households having illiterate household heads as well as for those self-employed in agriculture and manufacturing and lowest for self employed in trade and service. It is also recorded that poverty increases with the number of small children in the family.

Table 2: Poverty Rate by Regions in Nepal, 1995-1996 and 2003-2004			
Rural/Urban	1995-1996	2003-2004	Change in Percent
Urban	21.6	9.6	-56
Rural	43.3	34.6	-20
Total	41.8	30.9	-26
Development Regions			
Eastern	38.0	29.3	-25
Central	32.5	27.1	-17
Western	38.6	27.1	-30
Mid Western	59.9	44.8	-25
Far Western	63.9	41.0	-36
Total	41.8	30.9	-26
Ecological Belts			
Mountain	57.0	32.6	-43
Hills	40.7	34.5	-15
Terai	40.3	27.6	-32
Total	41.8	30.9	-26

Source: NLSS I and NLSS II (1997, 2004)

2.5 The 10th Plan's Provisions on Poverty Reduction and Microfinance

Poverty reduction has been receiving high priority in the periodic development plans of Nepal. While the Tenth Plan enunciated policies and strategies on cooperatives and rural/micro-finance, the Poverty Reduction Strategy Paper (2002-2007) provided the most pertinent enabling framework for them. The "four pillars" of the Strategy as elaborated in the Plan have been (i) broad-based high and sustainable economic growth; (ii) social sector development; (iii) targeted programs for the poor, deprived and excluded sections; and (iv) good governance. These strategies were designed to reduce poverty level from the then estimated 38 percent to 30 percent by 2007 (National Planning Commission, 2002), except that the Plan target of poverty reduction has been pre-empted by the findings of the NLSS regarding remittance-induced poverty reduction. It may be recalled that the findings of NLSS II were that the poverty reduction during the above period is mainly attributed to the exodus of labor and increase in remittances and can hardly be attributed to the country's success in development performance. The plan has earmarked a total allocation of 100.75 billion rupees for "rural and agricultural credit" during the plan period, and it includes a sum of 11.90 billion to be financed by MFIs. The strategies for achieving this objective include: (i) improvement in the institutional mechanism to expand credit flow through MFIs in rural areas, and (ii) gradually hand over the ownership of Rural Development Banks to the private sector (NPC, 2002). Along this line, the government has also established a Poverty Alleviation Fund, which extends credit through the local NGO/CBO intermediaries in the rural areas. It should, however, be noted that while the first PRSP strategy of " broad-based, high and sustainable economic growth" has generally eluded

the country during last fifty years of planned development effort, the recent successes of the various micro finance initiatives have generated an optimism that the "targeted programs for the poor" that should encompass microfinance initiatives, if properly implemented, could go a long way in significantly contributing to the poverty reduction goals enshrined in the plan.

2.6 The 11th Three Year Interim Plan's Provisions on Microfinance

The proposed final draft of the Eleventh Three Year Interim Plan (2007-2010) also mentions some aspects of Micro Finance Programs under the headings of **Money, Banking, and Credit**; that through the meaningful net working of bank, corporate institutions and MFIs, the access of credit will be intensified in rural areas of Nepal during Plan period. It also mentions that the mechanism will be developed in such a way so that microfinance activities would be carried out from both private and non-government levels, particularly in rural areas targeting marginalized farmers, petty traders and poor/destitute households members with the means of heterogeneous income generating activities.

2.7 NRB's Monetary Policy and Program Related to Micro Finance

NRB's Monetary Policy of 2007/08 has accorded top priority to micro finance, providing impetus to its cause, importance and relevance especially in poverty reduction efforts. Accordingly, it has urged commercial banks to disburse credit to the deprived sector up to 3 percent of their total outstanding credit. NRB's Monetary Policy also spells out that a directive will be issued to the development banks and finance companies too to disburse credit gradually to the deprived sector in the near future. Similarly, this policy has appreciated the existing single borrower limit cap of rupees 40 thousand for individual and Rs. 100 thousand for micro-enterprises to Rs. 60 thousand and Rs. 150 thousands, respectively. The provision of refinance facilities, provision of loan facilities to small and marginal tea farmers to establish a green tea processing center from RSRF's Loan, the provision of credit plus the approach to uplift the life of economically deprived small and marginal households through RSRF's credit facilities, the line of credit facilities to the deprived and poor families living in the remote area, etc., are instances of other provisions mentioned in Monetary Policy of 2007/08.

2.8 Interest rate Structure in Micro-finance

As the central bank has already adopted the policy of deregulation of interest rates, it is observed that the interest rates charged on microfinance loans vary considerably. The moneylenders in the informal market charge interest rates of 3-5 percent per month. The high interest rates charged is justified on the basis of easy availability and minimum procedural delays. The savings and credit cooperatives charge between 0.75-1.5 percent per month which is around 24-48 percent per year and pay 6-8 percent per annum on savings account when paid. These interest rate levels are based on the need to cover their high operating costs including monitoring and supervision costs as well as their cost of funds, if such funds are sourced from wholesale lenders such as ADB/N, RMDC and so on. ADB/N charges between 12-16 percent per year on the reducing balances, and pays interest of 6 percent per annum on savings accounts. The commercial banks' prime lending rates vary between 11-12 percent per annum for working capital loans and 3 percent per annum on loans to entities qualifying as deprived sector loans under the Priority Sector Credit Scheme. The current interest rate paid on savings accounts with the commercial banks is about 3.3 percent per annum.

2.9 Review of the Past Micro-finance Programs

The government of Nepal and NRB have made great efforts in conducting various rural financial programs since the 1970s decade in poverty alleviation drive led by

Periodic Plans through the aid of different participatory financial institutions such as commercial banks, development banks, rural development banks, saving and credit cooperatives, NGOs micro-finance institutions. The main objective of such initiatives is to improve and upgrade the economic and social condition of rural people especially those living on the abject poverty line.

NRB was committed to working for the implementation of priority sector credit program in 1974. Under this, commercial banks were urged to extend 12 percent of their loans towards the deprived sector. The commercial banks could lend to ADB/N, RDBs, Saving and Credit Cooperatives, and Financial Intermediary – Non-governmental organizations that were the major suppliers of rural micro-finance services. ADB/N is one of the pioneering financial institutions in Asia, which initiated the first group based micro-credit program in 1975, also known as Small Farmer Development Program (SFDP). Under this program, the ADB/N has availed credit to more than 200 thousand micro-borrowers. It had spread out the activities in 650 VDCs of Nepal. From the beginning of FY 1993/94, the ADB/N initiated another innovative approach of developing self-help organizations at grass-root level, i.e., Small Farmers Cooperative Limited (SFCL with the technical support of GTZ). ADB/N had also introduced women centered programs, mainly Production Credit for Rural Women (PCRW), through IFAD fund in 1982 for the upliftment of the economic status of low income rural women. This program was completed in 1998 covering 67 districts and disbursing credit amounting to Rs. 605 million to nearly seventy thousand rural women.

Micro-credit Project for Women (MCPW) was another activity in micro-finance sector of Nepal. This program was launched in 1994 with the financial assistance of ADB/M to supplement the PCRW. The main objective of this program was to provide various types of skill oriented trainings particularly to women to undertake divergent income generating activities, institutional strengthening of NGOs and the provision of micro-credit to women. The major outcome of MCPW is that women groups were organized as cooperatives. More than 82 women savings and credit cooperatives were formed and registered at the Cooperative Department, out of which 25 savings and credit cooperatives have been able to become POs of RSRF. Similarly, 27 FINGOs formed by women groups under MCPW have gotten limited banking license from the NRB. Similarly, as in the case of PCRW, this program was extended to 67 districts and altogether 68,000 women benefited directly or indirectly from this project. The outstanding loan amount under PCRW as at mid-January 2005 stood at Rs. 158.35 million. Women Development Division (WDD), Ministry of Local Development and Nepal Rastra Bank jointly implemented this project. NRB channeled the credit through counseling and participation with commercial banks, Nepal Bank and Rastriya Banijya Bank. Under this program, women of rural and urban areas were provided soft loan on consortium as well as on individual basis to operate agriculture and small enterprises. NRB had paid principal and interest amounting to Rs. 30.5 million and 26.8 million respectively to Nepal Government as of Mid-July, 2005.

At this juncture, Banking with the Poor Program was initiated by an Austrian NGO named Foundation for Development Corporation (FDC) in 1991. The vision of the program was to enhance access of rural poor to credit RBB remained in-charge of executing this program through its 31 branches in 18 districts. As of mid-July 1999, this program had extended Rs. 80 million credit approximately to some 9000 poor families through NGOs and rural self-help groups. Besides, the Savings and Credit Cooperatives (SACCOs) and Financial Intermediary Non-Government Organizations (FINGOs) were also involved with the various micro finance activities since the 1980s. Similarly, NGOs are established under the Society Registration Act-1978 in the various district administration offices for the socio-economic activities in Nepal. Generally,

NGOs are required to obtain license from NRB, if they genuinely would want to extend their services to the Nepalese financial sector. By July 2006, more than 50 NGOs involved with various income generating activities were permitted by NRB to do limited banking transaction.

Other major past micro finance programs were Poverty Alleviation Project in Western Terai (PAPWT) and Third Livestock Development Project (TLDP). The project PAPWT was financed under the loan agreement between Nepalese Government and the International Fund for Agriculture Development (IFAD) established on 12 December, 1997. This project was implemented primarily with the aim of alleviating poverty in 8 districts of western Terai, namely Kapilvastu, Rupendehi, Nawalparashi, Banke, Bardiya, Dang, Kailali and Kanchanpur. To achieve the above mentioned target, 16 branches of PFIs comprising of Western Regional Rural Development Bank, Mid-Western Regional Rural Development Bank, Nirdhan Utthan Bank Limited and Centre for Self-help Development were selected for micro credit delivery through which the branches were also expected to run in a sustainable basis.

CHAPTER III MICRO FINANCE MODELS vs POVERTY

3.1 Preview of Micro-Finance models and Poverty

To date, Nepal about three decades of experience in Micro-Finance, which has been exclusively recognized as a poverty-reduction program focused towards raising the income level and social standard of the people living in poverty, particularly women. In due consideration of the success of the micro-finance program in bringing positive impact towards poverty reduction, the 10th Plan (2002-2007) incorporated micro-finance as a major financial tool to achieve the objective of poverty reduction.

The micro-finance practices of the organized sector that are prevalent in the country can be grouped broadly into seven (7) micro-finance models as follows.

A) Grameen Model

A concept of Grameen bank was evolved in 1992 when the Nepal Government felt the need to establish a separate institution which would take sole responsibility for financing the rural poor and supplementing, to some extent, the rural micro-finance activities of the previously established institutions. The aim of the Grameen Bikas Banks (GBBs), established as a regional development bank in 5 development regions between 1992 and 1996 and operating on the Bangladesh Grameen model, is to engage the targeted rural poor with the appropriate credit delivery mechanism and on a group liability basis. These banks are the largest MF operators in Nepal. Training as an entry point of banking has been introduced, as a new specialized banking system by Grameen Bikas Bank. Although Nepal Rastra Bank had the major share ranging from 55-70 percent in GBBs, NRB is in the offing to divest its share of all GBBs to the private sector. As a result, Nepal Rastra Bank has been successful in divesting its share in three of five GBBs. Besides the government owned 5 GBBs, 4 MFIs based on Grameen model, and established as a development bank, are operating in the private sector.

	Eastern	Central	Western	Mid-Western	Far-Western	Total
No. of centre	1,416	1,379	1,176	611	625	5,207
No of groups	11,613	9,492	8,327	3,897	3,546	36,875
No. of members	57,434	43,654	41,139	18,650	19,957	180,834
No of borrowers	52,477	42,674	39,680	13,091	13,463	161,385
General loan disbursed	5,081,810	2,592,071	3,710,462	966,796	1,055,095	13,406,234
General loan repaid	4,681,209	2,312,902	3,335,971	860,743	925,488	12,116,313
General loan outstanding	400,601	279,169	374,491	106,053	129,607	1,289,921
Other loan disbursed	1,038,070	283,448	182,958	369,976	3,755	1,878,207
Other loan repaid	778,537	227,816	101,824	289,028	3,651	1,400,856
Other loan outstanding	259,533	55,632	81,134	80,948	104	477,351
Total loan disbursed	6,119,880	2,875,519	3,893,420	1,336,772	1,058,850	15,284,441
Total loan repaid	5,459,746	2,540,718	3,437,795	1,149,771	929,139	13,517,169
Total loan outstanding	660,134	334,801	455,625	187,001	129,711	1,767,272
Personal saving balance	48,806	10,875	5,274	7,783	4,743	77,481
Group fund balance	124,462	103,094	90,812	42,051	32,777	393,196
Group fund loan dis.	139,058	63,946	0	35,542	112,594	351,140
Group fund loan repaid	136,732	59,262	0	33,021	108,560	337,575
Group fund loan outstanding	2,326	4,684	0	2,522	4,034	13,566
Staffs	294	248	215	133	112	1,002
No. of Branches	41	28	36	23	17	145
VDC covered	262	300	277	112	93	1,044
Districts covered	9	14	12	5	7	47

Source: NRB, MFD 2007.

The bank provides credit basically for micro level income generating activities on a group guarantee basis to the group members through 2+2+1 system. In a group, there should be 5 women and have less than 1 bigha (0.71 hectare) in terai and 10 ropanis (0.55 hectare) in hills. The interest charged in the disbursed credit is 20 percent and the bank recovers the credit in 50 weekly installments from the borrowers. As of mid-January, 2007, 5 GBBs have altogether disbursed loans of Rs.13,406 million to 161,385 female borrowers covering 36,875 groups through 5,207 centers. The activities of five GBBs have been expanded to 47 districts of the country.

There are four institutions working as replicas of GBBs. They have disbursed loans of Rs. 7500 million to 156,958 women covering 39,256 groups through 7,597 centres and have successfully spread their heterogeneous income generating activities to 45 districts of the country.

i. Swabalamban Bikas Bank Ltd. (SB Bank)

SB Bank (literally means Self-help Development Bank) is a Microfinance Development Bank, which started its operation on January 14, 2002. The Bank's registered (central) Office is situated in Janakpur, Dhanusha, Nepal. Over 13 years ago, Centre for Self-help Development (CSD), an NGO, initiated the Self-help Banking Program based on the Grameen Bank Model with some adaptations in September 1993. The primary objective of the institution is to provide the disadvantaged section of the rural poor with easy access to credit, which will help them to improve their socio-economic status and make full use of their existing skills and resources. SB Bank targets families having per capita income not more than NPR 4,400 (USD 62) and serves women exclusively. At Mid-January 2007 SB Bank covers 417 Village Development Committees in 15 districts namely Panchthar, Illam, Therhathum, Dhankuta, Sunsari, Udayapur, Saptari & Siraha of Eastern Development Region and Dhanusha, Mahottari, Sindhuli, Sarlahi, Bara, Parsa & Makwanpur of Central Development Region of Nepal.

As of Mid-January 2007, SB Bank has reached 69,053 members (families) from its 47 branches. The current outstanding portfolio amounts to NPR 373.64 million (USD 5,262,479). However the cumulative disbursement has reached NPR 3,272.42 Millions (USD 46,090,470) including the CSD/SBP period. The repayment rate has been very satisfactory (99.57%). Savings balance of the members (clients) has reached to NRS 171.59 million (USD 2,416,750).

ii. Nirdhan Utthan Bank Ltd.

Nirdhan Utthan Bank Limited, "the bank for upliftment of the poor" is a microfinance bank established in November 1998. It was granted a license in April 1999 to undertake banking activities. It provides microfinance services such as loans, deposits, micro-insurance, and remittance services. The lending methodologies are individual lending based on Grameen Bank, Bangladesh model and group lending based on Self-help Group model through a few specified branch offices. As of mid-January 2007, NUBL has succeeded to expand credit to 78,155 member families from its 45 branches, its loan disbursement stood at Rs. 318.3 billion by mid-January 2007.

Though, legally established as a company in 1998, the operation of NUBL is a continuation of microfinance services provided by an NGO called "NIRDHAN" which was providing microfinance services since March 1993.

NIRDHAN, as an NGO has limited resources and capacity to satisfy the demand of poor people in different parts of the country. Hence, in July 1999, NIRDHAN transferred all microfinance operations to Nirdhan Utthan Bank. NIRDHAN was reoriented to Nirdhan Utthan Bank Limited.

iii. Chhimek Bikas Bank Ltd.

Chhimek Bikas Bank Ltd is a micro finance development bank providing microfinance service to the poor, the marginalized and the deprived, with a main focus on women living below the poverty line. It was registered with the company Registrar's Office in December 2001 and obtained a license in January 2002 from Nepal Rastra Bank.

iv. Deprosc Development Bank Ltd.

Deprosc Development Bank (DD Bank) is a microfinance bank working in the central and western region of Nepal. The bank has been promoted by DEPROSC Nepal (an NGO active in microfinance business). The other promoters are Agriculture Development Bank, Nepal Bank, NABIL Bank, Lumbini Finance and Leasing Company, CEAPRED (an NGO) and former bankers having 15-20 years experience. This bank was registered in January 2001. Deprosc Development Bank has been established to provide microfinance services, which are adaptable to local situations, cost effective, and financially viable and sustainable.

B) Small Farmers Co-operative Model (SFCLs)

Agricultural Development Bank of Nepal (ADB/N) initiated a newly developed financing concept on co-operatives known by the name of Small Farmers Co-operative Limited (SFCL) which is, in fact, a convergent form of a 3-decade old Small Farmers Development Project (1976) of the bank, considered the first poverty focused credit program in the country. To meet the wholesale requirement of SFCL for on-lending to small farmers, ADB/N, has established Small Farmers Development Bank (SFDB, 2002). The main objective of transformation of SFDP into SFCL is to ensure the viability and sustainability of Micro-Finance Institutions (MFIs), which would be managed and administered by the members themselves. Many international organizations including IFAD, ADB/M, CGAP have lent their support to this program in one way or other and GTZ has been continuously providing technical support to help upgrade these institutions. As of mid- July, 2006, a total of 117,094 members (18,365 no. of small farmers groups) were associated with 200 numbers of SFCL in the country. During the same period, however, only 141 SFCLs have taken wholesale loan from SFDB for on-lending to the small farmers with the credit disbursement amounting to Rs.1,347 million. In this model SFDB provides the wholesale loan to SFCL at 9.5 percent interest rate per annum. Whereas SFCLs disburse loan to their clients at the interest rate ranging between 12 to 16 percent per annum and the loan is repaid within 2 to 5 years from the date of disbursement.

C) FINGOs Model

This is the latest form of development in micro-finance in terms of financial intermediary process. It is believed that more than 10,000 unregistered NGOs are operating in the country either in the field of micro-finance or in social and community based development activities. However, only 47 NGOs (mid-July 2006) have been permitted license for doing limited banking operation from NRB. Till, mid-July 2006, 51 NGOs are associated with the Rural Self Reliance Fund (RSRF, 1991). After the promulgation of Financial Intermediary Act 1998 (1st amendment 2002), a broader scope has been created for the NGOs to function as financial intermediaries for mobilizing savings and promoting credit activities within the group. In this model, the NGOs disburse loans for micro-finance on a group basis. The interest rate ranges between 18 to 25 percent per annum and the repayment system of NGOs in MF is on a very short term periodic basis i.e. weekly, fortnightly and monthly.

D) Priority Sector and Deprived sector Credit Model

Priority sector lending model was introduced in early 1974 through the mandatory credit requirement as put forward by the NRB in agriculture, cottage industry and

services sector. This mandatory requirement is presently called Priority Sector Credit Program (PSCP) and Deprived Sector Credit Program (DSCP). Priority sector credit program was renamed later as Intensive Banking program (IBP) in 1981 while Deprived Sector Credit Program was introduced in 1991 by the NRB. Both the programs have provision of direct and indirect financing. Under the direct financing mechanism, commercial banks provide loans to the beneficiary directly as retail lending while under indirect financing, commercial banks act as wholesale micro-financer and the loan-able funds are channeled through MFIs, co-operatives, FINGOs and MFDBs for on-lending to the beneficiaries. Notwithstanding the fact that Nepal is currently passing through a World Bank led Financial Sector Reform Program (FSRP), NRB has opted for a phasing out policy of this priority sector credit program within 5 years starting from 2002/03. It may be recalled that mandatory requirement to flow funds into priority sector credit program was 12 percent of the total credit outstanding, while for DSCP commercial banks are required to finance micro finance sector at least to the tune of 3 percent of their total credit outstanding. Thus, DSCP is also a major source of fund for on-lending purposes to MFIs. In priority sector credit program, the commercial bank charges 4 to 12.75 percent interest rate per annum whereas in DSCP the interest rate ranges between 4 to 11 percent per annum.

E) Savings and Credit Co-operatives (SACCOS) Model

As stated earlier, the co-operative model of financing emerged in Nepal as early as the 50's. This is a member-based organization, registered with the objective of self-help development among the members. As of mid-April, 2006, around 8,045 co-operatives have been registered with the Department of Co-operatives of which 2,692 are savings and credit co-operatives (SACCOSs) and 447 or 5.55 percent of them are women SACCOSs. Such SACCOSs provide micro-finance services to their members for running income-generating activities. Out of 2,692 SACCOSs only 19 savings and credit co-operatives have received licenses from NRB for limited banking transaction. A separate legal framework called Co-operative Act-1998 governs co-operative societies.

Out of the 2,350 SACCOS, 199 savings and credit co-operatives (as of mid-July 2006) are associated with the Rural Self-Reliance Fund (RSRF) as a partner organization (PO). These POs of RSRF, all located at the remote and rural areas have been providing micro-finance services to their members/clients to the tune of Rs. 30,000/- per scheme per borrower, which is in line with the upper limit of deprived sector lending as prescribed by the NRB. RSRF is providing wholesale loan to SACCOS at 8 percent interest per annum but there is the provision of a refund of 75 percent of the paid interest back to POs having 100 percent repayment performance with the RSRF. So, net interest charged, in fact, comes to two percent only.

Financing from the RSRF is popular amongst SACCOS and FINGOs. SACCOS at the present juncture could be an alternative vehicle for micro-finance service delivery to the rural targeted people. But in absence of proper regulatory framework and clear-cut supervisory jurisdiction, it may not be so easy to generate faith with financial co-operatives. The regulation on the job of micro-financing may therefore be assigned to a separate institution like NEFSCUN and National Co-operative Development Board or new institutions such as Micro-financing Regulatory and Supervisory Authority.

F) Project-based Micro-financing Model

There were six major donor-funded project-based micro-credit programs. Some of them are still in inactive stage.

i. Production Credit for rural Women (PCRW)

This is the first donor supported micro finance program that was initiated in 1982 and completed in 1997 under two phases covering 26,616 groups and 82,416 poor women

borrowers from 75 districts of the country with the credit disbursement amounting to Rs. 933,812 thousand. Funded by IFAD with a loan amount of SDR 3.23 million, the project utilized the loan amount cent percent. Two major commercial banks (NBL & RBB) and ADB/N were the participating banks and it was executed by Women Development Division of Ministry of Local Development. Nepal Rastra Bank was the main executing agency of the credit component.

ii. Micro-Credit Project for Women (MCPW)

This project was launched in 1994 by Ministry of Local Development in coordination with NRB, RBB financial assistance of ADB/Manila amounting to SDR 5.0 million. The distinctiveness of its approach lies in using NGOs as facilitators in micro-finance. Under the project, 95 partners (87NGOs and 8 SACCOSs) have been involved in "financial and social intermediation", i.e. group formation, training, and delivery of bank credit. By March 2002, the project covered 25,000 women clients from 14 districts and 14 municipalities. The participating banks such as NBL and RBB provided micro-credit amounting to Rs. 135 million (outstanding balance) to the target beneficiaries through NGO's and women's associations. NRB was again the executing agency of the credit component of the project. The project was completed in 2002 and the utilization of ADB's loan remained at 90 percent. The project was awarded best run ADB funded project in Nepal by ADB in 2001. With the completion of the project, many NGO's associated with the program as a credit agent later converted or upgraded into FINGOs and SACCOSs. That is, 82 women savings and credit cooperatives were organized and 25 (twenty five) of them were registered at the Cooperative Department. 25 SACCOSs have been able to become partner organization (POs) of RSRF. Similarly, 27 FINGOs formed by women groups under the MCPW have received licenses for limited banking from the central bank.

iii. Poverty Alleviation Project in Western Terai (PAPWT)

This project was funded by IFAD and launched in December 12, 1997 in selected Terai districts of western, mid-western and far-western development regions. The project is to cover below poverty level clients of the MFIs through 16 branches of Grameen Banks and its replicating institutions from 8 districts of western, mid-western and far-western Terai. The project was completed in December 2004 and covered 29,000 small and marginal deprived sector borrowers. The project utilized 80 percent of total loan amount of SDR 2.57 million. The project was based on pre-financing model under which the selected branches were pre-financed by the NRB for on lending their clients based on their branch viability plan. As usual, Ministry of Local Development (MOLD) was the major project implementing body for overall project management and NRB acted as a credit component implementing body.

iv. Third Livestock Development Project (TLDP)

The project was started in the year 1996 with an aim to improve the quality of livestock and its production along with other livestock related development. The project was funded by ADB/Manila with a loan amount of SDR 2.0 million. The project was launched in three different phases in 26 districts of western, mid-western and far-western regions of the country for targeted marginal and middle-income people. Initially, the project was to be completed by July 30, 2003 but it was extended by one year to July 30, 2004. Besides, targeting marginal and middle income farmers, provision for high income level farmers was also made for raising livestock on commercial basis. During the project period, TLDP has disbursed Rs. 170 million through its 17 PFIs. While NRB was the implementing agency for the credit component, the overall executing responsibility was with the Department of Livestock, Ministry of Agriculture and Co-operative (MoAC). The project had shown remarkable performance

and as such has been rewarded three times (2000, 2002 and 2003) by ADB/M for its best performances.

v. Community Ground Water Irrigation Sector Project (CGISP)

With the objective of increasing agricultural productivity of marginal and small farmers through community-based shallow tube-well irrigation system, Government introduced CGISP in 12 districts of eastern and central Terai in March 1999. CGISP is funded by ADB/M with a loan amount of SDR 9.93 million for the STWs installation and production credit and US\$ 3.5 million as a grant from CIDA as technical assistance. RSRF (NRB) is the implementing agency for the credit component. As of mid-July 2006, RSRF under CGISP disbursed Rs. 134.98 million for 5365 STWs in-group thereby benefiting altogether 21,262 marginal farmers. CGISP was extended twice from July 2005 to July 2006 to July 2007. The project targeted to install 15,000 STWs (13,500 in groups and 1,500 in individual) through credit without subsidy. Department of Irrigation (DoI) has overall responsibilities for executing the project. Technical assistance part was implemented by Centre for International Studies and Cooperation (CECI).

vi. Rural Micro-finance Project

This was an ADB/M funded project for a period of 1999-2005. With a loan amount of SDR 14.2 million under the project, RMP aimed at improving the socio-economic status of poor women through wholesale credit to PFIs for on-lending to income generating activities and institutional strengthening of MFIs. Rural Micro-finance Development Center (RMDC) implemented the credit component. With the project, there was the establishment of a whole sale micro-credit institution called RMDC in October 2000. As of July 2006, RMDC was able to utilize only 30 percent of the ADB/M loan amount. It is argued that the poor utilization of loan-able funds of ADB/M was mainly due to conservative attitude shown towards large MFIs with undermining the prospects of micro-finance development banks such as GBBs in outreaching as well as scaling-up of operation of micro-finance.

G) Wholesale Micro-financing Model

Wholesale micro-financing in Nepal was introduced in 90's with the establishment of Rural Self-Reliance Fund (RSRF) in 1991. Later another institution called RMDC (Rural Micro Credit Development Center) under RMP came into existence in 2000 to cater to the wholesale credit needs of MFIs for on-lending purposes as well as for institutional capacity building of MFIs and capacity building of clients of partner organizations (POs). Concurrently, in the year 2002, another wholesaling micro-finance institution called Sana Kisan Bikas Bank (SKBB) was established to provide wholesale credit to Small Farmers Co-operative Limited (SFCL). Likewise, wholesale institution called National Co-operative Development Bank (NCDB) was also established in 2003.

3.2 On-going Major Micro Finance Activities

a) Rural Self-Reliance Fund (RSRF)

The Rural Self Reliance Fund was established in 1991 for providing credit to the rural deprived people for carrying out income generating activities using their skills, labors and other local resources, and thereby helps people to achieve economic self-reliance over the years. Nepalese Government provided a corpus fund of Rs. 40 million to the RSRF. Nepal Rastra Bank has been executing this program since 1991. From 2002 to 2005, Nepal Rastra Bank provided Rs.



253.4 million in this fund to boost the area of tea plantation, factory, processing, cardamom, cold storage, etc. and long term loan to rural development micro credit bank to provide loan to cooperatives in rural areas.

The target group of the fund is individuals of rural households, holding less than 15 ropanies (0.82 hectare) of land in the hills or less than 1 bigha (0.71 hectare) of land in Terai, or those who cannot meet the minimum annual consumption needed for their family members from their family income. And the fund will provide micro credit where the service of bank and financial institution does not exist.

The RSRF provides micro credit to the saving and credit cooperatives (SACCOs) and NGOs on the basis of total share capital, reserve fund plus profit. The ceiling of credit

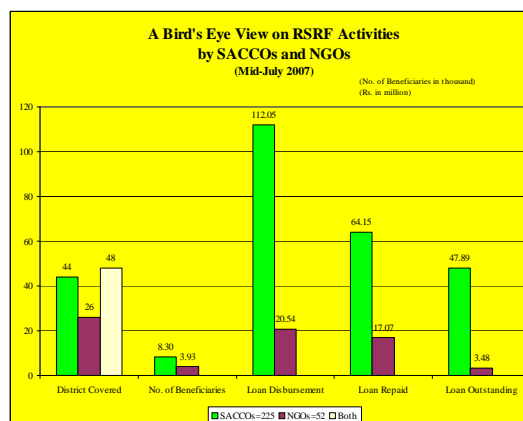
Table 4: Progress of RSRF (as at mid-July 2007)

	(Rs. in million)
No. of SACCOs	225
No. of NGO	52
No. of Benefited Rural Poor Household	12,228
Loan Disbursed	132.6
Loan Repaid	81.2
Outstanding Loan	51.4
Repayment Rate	91.6%

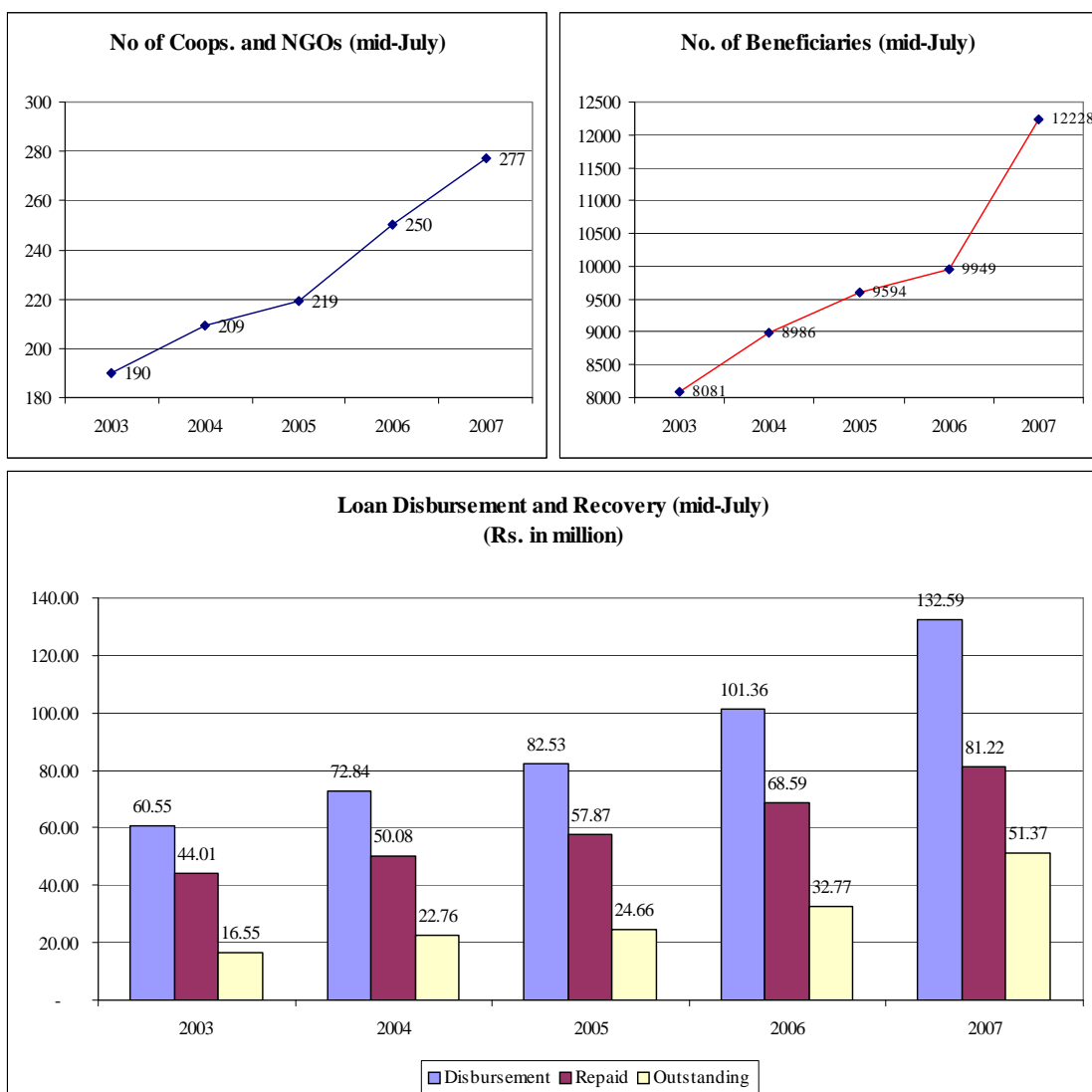
Source: NRB Micro Finance Department

to the SACCOs and NGOs is, 20 times of share capital, reserve fund plus profit or Rs. 1.5 million whichever is lower, in first installment and 15 times of share capital, reserve fund plus profit or Rs. 2.0 million whichever is lower, in second installment and Rs. 2.5 million or 15 times of share capital, reserve fund plus profit whichever is lower. The Fund provides a small loan up to Rs. 50,000 per borrower. The interest charged to the credit is just 8 percent. It is noteworthy that they will get back 75 percent of the interest in case of timely repayment of installment of their loans.

RSRF is the first micro finance institution not only in Nepal, but also in Asia Pacific Region. RSRF's activities have been found to be more confined to Eastern and Central Development region of Nepal. NRB/MFD is endeavoring to expand its activities particularly in Western, Mid-Western and Far-Western Development Region in the years to come through workshops, advocacy and allied activities. RSRF has motivated rural women to run various income generating activities for their meaningful economic empowerment. Some clients' cooperatives of RSRF are run by rural disadvantaged women. The success of RSRF lies on the fact that to obtain the loan from RSRF is easy, there is no administrative tapism on the process of obtaining such loans, and the monitoring mechanism is prompt. Beside, the staff of MFD are perfect, and have positive attitude towards their clients.



Five Years Progress Figures of RSRF
(mid-July 2003 to mid-July 2007)



Source: NRB, MFD, RSRF.

b) Rural Micro-finance Development Centre (RMDC)

Rural Microfinance Development Centre Ltd. (RMDC) is an apex microfinance organization in Nepal. It operates as a wholesale lender for retail microfinance institutions (MFIs) such as rural development banks, microfinance development banks, savings and credit cooperatives (SCCs) and financial-intermediary NGOs (FINGOs), which are providing microfinance services to the poor, the marginalized and the deprived people with main focus on women living below the poverty line. RMDC also provides supports to MFIs for their institutional strengthening and capacity building. RMDC was registered on October 30, 1998 as a public limited company. It has been operational since January 2000.

RMDC's vision is to emerge as a successful apex institution of microfinance that is financially viable and sustainable, operationally efficient and capable to establish a sound financial system that can cater to the needs of the majority of the deprived and disadvantaged families and thereby help contribute to the building of a poverty free self reliant society in the country. Its mission is to reach a large number of the poor and deprived families in Nepal with appropriate microfinance services and capacity building supports to help them realize their untapped huge potentials for self-development.

RMDC has set a goal of reaching 500,000 poor families with quality credit facilities through about 100 partner organizations by the end of 2008.

RMDC has been established with the main objective of improving socio-economic condition of the majority of the poor, the landless and the asset less through increasing their access to institutional microfinance services for productive undertakings and employment. The specific objectives of RMDC are:

- To provide wholesale funds to potential and viable microfinance institutions (MFIs) for on-lending to the ultimate borrowers for undertaking their productive activities.
- To help build and strengthen the institutional capacity of the partner organizations (POs) for implementing their efforts at providing access to resources for the poor.
- To promote financially viable and sustainable MFIs by providing necessary financial and technical supports to potential institutions.
- To develop and enforce appropriate accounting, auditing, performance and reporting standards in all MFIs throughout the country.
- To assist the central bank and the government in formulating and establishing conducive policy and legal environment for the promotion and the development of the microfinance industry in the country.
- To support or undertake studies and research works on aspects of appropriate and sound practices and products of microfinance.
- To assist POs to enhance their professional knowledge and skills on microfinance.
- To support, promote, develop and identify employment opportunities and micro enterprises for the poor, the landless and the asset-less families, particularly the women.
- To play an effective role as an efficient financial intermediary to channel international and national resources to the grass-root institutions and the poor people.

Box 2: RMDC's Eligibility Criteria for Lending

RMDC has made its eligibility criteria softer than before for allowing a large number of MFIs to avail wholesale credit. Institutions willing to borrow credit should fulfill the following requirements. An organization should

- (i) have registered under an appropriate act and received a license for microfinance operation;
- (ii) have minimum of one year experience in operating microfinance activities;
- (iii) have savings balance at least 5% of the loan outstanding in the 1st year, 10% in the 2nd year, 15% in the 3rd year, and 20% in the 4th year and onward;
- (iv) have attained minimum 90% loan recovery rate;
- (v) have committed and dynamic executive committee;
- (vi) have active and professional management;
- (vii) have appropriate management information system;
- (viii) have an appropriate business plan;
- (ix) have adopted modern accounting system;
- (x) have appropriate policies and procedures for implementing and monitoring its credit program;
- (xi) have at least 50 active borrowers;
- (xii) have at least 25% female borrowers;
- (xiii) have minimum financial resources Rs. 250,000;
- (xiv) have minimum net-worth of Rs. 100,000;
- (xv) have a trend towards self-sufficiency as per the last three years' financial position; and
- (xvi) have audited in time.

As of July 2007, RMDC has approved a total of Rs.2328.75 million for 58 MFIs, of which Rs.1943.67 million have been disbursed to 51 MFIs. Among the borrowing institutions, 2 are Regional Grameen Bikas Banks (RGBBs), 5 private micro-finance development banks/financial institutions, 25 financial intermediaries and 19 cooperative societies. RMDC has maintained almost 100 percent repayment rate from the very beginning of its operation. The partner-MFIs of RMDC are providing micro-finance services to about 500,000 women of the poor households. It is revealed that RMDC has made significant contributions to promote and develop the micro finance sector in Nepal. Following loan disbursement, RMDC monitors its partner MFIs to ensure that funds are properly disbursed to the targeted families. It regularly supervises them to check the quality of their operations and provides required training and technical supports in order to enhance their institutional capacities for increased outreach and better performance.

Table 5: Portfolio Status of RMDC (As at mid-July 2007)

				(Rs. in million)
S.N.		PORTFOLIO STATUS	Unit	Mid-July 2007
A	a	Approved (Cumulative)	NRs	2,328.55
	b	Disbursed (Cumulative)	NRs	1,943.67
	c	Recovered (Cumulative)	NRs	808.62
	d	Outstanding Loan	NRs	1,135.04
	e	Overdue Loan	NRs	Nil
OTHER INFORMATION				
B	a	Partner Organizations	Nos.	58
	b	Districts Covered	Nos.	47
	c	Members (Beneficiary in thousand)		500

Source: RMDC, Kathmandu, 2007.

c) Agricultural Development Bank Ltd. (ADBL)

With the main objective of providing institutional credit for enhancing the production and productivity of the agricultural sector in the country, the Agricultural Development Bank Nepal, was established in 1968 under the ADBN Act 1967, as a successor to the Cooperative Bank. The Land Reform Savings Corporation was merged with ADB/N in 1973. Subsequent amendments to the Act empowered the bank to extend credit to small farmers under group liability and expand the scope of financing to promote cottage industries. The amendments also permitted the bank to engage in commercial banking activities for the mobilization of domestic resources.

ADBL is an autonomous organization largely owned by Government of Nepal. The bank has been working as a premier rural credit institution for the last three decades, contributing more than 67 percent of institutional credit supply in the country. Hence, rural finance is the principal operational area of ADBL. Also, it has been executing Small Farmer Development Program (SFDP), the major poverty alleviation program launched in the country. Furthermore, the bank has also been involved in commercial banking operations since 1984.

The enactment of Bank and Financial Institution Ordinance (BAFIO) in February 2004 abolished all Acts related to financial institutions including the ADBN Act, 1967. In line with the BAFIO, ADBL has been incorporated as a public limited company on July 14, 2005. Thus, ADBL operates as an "A" category financial Institution under the legal framework of BAFIO and the Company Act, 2053. The bank initiated commercial banking operations since 1984 with the primary objective of mobilizing urban resources to the rural sector.

In view of the few shortcomings of SFDP, such as high operating cost and slow growth in outreach, the bank launched Institutional Development program (IDP). Under this approach, small farmers are encouraged to build up autonomous and viable institutions owned, managed and controlled by them. Such an autonomous body is named as Small Farmer Co-operative Limited (SFCL), which is registered under Co-operative Act. In the process, all assets and liabilities of Small Farmer Development Program offices are transferred into SFCLs.

To provide qualitative and effective financial and non-financial services exclusively to SFCLs, ADBN promoted Small Farmers Development Bank Limited (SFDBL) as its subsidiary development bank in 2002. The shareholders of SFDBL are ADBL, Government, two commercial banks and SFCLs. By July 2007, SFDBL is providing financial and non-financial services to all SFCLs. In the present situation, ADBL's major role is to provide wholesale credit to SFDBL.

After the enactment of Bank and Financial Institution ordinance in 2004, ADBN Act 2067 was repealed. In this context, the Agricultural Development Bank was re-incorporated as a Public limited company on July 15, 2005. Subsequently, Nepal Rastra Bank (Central Bank) issued operating licence of 'A' category financial institution to ADBL in March 2006.

The objective of ADBL is to provide quality banking and financial services to clients through the adoption of a market driven strategy delivering sustained and competitive return on investment.

The bank provides credit services broadly on short, medium and long term basis to individuals, co-operatives and corporate bodies. Short term loans are provided for the period of maximum 2 years for the activities such as production, working capital, marketing and non-farm activities. Medium term loans are extended up to the period of 2 to 7 years for irrigation, farm mechanization, agro/cottage industries (fixed investment) and agri-business including livestock. Long term loans are provided for the period of more than 7 years for the purposes like ware-house, cold storage, tea/coffee and horticultural crops having long gestation period. In addition to providing rural and agricultural credit, the bank accepts savings from borrowers in the form of Client Security Fund. Moreover, the bank is also involved in technology promotion particularly in the field of surface and ground water irrigation, micro-hydro and alternative energy including bio-gas as well as solar power.

Major Policies and strategies on Micro-Finance

With the primary objective of mobilizing urban resources to the rural sector, the bank is undertaking commercial banking operations since 1984. The activities of commercial banking operation broadly include deposit collection and lending operation. Besides, services related to guarantee and fund transfer through draft, fax, inward bill collection, outward bill collection etc. are also provided to clients.

Deposit services are made available for demand deposit (current account), saving and term deposits. In lending operation, the bank has concentrated on commerce, industry, overdraft (general and industrial), contract, hire-purchase (construction and transportation), service loan (tourism, health, secretarial services etc), demand loan, educational loan, house loan, project loan and agriculture loan.

Besides, the banking services offered presently, the bank will broaden its banking services and subsequently provide all types of credit and other banking services to meet the entire banking needs of small and medium enterprises as well as households of the

semi-urban and rural (trade centers) areas of Nepal. The bank will focus its financing entirely on the basis of feasibility of venture and repayment capability of borrower.

Description	Amount (in billion Rs.)	Amount (in US\$ million)
Share Capital including preference share	6.48	91.3
Deposit	29.63	417.3
Loan outstanding (Gross)	33.3	469.0
• Rural Finance (Inc. micro finance)	22.2	312.7
• Commercial banking	11.1	156.3
Outreach		
District covered (All)	75	
Office network	242	
Loan Account	477016	
• Rural Finance (Inc. micro finance)	455126	
• Commercial banking	21890	
Average loan Size*	69809	
• Rural Finance (Inc. micro finance)*	48778	687
• Commercial banking*	507081	7142

*In NRs/US\$

Source: ADB/N, Kathmandu, Nepal

Small Farmer Development Program (SFDP): The SFDP was initiated in 1975 with the objective of improving socio-economic conditions of the rural poor including women by bringing them into the mainstream of the development process. The group approach is the fundamental basis for the program implementation. Households having per capita family income of less than or equal to Rs. 2,500 and /or a land holding size up to 0.5 ha are categorized as small farm families for providing financial and non-financial services through SFDP.

Credit is provided for different purposes related to production, marketing, and other income/employment generating activities. To develop a saving habit among small farmers, group saving and its mobilization is also being undertaken as an integral component. As complementary input to credit and saving services, the target groups of the program are also trained in different areas such as group management and its functioning, saving mobilization, income generating activities etc. Moreover, social and community development activities are also being undertaken for the welfare of rural people.

Institutional Development Program and SFCLs: In view of the few shortcomings of SFDP such as high operating cost and slow growth in outreach, an alternative approach of empowering the target groups was initiated within SFDP framework through Institutional Development program (IDP). Under this approach, small farmers are encouraged to build up autonomous and viable institutions owned, managed and controlled by them. Such autonomous body is named as Small Farmer Co-operative Limited (SFCL), (as discussed earlier in SFCL model) which is registered under Co-operative Act. The beneficiaries of SFCLs are provided intensive training in different areas such as office management, bookkeeping, group functioning etc for capability development and the SFDP's assets and liabilities are ultimately handed over to the SFCL. After the completion of the hand over process, the bank provides wholesale credit to these institutions from which loans are provided to the target groups.

d) Small Farmers Cooperative Ltd. (SFCL)

The Small Farmer Development Program (SFDP) was Nepal's first group based poverty alleviation program, started by ADBN in the mid 1970's - with support of FAO and UNDP. Until 1993, there were 459 Sub Project Offices (SPOs), giving farm credits to 200,000 small farmer households.

However, due to rapid expansion, the program faced several problems: high overhead costs, low repayment rate and lack of competent staff. In 1987, ADBN –with support of the German Technical Cooperation (GTZ) - started to transform SPOs into fully self-administered and managed cooperatives of small farmers i.e. Small Farmer Cooperative Limited (SFCL) which is a multi-service cooperative designed to deliver primarily financial, but also non financial services to its members in rural areas. Small farmer groups are formed as joint liability groups, usually consisting of 5 to 12 members.

By mid-July 2006, 200 SFCLs had come into existence with a small farmer membership of 117,094, the total outstanding loan disbursed to them amounting to Rs. 1.86 billion and a saving deposit of Rs. 563 million. While 12 SFCLs are exclusively women; overall women's participation in the program stands at 46 percent. Some basic details about the program are given in Table 7.

Table 7: Achievement of Small Farmers Cooperative Limited (mid July 2006)	
Activities	Status
No. of SFCL	200
No. of Small Farmer Groups	18365
Members	117094
- Female	54200
- Male	62894
% of Women Participation	46
Saving (Rs. in million)	563.23
Handed over loan (Rs. in billion)	1.72
Loan Disbursement (Rs. in billion)	4.72
Collection (Rs. in billion)	3.82
Outstanding (Rs. in billion)	1.86
Average loan size (Rs.)	15988
Repayment Rate at cash basis (%)	94

Source: SFMFD/ADBL 2006

When SPOs are transformed into SFCLs the outstanding loans are handed over to them which, as seen above, amounted to 1.72 billion rupees. However, in the meantime 4.72 billion rupees have since been lent to them, which come to over 40,000 rupees per member, and the size of individual loans on average is also quite large at almost 16,000 rupees per loan.

One of the distinctive features of the approach, as in the case of NRB's RSRF approach, is that the ADBL extended bulk lending to the SFCLs which, coupled with their own increasingly large savings, enable their member farmers to make fairly large sized investments in their income generating activities such as agriculture, livestock, poultry, agricultural implements, irrigation, trading and cottage industries. It should be emphasized that loans are extended only for income generating activities which are universally adopted, in that most of the members in the coop do borrow, some more than one loan in different portfolios. From this perspective, the SFCLs have a very important role to play in rural finance: on the one hand they function as intermediary between the Bank and the small farmer borrowers; on the other, they are the capacity builders of the small farmers to make them increasingly more self-reliant and

enterprising. A recent study of four SFCLs in the country has observed that the tiered structure of the SFCLs with small groups at the base provides a very significant space for the men and women small farmers for self-help development, and that "poverty alleviation is quite effective as a self-help undertaking of the poor themselves, and it involves little or no cost to the government".

In order to achieve maximum impact, the GTZ project Rural Finance Nepal (RUFIN) is applying a systemic approach: on the micro level SFCLs are enabled to provide financial and non-financial services; on the meso level, the Small Farmer Development Bank (SFDB) and the SFCL Federations are supported to provide refinance and non financial services for SFCLs. At the macro level interventions are geared towards improving the regulatory and supervisory framework for rural finance.

e) Small Farmers Development Bank

The Agricultural Development Bank Limited (ADBL) started the Small Farmers Development Program (SFDP) in 1975 to extend credit to small and marginal farmers. Under SFDP, small and marginal farmers were organized into groups of 5–7 individuals to borrow from ADBL based on the group guarantee. SFDP was carried out through its subproject office (SPO), which promoted village level committees and was facilitated by a group organizer. Groups were formed based on the community members' common socioeconomic status, such as having income below the poverty threshold, being from a common locality, and having citizenship certificates. Separate male and female groups were organized. Loans under SFDP were subject to the ceiling of NRs 30,000 per individual group member. Loans generally started at lower levels, with members graduating to larger loans based on experience and satisfactory repayment performance. In addition to the financial operations to support SFDP, ADBL has assumed responsibility for group mobilization and group training.

Following resounding success in the pilot sites of SFDP, the number of groups has multiplied rapidly since 1980. Some aid agencies, including the International Fund for Agriculture Development and the Asian Development Bank, funded SFDP on a large scale. However, as the number of SPOs increased rapidly in all the districts of the country—reaching 452 by 1990—the performance of SFDP progressively deteriorated due to (i) mounting political interference, (ii) soaring overhead costs, (iii) ineffective loan appraisal and portfolio management, (iv) deliberate default, and (v) rapid and alarming decline in recovery rates. The supply of aid agency funds encouraged ADBL to pass down inflated loan disbursement targets to SPOs. As a result, lending accelerated and became more indiscriminate, leading to even more widespread defaults. In the early 1990s, with the emergence of many microfinance non-government organizations, the aid agencies stopped funding SFDP due to its worsening performance, and started channeling funds to non-government organizations.

This declining performance led to the restructuring of SFDP. In 1987, the Institutional Development Program (IDP) was initiated with the assistance of German development cooperation (GTZ). IDP was a 5-year program to transform SPOs into Small Farmers Cooperative Limited (SFCL), registered under the Cooperative Act. Under IDP, SPOs were federated into inter-groups, which were federated further into the main committee. A SFCL is composed of 9–15 inter-groups. The conversion of SPOs to SFCL was preceded by institutional development to improve their performance to make them eligible for conversion. Each SPO was required to improve the loan repayment rate to more than 70%, overdue loans against the total loans to below 10 percent, and interest arrears to less than 15percent. As of July 2005, 200 SFCL had been established.

For SFDP restructuring, ADBL established a separate and independent Small Farmers Development Bank (SFDB) owned jointly by ADBL, the Government, two private banks—Nepal Bank Limited and Nabil Bank—and SFCL. The function of SFDB is to provide wholesale lending to SFCL. SFDB, which was registered under the Company Act of 1991, conducts its business under the Development Bank Act 1996. In connection with the enactment of the Banks and Financial Institutions Ordinance, the umbrella act for financial institutions, SFDB also will be licensed as a financial intermediary.

SFDB, which started operations as an independent bank in 2002, makes loans for agriculture and livestock investments through SFCL. Its outstanding loans totaled NRs 960.5 million in July 2006, comprising loans for (i) crop and crop services, (ii) forestry and fishing, (iii) livestock and livestock services, (iv) agricultural machinery, (v) other agricultural and agro-services, and (vi) tea production. SFDB's performance, outreach, and impact on the rural finance sector have been limited relative to its resources and market potential. Concerns about SFDB focus on its scale of operations, loan portfolio management, and weak institutional capacity. SFDB's viability is also weak. The return on assets and on equity in the audited accounts is very low, and falls into deficit when the financial statements are restated to take suspense interest into account. Interest expense has grown much faster than—and now exceeds—interest income. Non-performing loans are not written off the balance sheet regularly. Thus, new arrears are added to un-recovered arrears of the previous year. Unpaid interest is not moved to suspense as required by the central bank.

As of July 2006, SFDB has taken over 141 SFCLs from the ADBL with loan and interest receivable amounting to Rs. 889.0 million and NRs. 70.8 million. As of mid-July 2006, SFDB too has invested some Nrs. 1347.0 million and has collected Nrs. 270.3 million in interest. The present status of the SFDB is given in the Table 8.

Activities	Status
No. of SFCL	141
Handed over loan from ADBL	889.0
Handed over interest from ADBL	70.8
Loan Disbursement	1347.0
Total Loan Collection	1275.5
Total Interest Collection	270.3
Loan Outstanding	960.5
Repayment Rate (%)	85%

Source: SFDB, 2006

In order to attend to the capacity building needs of the SFCLs mainly, the formation of district level federations of SFCLs is underway, and so far only one such federation has been established in Dhading district even as seven more adhoc regional level SFCL federations have been formed. After the formation of district level federation and one apex level federation, the bank will deal only with financial products/services and Federation with non-financial products and services.

While the SFDB (and ADBL earlier) has been undertaking farmer to farmer replication program, i.e. to have an existing SFCL to promote another in its vicinity, the Consultative Group to Assist the Poor (CGAP) with the International Fund for Agricultural Development (IFAD) has recognized the innovativeness of the approach by

conferring the Rural Pro-poor Innovative Challenge Award of US\$50,000 to undertake such replication in five more VDCs.

The organizational and administrative structure of SFDB is not consistent with ones for a financial intermediary. SFDB's operational approach—which recover loans through rebates rather than filed pursuit, and select clients by existing SFCL's discretion rather than proactive effort from SFDB—is an indication of weak operational capacity. The current staff incentive system does not distinguish between good and poor performance. SFDB does not have the policies needed to ensure that basic risks in areas such as credit portfolio management and cash management do not harm the bank's liquidity. The portfolio audit suggests passivity in servicing loans risk. SFDB does not have a reliable management information system, which is required for timely and accurate information for portfolio management.

SFDP generally has contributed positively to enhancing income-generating activities and employment opportunities through expanded rural finance outreach to poor small farmers, who otherwise would have been outside the reach of institutional financial services. As of July 2005, SFDP had 65,589 members, including 23,830 women. In addition to receiving tangible economic benefits, SFDP members have benefited from leadership development, group solidarity, empowerment, financial literacy, and skills development. Some of the SFCL members are emerging as viable credit cooperatives and replicating institutional development processes on their own. SFCL and SFDB are likely to play a significant role in reducing rural poverty. Thus, broad-based institutional reform is crucial to transform them into autonomous and viable financial institutions that can continue to provide affordable financial services to small and marginal farmers.

The operational and portfolio review of SFDB, conducted under technical assistance provided by the Asian Development Bank, identified several key operational issues and outlined strategies for SFDB reform. The Government and SFDB agreed to initiate the reform process based on (i) expanding and strengthening systems and controls for greater transparency; (ii) building a structure with greater business autonomy, and ensuring functional relationships of departments; (iii) improving the credit culture in SFDB and SFCL by re-emphasizing viability and the borrower's sustainable capacity to generate income sufficient to maintain the society and service debt; (iv) building a viable and balanced portfolio in which non-performing loans are minimized; (v) upgrading the management information system to cover all aspects of the bank's operations; and (vi) adopting practices that ensure accounting records and financial statements give an accurate picture of the financial health of SFDB and SFCL.

f) Federation of Small Farmer Development Center (FSFDC)

There were two major reasons behind establishing SFCL. First, the rapid expansion of SFDP through ADBL was not possible due to the overhead costs carried by the bank in establishing a SPO thereby creating a limitation to the bank expanding each year. This was because given the magnitude of poverty in rural Nepal, without a rapid expansion of the program it was unrealistic to expect any significant improvement in poverty situation. Secondly, transforming the ownership of the program to the farmers themselves was to create conditions that helped in the sustainability of the organization.

The process of transformation of SPOs into SFCLs gained momentum in the second half of 2007. By July 2007 a total of 228 SFCLs were established in 42 districts of the country. Of those, 11 SFCLs do limited banking operations with the permit from Nepal Rastra Bank (NRB). The total membership of SFCLs is roughly 135,000 people with an outstanding loan portfolio of Rs. 2,294 million and an outstanding savings balance of

Rs. 734 million. SKBB and Sana Kisan Sangh jointly worked to increase outreach of SFCLs through farmer to farmer replication process in other VDCs.

Transferring the ownership of grassroots organizations to the beneficiaries is the only way to sustain the program. Capacity building of the local management play a vital role towards the smooth operation of the organization, maintaining financial health of the organization and improving the economic and social well being of the members are crucial to organizations sustainability. To support SFCLs particularly non-financial services, SFCLs established a Sana Kisan Kendriya Sangh (FSFDC) in March 2007 as an apex body of SFCLs.

The objective of FSFDC is to undertake institutional development of member organizations; establish linkage and coordination with different government, non-government and donor organization; facilitate imparting required knowledge and skills to the member organizations and their members for the improvement of their socio-economic status; facilitate business expansion and industrialization by enhancing the management capacity of member organizations; increase transparency and reliability of member organizations; undertake research and good practices of the federation and member organizations and disseminate those practices; facilitate mutual cooperation and collaboration among member organizations; and, motivate member organizations to bring the members in leadership proportionately on the basis of social inclusion.

g) Self-help Groups (SHGs)

The history of the group approach to poverty reduction in Nepal dates back to mid 1970s wherein about 9-25 people below poverty line and living in a settlement are organized into groups (male only, female only or mixed) under the technical backstopping support of the government promoted programs such as SFDP and Intensive Banking Program (IBP) to work together for addressing their common problems. Other programs such as PCRW, Banking with the Poor (BWTP), MCPW, etc. also attempted to address poverty using the group approach. Success of the program implementation using group approach led to its expansion among different government organizations (GOs) and Non-Government Organizations (NGOs) in the recent years with the idea that people living in a settlement share an environment and common need together and they are bound to take up activities jointly which are meant for the welfare of the whole group. In most cases, these groups exhibit features of SHGs with savings collection and loan operation as one of their key activities.

At present there is hardly any cluster or village in Nepal without SHGs. There are cases where members of the households have participated in more than one group promoted by different organizations. Since mid 1990's UNDP, in close collaboration with Ministry of Local Development, Ministry of Forest and Environment, Ministry of Tourism and Civil Aviation, Ministry of Industries, Supplies and Commerce and Ministry of Women, Children and Social Welfare have been implementing rural development and poverty reduction programs organizing the beneficiaries into SHGs.

The number of SHGs formed by different government and non-government programs in Nepal is estimated to be at least 41,781 with 1,182,653 members. Most of them are promoted under social mobilization process and possess potential for poverty reduction. Most of these SHGs are involved in mobilizing members' financial savings for income generation and asset creation, and implementing activities for social and economic development.

As far as savings mobilization is concerned, SHG members save every week or fortnight or month on a regular basis and use the savings thus collected for making

small interest bearing loans to their members. Interest charged by most SHGs on such loans ranges between 24 percent and 36 percent, which is higher than the interest charges by most microfinance service providers. Quality of the loan portfolio managed by most SHGs is better than the portfolio quality of microfinance service providers, which exceed more than 90 percent. There is a large number of SHGs demonstrating their competency to act as an efficient financial intermediary; to set efficient lending terms and conditions; to maintain proper books of accounts and financial management systems; to build financial discipline and credit history for themselves. These SHGs have also learned to handle resources of a size that is much beyond their individual capacities. Most SHGs have increased their capacity to properly handle more financial resources to address their poverty problems.

These SHGs are invaluable resources for poverty reduction endeavors and the prime need currently is to ensure that poor can live with dignity, sufficiency and responsibility; and to recognize that poor are bankable and they themselves are likely to have better appreciation of their socio economic situations than larger official and private institutions.

Potentials of SHGs on Promoting SHG Banking and Ensure the Access to sustainable Microfinance Services

The savings and lending procedures adopted by SHGs are very simple and are based on mutual trust and confidence of the members. As a democratic body, all members have equal opportunity to speak and express their opinions. Any decisions to be taken are to be made unanimously after thorough discussion among them. The loans provided are need based, prioritization among different purposes and members' collective decisions. The interest rate charged varies widely among different groups and for different purposes within the same group. Even though in some SHGs interest rate charged is higher than formal credit systems, borrowers are willing to pay higher interest rate as this is still far less than the interest rate charged by local money lenders. At the same time, members can access services in time and the benefit of the higher interest rate goes to the group itself. The terms and lending norms, such as cost, repayment, interest rates, etc., are often different from lending procedures followed by formal credit institutions. Thus, most of the SHGs are already engaged in informal banking operations i.e. savings and credit activities and there is a dearth of mechanism to encourage efforts of SHGs that are already functioning with good financial discipline to scale up the provision of complete micro finance packages. The SHG banking scheme could be one of the options to enable SHG to scale-up their financial services. Hence there is a need to ensure the linkage of SHGs with banks; preferably, banks can establish linkages with SHGs after some time of their formation.

SHG members have received microfinance services of varying degree, either through internal capital or linkages to external credit capital created under different programs as Local Funds or revolving loan fund, but these funds are insufficient to meet the credit need of most SHG members. Credit rationing mechanism adopted by these programs to allocate available resources aggravated the problem related to loan fund allocation thereby leading to significant inefficiencies and distortions in the Nepalese microfinance sector.

SHG banking scheme has a special significance to expand the outreach of microfinance services to the poor living in inaccessible hills and mountains using the existing decentralized formal banking networks, as well as several organizations in formal and non-formal sectors, as banking partners. The scheme has potential to extend the microfinance services to meet poor people's needs at a low cost. Providing SHGs access to external credit to a size justified by their capacity and potentiality may

stimulate their self-help capacity and eventually appear as one of the most essential strategies to overcome poverty and address some of their crucial social concerns.

Ensuring access to sustainable microfinance services to these SHG members is an arduous task in view of the fact that the operation of existing service providers is concentrated in Terai and accessible hills with limited or no services in inaccessible hills and mountains, and the SHG linkages scheme is yet to be formalized/institutionalized among key actor in the financial sector. However, SHG banking scheme possess prospects of properly using SHGs to ensure access to sustainable microfinance services to their members, expand the frontier of microfinance service, especially in inaccessible hills and mountains of Nepal.

As discussed already, SHG banking is a new concept among Nepalese planners and policy makers though some leading micro finance service providers (MDBs and FINGOs) have already felt the need to be part of this scheme to expand their services as well as attain operational and financial self-sufficiency. In the present context of Nepal, operation of SHG banking encompasses at least the following four elements:

- Identify SHGs, devise mechanism to record their existence and enhance their capacity on self regulation (i.e. support to prepare a code of conduct of their operation, savings policy, loan policy, book keeping/accounting and financial management) and support to build-up capital by regular savings,
- In-depth study on different models of promoting SHG Banking,
- Legal and regulatory arrangements to enable micro finance service providers extending *A line of credit directly to mature SHGs (not through an intermediary) without determining the purpose for which the members could use the loans* or any other norms like restricting loan size to tangible assets or determining unit costs for loans coverage. The SHGs could only lend to their members for any purpose including meeting various emergency expenses, consumption requirements and productive investment, without any prescribed ceiling on interest rate,
- Consultations with potential microfinance service providers to be involved as partners to extend microfinance services to identified SHGs of the VDCs in the district.

SHG banking scheme must revolve around initiating linkage processes in two dimensions:

- Institutional linkages between SHGs and microfinance service providers either indirectly by involving NGOs and other SHGs promoting institutions as financial intermediaries or directly.
- Financial linkages between savings and credit in fixed ratios or in dynamic ratios of savings: credit which increases in repeat credit cycles.

The pre-requisites underpinning SHG banking scheme includes:

- Amendment of micro-finance policy and related ordinance/acts/rules to enable existing MFIs/DBs/CBs/FINGOs provide wholesale loans to SHGs; and
- Upgrading the capacity of the SHGs to be creditworthy with micro finance service providers to receive and manage the wholesale loans.

Self-help Groups (SHGs) are also involved in rural finance activities in developing countries. It is estimated that there are 400,600 SHGs in Nepal which are operating with different purposes. Among these, some are involved with credit and saving activities and some have provided loans for various income generating activities especially in rural areas. It is confessed that if such groups are supported financially and tied up within the banking sphere, these SHGs would play a crucial role for

expanding micro financing activities in rural areas. This process in turn would further facilitate to lessen the poverty level in rural communities.

h) Institutional Dimension of Cooperative in Nepal

Besides the National Planning Commission (NPC) and the Ministry of Agriculture and Cooperatives (MOAC) that are responsible for policy formulation, program approval and progress monitoring at the national level, the major national players in the field of cooperatives in program planning and implementation include DOC, NCDB, and NCF.

a. Department of Cooperatives

The Department of Cooperatives (DOC) was established as early as 1953. The first cooperative society was established as a credit cooperative in 1956 in Chitwan District. The first Cooperative Act was promulgated in 1962.

In accordance with the Cooperative Act of 1992 (amended in 2000), and Cooperative Bylaws 1993, the DOC seeks to achieve the objective of registration, supervision, regulation, monitoring and promotion of cooperative societies/unions within the framework of the cooperative principles put forward by the International Cooperative Alliance (ICA).

The following activities fall under the mandate of DOC¹:

- (i) Assistance to the Government of Nepal (GON) in formulation of cooperative policy and programs (claimed by DOC, but disputed);
- (ii) Registration of cooperatives;
- (iii) Actions regarding revision of cooperative by-laws;
- (iv) Collection of cooperative related information and documents and monitoring of cooperatives;
- (v) Approval of auditors appointed by cooperatives;
- (vi) Conducting election of cooperative officials if societies fail to do so as decided by the executive committees;
- (vii) Issuance of directives for convening of general assemblies if societies/unions fail to do so on time;
- (viii) Making enquiries when societies/unions fail to perform satisfactorily;
- (ix) Assistance to societies/unions in recovery of their dues if they fail do so themselves and request for it;
- (x) Taking actions for merger and splitting of societies/unions as requested;
- (xi) Liquidation of inactive societies/unions or those deviating from their objectives;
- (xii) Appointment of liquidators and taking actions related to liquidation;
- (xiii) Fining defaulting societies/unions in accordance with the law;
- (xiv) Issuing necessary information and guidelines for transparent operation of societies;
- (xv) Taking action to enable societies/unions and recommendation of actions to remedy the observed shortcomings and problems;
- (xvi) Advisory services to cooperatives on formulation and implementation of plans;
- (xvii) Provision of cooperative education and training;
- (xviii) Administrative control, direction and inspection of offices under the DOC;
- (xix) Provision of services of cooperative specialists by preparing necessary human resources in the cooperative sector (claimed by DOC, but disputed); and
- (xx) Representation in international conferences/meetings/seminars related to cooperatives.

¹ This and the ensuing sections are adapted from the recent Briefing Note (in Nepali) prepared by DOC.

The DOC has gone full circle with regard to its parent ministry- it was under MOA (then called Ministry of Food, Agriculture and Forestry) when created in 1953, put under Ministry of Panchayat (now MLD) in 1962, then back under Ministry of Land Reforms, Agriculture and Food in 1966, under Ministry of Land Reform in 1969, and under Ministry of Agriculture in 1987 when cooperatives were rechristened as *sajha* and the ministry was renamed as MOAC in 2000. While the government policy has always been to accord high priority to the development of cooperatives in the country as reflected in the periodic plans, the lack of firmness about the appropriate "home" for the sector indicated a huge gap between the policy commitment and its translation into actual action.

Until recently, DOC operated with one central level department and 68 district offices (seven districts without a cooperative office were Khotang, Manang, Rolpa, Dolpa, Mugu, Jumla and Kalikot). The department was restructured in mid-April 2005, converting the 68 district offices into 33 Division Officer and five Regional Cooperative Training and Division Offices. The division offices have been divided into five categories based on workload, geographic location, communication and transport facilities, and existing infrastructure. Staff strength was accordingly reduced by nearly 38 percent from 953 to 594. On the other hand, the number of registered cooperatives kept growing after the restoration of democracy in 1990, and particularly after promulgation of the Cooperative Act 1992, from 1814 in 1995 to 7,716 in 2005, putting further burden on the services provided by DOC.

The need to restructure DOC was first recognized in the Eighth Plan (1997-2002). This recognition emanated from a series of institutional changes foreseen in the cooperative sector, namely, reorganization of cooperatives to make them truly democratic and capable of performing a wider range of economic functions in rural areas, establishment of a cooperative bank, formation of the National Cooperative Development Board, creation of a cooperative development fund, and setting up of a National Cooperative Federation. With such new players in the sector, the department needed to be responsive to the emerging roles and challenges and hence the proposition for its restructuring. The plan did not however make it explicit that restructuring meant reduction in its district level presence and in staff strength. On the contrary, in view of the expanded scope and emerging new challenges, one could infer from the Eight Plan's assertions that both the existing network and its capacity needed to be bolstered further.

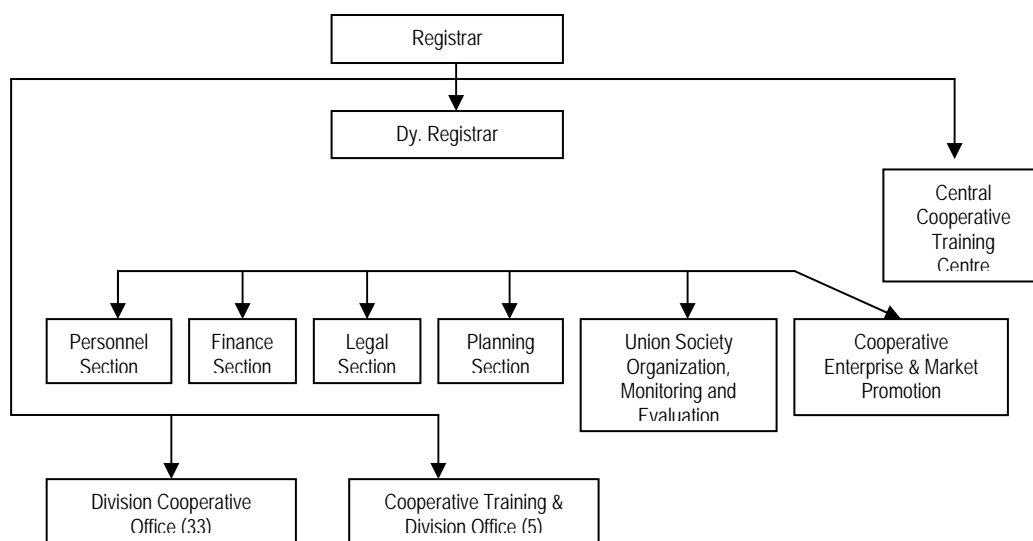
The present restructuring of the department appears to have been guided apparently by two previous mutually unrelated works rather than the Eighth Plan. One was study entrusted to APROSC by DOC to analyze the structural and legal aspects of the department (APROSC 1996). The report unfortunately was rather superficial and lacked a sound logical connection to its recommendations. It nevertheless suggested that the district offices of the department be limited to 40, the number of cooperative inspectors by increased from 129 to 184, and that of cooperative sub-inspectors be reduced from 414 to 160. It even went to the extent of recommending the number of non-gazetted Class II level office assistants and sub-accountants (*kharidar*), typists, drivers, non-gazetted Class III staff (*mukhiya*), office helpers (*peons*) and night guards. This again was done on an ad hoc basis without any logical connection to the objectives and workload of the organization. It is hard to believe that, given its inherent weaknesses, the APROSC report would have been instrumental in prompting the change that eventually occurred.

The other study that questioned the relevance of DOC at the district level and its existing organizational structure was the report of the Public Expenditure Review

Commission (PERC) submitted to the government in 2000 (PERC 2000)². The analysis of this report was based on a different frame of reference since it questioned the presence of multiple line agency offices at the district level to perform similar functions. This report narrowly construed the role of DOC as being only to register societies in the districts. It thus argued that the registration function could be transferred to a consolidated registration office at the district level that would be responsible to register not only cooperatives but also cottage industries and non-governmental organizations. Hence the central level DOC and its district outfits could be dissolved, and the training function of the department could be transferred to the existing Cottage Industry Development Board and NCDB. Understandably, restructuring DOC without initiating concomitant actions on other recommendations could not have been the intention of the PERC report.

The Department of Cooperatives is headed by the Registrar. The Central Cooperative Training Centre (CCTC) and six sections (Personnel Administration; Finance; Law; Planning; Union Organization, Monitoring and Evaluation; and Cooperative Enterprise and Market Promotion) are the various units operating under the department in Kathmandu, while 33 Division Cooperative Offices and five Cooperative Training and Division Offices operate at the sub-national level in various districts (Figure 2).

Fig.2
Organization of the Department of Cooperatives



The Central Cooperative Training Centre in Kathmandu organizes training programs for cooperative members and staff at three different levels; central, regional and district. Major areas covered in the training curricula are: (a) Formulation of cooperative plans, plan implementation, and monitoring and evaluation in the context of decentralization; (b) cooperative business and market promotion; (c) management skill development

2 This was a high level commission constituted by the government under the chairmanship of a member of the parliament. It looked into the scope and relevance of existing public sector organization at the central, regional and district levels from the standpoint of enhancing delivery of public services and their cost-effectiveness. Its far-reaching recommendations included reduction in the number of central ministries, dissolving ineffective regional offices of a number of departments, and devolving several functions of line agencies to elected local bodies. Restructuring of DOC was recommended in that broader context.

training for institutional development of cooperatives (this has ten different components, namely, (i) cooperative principles; (ii) legal aspects of cooperatives; (iii) management aspects of cooperatives; (iv) planning, monitoring and evaluation systems; (v) institutional development of cooperative societies; (vi) market management of cooperatives; (vii) entrepreneurship development in cooperatives; (viii) business plan formulation for cooperatives; (ix) inter-relational issues in cooperatives; and (x) PEARL rating); (d) strategic planning for savings and credit cooperative societies; (e) business development for electricity cooperative societies; (f) subject-specific cooperative business enhancement; (g) basic cooperative accounts keeping; (h) basic cooperative management; (i) pre-cooperative education and training; and (j) cooperative awareness education.

b. National Cooperative Development Board (NCDB)

NCDB was created in 1992, first as an ad hoc organization by dissolving the then existing Sajha Central Office, and then as a permanent national organization under a separate act.

The National Cooperative Development Board carries out the following functions:

- (i) Formulation of necessary policy for the promotion and development of cooperatives at the national level under the principles of cooperation and recommendation to Government of Nepal (GON) for implementation of that policy;
- (ii) Render necessary assistance to GON in the formulation of necessary policies for the development of cooperatives and related development programs and implementation of such policies;
- (iii) Undertake, or cause to be undertaken, necessary studies and research on cooperative development;
- (iv) Establishment of a Cooperative Development Fund for readily providing credit or subsidy to cooperative societies/unions, and provision of necessary capital for societies/unions from that fund for implementation of development oriented programs;
- (v) Investment in the share capital of cooperative societies/unions and the cooperative bank;
- (vi) Grant, if requested, necessary credit guarantee for cooperative societies/unions when they borrow from national banks or other agencies or when they issue debentures;
- (vii) Provision of technical support for the implementation of programs leading to the development, promotion and protection of cooperative societies/unions;
- (viii) Provision of coordination and support in promoting entrepreneurship among societies/unions and fostering cooperation among the various GON agencies, cooperative societies/unions and nongovernmental organizations;
- (ix) Assisting GON in entering into joint investment agreements with national and foreign investors, cooperative societies/unions, companies and corporations for industrial promotion in the cooperative sector; and
- (x) Carrying out, or causing to be carried out, other necessary functions related to cooperative development.

The Minister or State Minister of Agriculture and Cooperatives chairs the Executive Committee of the Board. The Board has 23 members.

c. National Cooperative Federation (NCF)

The National Cooperative Federation of Nepal (NCF) is an apex level umbrella organization of all the central and district level cooperative unions and specialized

unions. It was established in June 1993. It is a member of the International Cooperative Alliance (ICA).

The following are the objectives of NCF:

- (a) to promote and develop cooperative unions/societies;
- (b) to support economic and social programs and enterprises in cooperative unions/societies with a view to uplifting their economic and social status;
- (c) to assist in improving management within cooperative unions/societies; and
- (d) to provide leadership in the cooperative movement and act as a representative body in national and international forums.

The NCF carries out the functions:

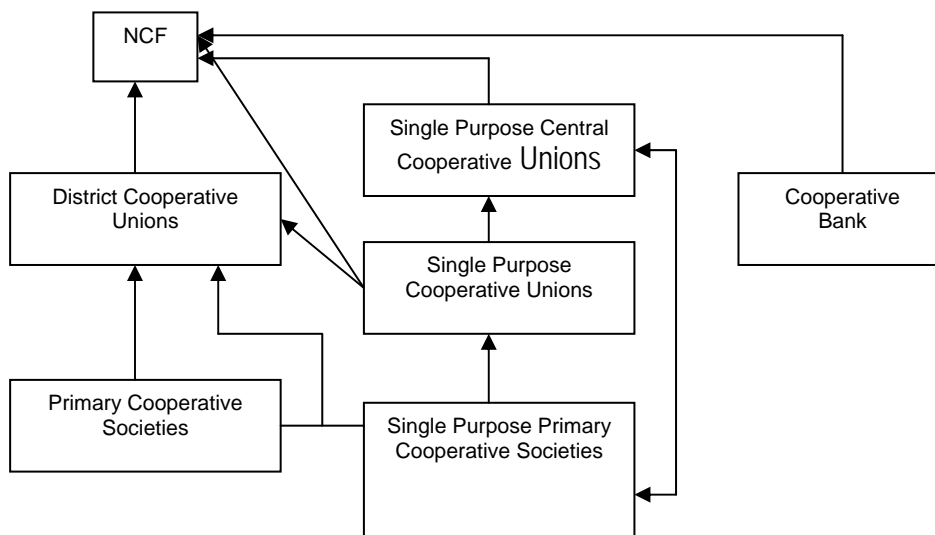
- (i) Wide-scale promotion of the cooperative movement and honesty in financial dealings and publicity and extension to instill the spirit of cooperation among the people;
- (ii) Organization, development and promotion of cooperative unions/societies and banks as vehicles of self-motivated and voluntary movement based on people's needs;
- (iii) Undertaking, and assisting in, studies and research on various aspects related to cooperatives;
- (iv) Collection, processing and publication of necessary statistics related to the contributions of the cooperative movement;
- (v) Support in developing capacity of cooperative leaders;
- (vi) Organization of training and education programs to prepare human resources necessary for developing management capacity among cooperative unions/societies;
- (vii) Provision of essential technical support and information for cooperative unions/societies;
- (viii) Implementation of suitable project on experimental basis for developing and extending the cooperative culture;
- (ix) Importation and distribution of agricultural inputs;
- (x) Marketing of farmers' agricultural and other products and their export if necessary;
- (xi) Promotion of processing of farmers' products through unions/societies;
- (xii) Importation and supply of raw materials, equipment and machinery, and consumer goods required by cooperative unions/societies;
- (xiii) Operation of agro-based and other industries solely through cooperative unions/societies, or in collaboration with other cooperative unions/societies or other agencies, or support unions/societies in undertaking such ventures;
- (xiv) Provision of financial resources for cooperative unions/societies and mobilization of savings as internal resource;
- (xv) Assistance in plan formulation, implementation, progress measurement, evaluation, etc., for efficient management of cooperative unions/societies;
- (xvi) Provision of necessary management related and legal advice to cooperative unions/societies;
- (xvii) Assistance in internal auditing to maintain fiscal discipline in cooperative unions/societies;
- (xviii) Creation of a favorable environment for the employees of cooperative unions/societies;
- (xix) Assistance in internal auditing to maintain fiscal discipline in cooperative unions/societies;
- (xx) Creation of a favorable environment for the employees of cooperative unions/societies in terms of their service conditions, facilities and career enhancement;

- (xxi) Representation of the cooperative movement at national and international levels and serving as the principal spokesperson;
- (xxii) On behalf of cooperative unions/societies entering into formal agreements with national and international unions/societies; and
- (xxiii) Undertaking other activities and enterprises in pursuance of, and contributing to, the objectives mentioned in the Constitution.

The NCF board has an elected Chairperson and 23-members as Board of Directors. The composition of the Federation Board is thus more representative of its member organizations that select their representatives democratically through election.

NCF has established a National Cooperative Development Fund with a total initial amount of Rs.2,600 thousand (Rs.1,600 thousand received from the Indian Farmers' Fertilizer Cooperative Organization (IFFCO) and Rs.1,000 thousand from GON). This fund is to be utilized for information exchange, training, and promotional activities. The organizational configuration of the Federation is presented in Figure 3³.

Fig.3
Organizational Configuration of the National Cooperative Federation



Organizational Mandates and Effectiveness

The above review of the functions of the three organizations indicates overlaps, particularly with regard to DOC and NCDB. This has arisen mainly due to the presence of two separate legal instruments, the Cooperative Act with regard to DOC and NCF, and NCDB Act applicable to NCDB. The NCDB Act makes no reference to the Cooperative Act and thus leaves the impression that it was formulated just to create a new organization, rather than to position the Board in the broader context of cooperative development in the country. If the latter were the objective, then it would have been more logical to add the provision of the Board in the Cooperative Act itself as done in other countries such as Thailand. Such a consolidated act would then have defined the key agencies responsible for implementing the various provisions of the act and their respective roles and responsibilities. This would also have required

3 NCF (nd). National Cooperative Federation of Nepal.

broadening the scope of the Cooperative Act which at present is confined to describing the responsibilities of DOC with regard to regulating establishment and functioning of cooperative societies and unions, rather than integrating under one legal framework the twin functions of promotion and support, on one hand, and regulation and enforcement, on the other.

It could also be argued that having two acts as such need not be a problem as long as these are mutually complementary. The problem lies in the failure of either act not only in recognizing the provisions of the other, but also in clearly defining the mandates of the organizations responsible for implementing the various provisions of the acts in order to avoid overlaps, and in recognizing the need for a coherent mechanism to coordinate and complement the functions of different implementing agencies. The NCDB Act vests the responsibility of coordination on the Board, but since this act is not referred to in the Cooperative Act that governs the actions of DOC and societies/unions, the Board often faces difficulty in fulfilling its coordinating role.

The existing two acts have created other overlaps in the mandates of the two public sector agencies- DOC and NCDB. The Cooperative Act mandates DOC to assist GON in the formulation of cooperative policy, while the NCDB Act assigns this responsibility to NCDB. There is a similar duplication in function with regard to providing technical support to cooperative societies/unions. It should however be recognized that presence of two agencies performing the same function need not be a problem as long as their programs are mutually shared and coordinated with a view to making these complementary. There is no legal mechanism at present to achieve this at the operational level.

The Constitution of NCF essentially assigns most of the functions of DOC and NCDB to the federation. Since NCF is an autonomous and representative organization, it is entitled to determine its own agenda and procedures for conducting business as long as these are in keeping with the universally accepted principles and within the provisions of existing laws and regulations. Hence our institutional analysis is confined to the two public sector agencies, DOC and NCDB.

With regard to promoting the cooperative movement, three broad functional areas can be identified. These are: (a) enforcement of legal provisions; (b) promotion and support; and (c) protection of constituency interests and lobbying. Under the present organizational configuration and mandates of respective organizations, all three agencies (DOC, NCDB and NCF) are undertaking function (b), DOC is additionally responsible for function (a), and NCF for function (c).

A relevant question to ask is which organization is best placed to undertake each of the above functions effectively. We critically examine below this issue together with the existing strengths and weakness of DOC and NCDB. Based on this, we identify various options and their implications.

3.3 Deposit Insurance and Credit Guarantee Corporation (DICGC)

DICGC was established in 1974 with the joint investment of the NRB, RBB and NBL with the major share being that of the NRB. The corporation charges one percent premium per annum on the outstanding amount of priority sector loan. It provides guaranteed compensation up to 75 percent of the defaulted rural loans. It has also started to give guarantee against loans for buffalo/cattle since 1987/88. Even after the phasing of Priority Sector Loan, the corporation if it continued to give compensation for the default of the rural lending of commercial banks it will encourage the commercial

banks to expand the rural branch network and wholesale lending to MFIs on lending to targeted poor people.

3.4 Total Outreach, Savings Generation and Credit Flow

Assessment of outreach and total credit flow by 2006 with respect to the activities of SFDP, RRDBs, GBB replicates and SFCLs reveals that substantial amount of savings could be generated from rural savings and credit schemes. The size of the savings mobilization is estimated to reach Rs. 15 to 20 billion, which is about 10 percent of commercial banks' total deposits (UNDP, 2003). The savings thus generated could be used for small-scale needs of poor people for which some sort of legal framework is to be designed.

By mid-July 2006, RRDBs, GBB replicates, SFDP and SFCLs combined together had provided a total of around Rs. 31.25 billion of micro-credit to 578,474 micro-entrepreneurs. Assuming that 31 percent of the nation's total population is living below poverty level (7,176,941 people), these microfinance service providers have been able to benefit only 8.06 percent of total population living below poverty level, revealing a very limited coverage by these MFIs. The normal practice being followed by MFIs is one member one household. Assuming this criterion is being strictly followed, the outreach of 578,474 may be considered as equivalent to 578,474 households. It means that by mid- July 2006, MFIs have been able to serve 44 percent of the total poor households (1,318,430).

Micro-finance has been recognized as a particularly effective development intervention for the following three basic reasons:

- The services provided through micro-finance can be targeted specifically at the poor and poorest of the poor level,
- These services can make a significant contribution to the socio-economic status of the targeted community, and
- The institutions that deliver these services can develop within few years, into sustainable organizations with steady growing outreach.

Despite these efforts "The Nepal Living Standard Survey 2004/05" reveals that "majority of poor and ultra poor (20-25 percent population of rural communities) are still by passed from the soft loan access and they are in dire need of such credit/loan". There are arrays of institutions active in the micro-finance sector in Nepal, each having its own way of going about the task of making financial services accessible to the poor.

Sophisticated topography, remoteness, heterogeneous groups and culture, etc. have hindered the successful delivery of micro-finance in Nepal. The major challenges are:

- Formulating a micro-credit delivery mechanism that is better suited to the people in hills and mountains,
- Successfully extending the outreach to the hills and mountains,
- Redesigning the existing programs of the formal MFIs to better target the poorest, and
- Unsustainable delivery mechanisms of government initiated MFIs and programs.

CHAPTER IV REGULATORY FRAMEWORK IN MICROFINANCE

4.1 Prudential Regulation in Micro-Finance

Although microfinance practices in Nepal started as early as in 1974, efforts in creating legislative and regulatory environment for this sector were made possible only after the introduction of Development Bank Act-1995 and Financial Intermediary Act-1998. Nepal Rastra Bank introduced with effect from mid-April 2003, prudential regulation for micro-finance development Bank (MFDB). This regulation with effect from the fiscal year 2005/06 has made further amendment in some areas. Presently, there are nine MFDBs in operation out of which five (GBBs) are in the government sector and the remaining four in the private sector. There are two separate legal frameworks for micro-finance operations. BFI Ordinance 2005 among others also permits MFDB to do micro-finance business, whereas Financial Intermediary Act-1998 (1st Amendment 2002) facilitates FINGOs for doing limited financial intermediation like small savings, group savings, micro-credit and agent banking. With the introduction of BFI Act (now BAFIO-2005) all micro finance development banks fall under category 'D' financial institution. Details of NRB's prudential regulation for MFDBs are presented below.

- a. **Capital Requirement:** A minimum of paid-up capital of NRs. 100 million is required to open a MFDB at national level. Similarly, MFDB which is to be operated within 4 to 10 districts excluding Kathmandu valley requires NRs. 20 million as its minimum paid-up capital. The lowest capital requirement for MFDB is NRs. 10 million and such MFDB can operate with the coverage of 3 districts, excluding Kathmandu valley.
- b. **Limit for Promoter's Stake:** A minimum of 15 promoters are required to promote an MFDB. The promoters of MFDB can hold a maximum stake of 70 percent. At least 30 percent shares should be allotted to the general public, which should be issued within 2 years of the operation of the bank. The promoter can off-load their stake with the permission of the NRB after meeting the following two conditions: (a) public issue has been done; and (b) listing of shares at the Stock Exchange has already been done for the last 3 years.
- c. **Provision for Foreign Stake Holding:** Foreign institutional investors can hold a minimum of 20 percent to maximum of 85 percent stake at the MFDB. However, such stake should not effect the public allocation i.e. 30 percent if the foreign investment is less than 50 percent. If foreign investment is equal or greater than 50 percent of the total paid-up capital there should be a provision of 20 percent for public allocation. But foreign individuals are restricted to have equity in MFDB.
- d. **Individual Share Holding Limit:** Any individual, firm, family, group, house, company falling in the same group cannot hold more than 15 percent share of MFDB. Such limit is also applied to the promoters.
- e. **Licensing Procedures:** If the proposal for establishing MFDB is found technically and financially viable, NRB will issue banking license to such MFDB within four months of the application submitted with cash deposit to NRB by the promoters. An amount equivalent to 20 percent of the promoter's shares should compulsorily be deposited with the NRB's account at the time of application. Another 30 percent of such amount should be deposited at the time of receiving 'letter of intent' from the NRB. The remaining 50 percent of the promoter's commitment should be deposited at the time of getting business license from the NRB. The NRB does not provide any interest on such deposits. On the other hand, if the proposal is found non-viable, and the promoters could not submit the required documents and also they

failed to deposit cash amount within the timeframe given, the NRB will reject such proposal and notify to the applicants within the timeframe as mentioned above.

- f. **Graduation of MFDB:** AMFDB (that presently falls under grade D) can be graduated if it fulfills all requirement for upgrading from grade 'D' to 'C' and so on to grade 'A'.
- g. **Priority for License:** A MFDB, to be operated in rural areas, is given top priority for business license by the NRB.
- h. **Other Prudential Regulation:** NRB has introduced , with effect from mid-April 2003, prudential regulation for MFDB operating in the country with an objective of making micro-finance business more viable and sustainable as well as competent and effective in delivering services. The prudential regulation of the NRB has been designed in line with the **Basle's** prescription for commercial banks. However, some relaxation has been made in this regulation intended for micro-finance activities. These regulations, with effect from fiscal year 2005/06, have been incorporated into single regulatory framework designed for all types of financial institutions including category 'D'. The highlights of such regulations are presented below:

4.2 Capital Adequacy Ratio

Based on weighted risk assets (WRA), MFDB is required to keep its capital adequacy at the ratios presented in Table 9.

Table 9: Capital Adequacy Ratios		
Fiscal year	In Percentage of WRA	
	Primary Capital Ratio (Tier-I)	Total Capital Adequacy Ratio
2003/04	2	4
2004/05	3	6
2005/06	4	8

Primary Capital includes paid-up capital, general reserves, retained earnings, irredeemable preference, capital redemption reserves, other reserves and premium on shares while secondary capital (Tier- II) includes other reserves that are not reflected in primary capital.

Risks associated with the assets of MFDBs are categorized as under:

<u>Assets</u>	<u>Weighted Risk (%)</u>
1. Cash in vault	0
2. Cash with NRB	0
3. Balance with CBs and FIs	20
4. Investment on NRB's & Govt. securities	0
5. Any other investments	100
6. Loan & Advances (Micro-credit)	100
7. Fixed Assets	100
8. Other Assets	100

4.3 Cap on Mobilizing Financial Resources

Initially, MFDB can mobilize financial resources up to the maximum limit of 20 times of the core capital (Tier-I capital). This capital has been somewhat relaxed and with effect from fiscal year 2005/06, the maximum limit has been raised to 30 times of the primary capital. Such financial resources include deposits (group-based), special savings deposit and borrowings. For the calculation of capital adequacy, MFDBs are monitored bi-annually (mid-July and mid-Jan).

4.4 Liquidity Requirement

MFDB are compulsory to maintain a minimum liquidity balance at 2.5 percent of their savings deposits as a liquidity ratio, of which 0.5 percent should be kept as cash reserve requirement. 'Liquidity' includes cash in vault, investment in government securities, investment on NRB-bonds and balance held at category 'A' financial institutions (commercial banks). For monitoring purposes, such liquidity ratio is calculated each month, based on daily averages. Failures to keep the minimum liquidity requirement, MFDBs are subject to pay a heavy penalty to the central bank as stated in NRB Act-2002 (generally highest bank rate is applied as penalty for such shortfalls).

4.5 Loan Classification and Provisioning for Loan Losses

Based on the aging of overdue loan of MFDBs, loan has been classified into four groups and according to the loan classification, necessary provisioning is required to be maintained annually, as in the following ratios:

Loan Classification	Basis of Classification (Aging of Overdue)	Provision Required P.C. of the Loan
Pass	No overdue and overdue by 3 months	1
Sub-standard	Above 3 months-6 months overdue	25
Doubtful	Above 6 months- 1yr. overdue	50
Loss	Overdue by above 1 yr.	100

4.6 Business Operation Area and Branch Expansion

MFDB's are given autonomy for the expansion, closure and merger of their branches within the approved geographical working area. However, the bank should seek prior-approval from NRB while expanding their existing geographical working area. The opening up of a new branch should be based on the Business Plan approved by their respective Board.

4.7 Single Borrower/Member Limit

Initially MFDB can extend a loan up to the amount of Rs. 30,000 per member of the group, as micro-credit for income generating activities which has now been raised up to Rs. 60,000. However, the bank can extend loan up to Rs. 150,000 to graduated members for running micro and small enterprises. Such loans are collateral based. The MFDB can invest on such micro-enterprises up to 25 percent of its total loans and advance.

4.8 Good Governance

To establish a good corporate governance culture in the MFDBs, various norms and standards are set, of which some are mentioned below:

- a. Minimum qualification requirement for promoters, member of the Board of Directors and Chief Executive Officer
- b. Restriction on family related borrowings
- c. Disciplines for Board Members, CEO and staffs
- d. Restriction to staff for affiliating own-self to any political parties and their sister-organization
- e. Segregation of internal and external audit
- f. Declaration of property by bank's officials for transparency purpose

4.9 Other Regulatory Arrangements

Deposit-taking: In general, provision of deposit-taking activities for micro-finance institutions has not been established in Nepal. As per the Section 47 (4) Clause of the Banking and Financial Institutions Act (BAFIA) 2006, these institutions are allowed to accept interest bearing or non-interest bearing deposits within the limit issued by the Nepal Rastra Bank (NRB). While, the Clause-B of the same section of BAFIA, these institutions can mobilize the savings among their group members while it is prohibited for non-group members.

Borrowings: According to the section 47 (4) Clause-C of BAFIA, in order to effectively use micro-credit disbursement, licensed micro-finance institutions are allowed to collect loans and grants from domestic and foreign institutions. However, they are required to take NRB's approval for accepting loans and grants from foreign institutions.

CHAPTER V INNOVATIONS AND SUCCESS STORIES OF MICRO FINANCE

5.1 Remittances & Loans for Migrant Workers (outward) –

Because of the insurgency which prevailed for almost 12 years in Nepal, laborers started working in the Southeast and Middle -east countries out of economic necessity. The pace of globalization on one hand and ever-growing poverty and inequality on the other were the main causes of migration of Nepalese laborers to India, Asian countries and also towards western countries. As a result, workers' remittances expanded from Rs. 47.2 billion in 2000/01 to Rs. 97.5 billion in 2005/06. The NLSS-II shows that 35 percent of the Nepalese household income is from remittance including both internal as well as external sources. It is estimated that remittances in Nepal is growing at an average rate of 8 percent in recent years. In effect, total remittances which accounted 11.5 percent of GDP in 2000/01 rose to 16.7 percent of GDP in 2005/06. It is also revealed from NLSS-II that on average; only 6.0 percent of remittances are made through the financial institutions. Persons carry more than 78 percent of the remittances. There is however, marked variation on means of transfer by the origin of remittances. About 55 percent of the remittances from Malaysia is through the banking channel and 29 percent of the transfer from Middle-east and while less than one percent in the case of India. Excluding India, officially, it is estimated that the Nepalese workers in Asia accounts to 177,576 but unofficially it may exceed to more than 500,000 people. Interestingly, most of the remittances went for consumption followed by buying land and construction of houses and some savings rather than investment.

The government of Nepal is therefore concerned for two reasons. First is how to avail loan for these poor people to work as migrant workers in foreign countries? Second concern is how to make use of remittances sent back from these workers for productive investment? NRB has come up with some regulations concerning remittances in which there is also provision of providing credit to the poor migrant workers. That is the credit amount not exceeding one hundred thousand per person provided for proposed foreign employee through commercial banks as well as foreign employment credit flow from any finance institutions who have taken loan from commercial banks has been counted under deprived sector lending. Some of the commercial banks have disbursed such loans to migrant workers but the scheme has not been that successful.

The commercial banks such as NABIL, BOK and ADB/N and some remitting agencies provided foreign employment loans to those Nepali workers who usually go abroad for job. NABIL bank started direct lending on Foreign Employment Loan from March 7, 2005 based on the terms of tripartite contract between NABIL, DICGC and Ministry of Labor & Transport Management (MOLTM). It is learnt that NABIL has disbursed loan worth Rs. 9.7 million (Rs. 66,000 per person on average) to some 150 clients who went abroad for foreign employment. There was however, problem on repayment of this kind of loan, which caused slackness in disbursing foreign employment loan. Likewise, BOK, another commercial bank provided such loan to almost 151 migrant workers to the tune of Rs. 9.44 million. Around 11 commercial banks and two development banks as per Inter Creditors Agreement (as per agreement between Bank of Kathmandu & Ministry of Labor and Transport management) disbursed the loan amount of Rs. 25.76 million as foreign employment loan to 414 migrant workers. The single borrower's limit to such loans was 100 thousand rupees or 80 percent of the total expenses not exceeding 100,000 rupees. While the repayment of BOK loan was around 53 percent, that of consortium loan was a mere 2.6 percent which resulted in discouragement to provide foreign employment loan then onwards. A pioneer remitting agency IME (money transfer agent) licensed with Nepal Rastra Bank was also involved in providing such loans up to Rs. 85,000 per person on pledging of the collateral. Some of such

loans were provided on a group guarantee basis, with the group members not exceeding 5 persons. It is informed that IME has extended the loan worth Rs. 4 million within a year to the youths who already has gone abroad for foreign employment. One of the Government Development Banks (Eastern Rural development Bank) is also on offing to provide Foreign Employment Loan. It is interesting to note that commercial banks and agricultural development banks have agreed to work as sub-agents for international money transfer agency like Western Union in the rural areas. Looking at the satisfactory operation of cooperatives in the country, it is felt that a concrete policy on Foreign Employment Loan has to be prepared so that poor migrant workers can have easy access to Foreign Employment Loan. This would create a safe environment to remit money through the banking channels in the country. An awareness program also needs to be introduced to make productive use of certain portion of remitted money in the various productive activities in the rural areas by their family member themselves.

5.2 Critical Elements of Success in Nepal's Micro-Financing

The historical record thus reveals that rural credit program has been considered as one of the strong components of poverty reduction program and policy of the government. A better output has come out with the extension of micro-finance programs through semi-government, non-governmental organizations (NGOs) and Grameen Bikas Bank replications and INGOs. The success of such programs is attributed to the following features:

- The program is generally based on group dynamism and solidarity.
- Group is formed only after intensive training is imparted.
- A strong inter-linkage is established among the groups with the formation of a kind of Coordination Committee.
- Decision making process is guided by the participation of the member farmers/entrepreneurs themselves.
- The field staff or field officer/coordinator is very devoted to encouraging and motivating the participating targeted clients.
- A system exists from imparting training on new technology and creating awareness basically through inter-group exchange visits among the beneficiaries.
- Savings mobilization scheme is inherent as an integral part of the program.
- Group responsibility is imminent in case a member of a group defaults in loan repayment, therefore obliging the rest of the members to repay the loan default out of their own deposit amount.
- There is built-in monitoring and supervision system, and,
- Supplement programs to create awareness and development of skills run parallel along with credit provision programs.

**VYCCU Savings and Credit Cooperative:
A Pioneering and Model Micro Finance Institution for Socio-economic Empowerment at
Grassroots Level**

VYCCU Savings and Credit Cooperative was initially established as a Club known by the name of "Vijaya Yuba Club" at Gaidakot of Nawalparasi district in the Terai (plain) region of the country in August 1990. This Club was established at the time when there was no clear cut policy in the country as to how to obtain legal status for an institution meant for facilitating savings and credit activities. The organization was established with the initiative of 26 of poor and unemployed youths of Gaidakot with the motto of "Savings is the seed of Growth" in order to empower poor and disadvantaged household members through various income generating activities. During the starting phase, the core youth members of this institution used to save just a meager 50 paisa per day or NRs. 15.0 per month which is equivalent to US \$ 0.23 as compulsory savings. The rationale behind these petty savings from the members of VYCCU was to encourage the habit of savings in the community in order to lessen the severity of poverty and illiteracy by undertaking income generating activities. Vijaya Yuba Club received for the first time a soft loan amounting to Rs. 46,500 for its 35 members in September 1993 from Rural Self Reliance Fund, an apex whole sale fund body which provides seed money in the form of soft loan to such NGOs /Cooperatives for on-lending to down trodden, poor and disadvantaged group of people, to run various income generating activities from Rural Self-Reliance Fund (RSRF) the secretariat of which is in Micro-Finance Department, Nepal Rastra Bank.

In 1994, VYCCU was registered as Savings and Credit Cooperative under the Cooperative Act 1992 and Co-operative Regulation 1993 and renamed as VYCCU. In 1998, the Nepal Rastra Bank (NRB) granted permission to VYCCU to undertake limited banking transactions thus opening the room for collecting deposits from the non-members too. By November 1999, VYCCU obtained soft loan from RSRF to the tune of Rs. 1092.5 thousand for initiating various income generating activities.

Today this co-operative has developed and expanded in such a way that its share capital and other fund has reached to Rs. 8.3 million with around 2,659 shareholder members. Interestingly, of the total shareholders, females account for 54.16 percent, thus emphasizing on the empowerment of rural women. VYCCU has already invested to the tune of Rs. 144.07 million by mid-January 2007 while promoting savings to the tune of Rs. 41.4 million revealing ratio of savings to loan investment at around 29 percent. VYCCU has now been running several programs, both economic and social. It has been successfully running various savings programs such as **compulsory saving program, Regular Saving Program, Petty Cash Saving Program (Khutruke), Optional Saving Program, Fixed Savings Program** etc. for its members as well as non-members in three VDCs namely Gaidakot, Mukundpur and Amarapuri of Nawalparasi District. Average interest rate of 4 to 7 percent per annum is paid to depositors participating in those savings programs. Likewise, VYCCU provides credit to its clients for running various types of income generating activities and charge annual interest ranging from 8 to 13 percent. Apart from core activities, it also provides loans for **hire-purchase, service running enterprises** and **other social purposes** at an interest rate not exceeding 14.0 percent.

VYCCU has shown its commitment for **social inclusion** by way of providing **co-operative training**, various training related with micro-credit, establishing **cantonment for running adult educational programs** and **awareness programs**. VYCCU Savings and Credit Cooperative Limited have, thus, gained popularity as a philanthropic and social awareness institution in the country. It has made efforts in motivating rural households to install bio-gas and has provided consultancy services for this. VYCCU is also actively involved with **family planning advocacy programs** by providing some incentives for those couples intending to undergo permanent family planning measures. It has distributed ration card especially to the poor household members for buying daily needed goods from the local market at concessionary price so as to provide relief from the increasing market prices of those commodities. It has also opened its **own school** in order to provide easy access to schooling for children, especially from disadvantaged families. It has run its own **FM Radio Station** to inform people of local people of local, national, international news and events. Presently, VYCCU is also involved with **remittance activities** through the Western Union Money Transfer particularly to its members as well as other non-member local people.

The fund mobilized from the energetic youth members in combination with the seed money obtained from RSRF in 1990s has enabled VYCCU to transform itself from an NGO to a successful savings and credit cooperative limited. It also stood as a strong institution in helping towards improving the socio-economic status of not only its members but also the community at large. No wonder, this institution in a relatively short span of 15 years of life has established itself as a model cooperative institution by graduating from a simple NGO to a SACCOS to be emulated by other cooperatives in the country.

Effectiveness of Microfinance Program

In rural areas where commercial banks do not operate, Savings and Credit Cooperatives are the only source of financial services to the community people. In addition, during insurgency, when all commercial banks withdrew from the rural areas, the sources of microfinance services in the rural areas were community-based SCOs. The community-based Savings and Credit Cooperatives were found effective in:

- Generating funds for further investments
- Attaining financial viability
- Protecting target groups from exploitation by providing informal sources of credit in the project area
- Establishing networks for widening financial activities
- Generating self employment opportunities for family members
- Increasing member households' income, and
- Reducing poverty

*Excerpted from
"Effectiveness of Microfinance Programme in the Western Hills of Nepal
published by CECI in November 2007*

CHAPTER VI ISSUES AND FUTURE PERSPECTS

In the history of rural financial system, NRB has played an important role in building up the institutional mechanism of rural people to easily and smoothly avail micro-finance services for taking up of income generating activities. As a result, many MFIs have come into the rural scenario and have been participating in the micro-financing as an effective financial tool for poverty reduction. The adoption of liberal financial system by the NRB in 1991 led to the growth of financial institutions such as Grameen Bikas Banks. The financial position of some of these banks is not at a satisfactory level questioning on its viability, competency and micro-finance friendliness. So, major challenge felt these days in micro-finance is how to make this industry viable, sustainable and profitable. Reaching out to the majority of the poor people with micro and rural finance and making the financing institutions viable, sustainability and profitability are two different aspects of micro-finance. Both aspects are equally important in making rural financing accessible to the rural people. Realizing the later part of the above two aspects, NRB in October 2001 initiated an important policy correction step known as 5 year restructuring program for the GBBs. The on-going restructuring program for GBBs is managed internally by Nepal Government and the NRB. After the restructuring, one out of four ailing GBBs came into profit, two got privatized and another is in pipeline for privatization process.

The GBBs restructuring 2001 has a 15 point reform package, which is directed towards making micro finance business viable, sustainable and accessible to the deprived sector of the society. This has in a way led the NRB to come up with the prudential policy 2003 for MFDBs.

Phasing out of the Priority Sector Loan Program will deprive microfinance institutions of the important source of fund coming from commercial banks. Hence, Deposit Insurance and Credit Guarantee Corporation need to be strengthened for small credit and deposit insurance to provide support in both livestock and cash crop insurance.

It indicates that there is a need to promulgate some sort of affordable policy to address these issues. But in the micro finance world, there are so many actors such as cooperatives, FINGOs and others, apart from banks actively involved in assisting weaker sections of the society to raise their income and living standards.

To bring all of them under a same regulatory umbrella might be a challenge in itself. At present, the regulated microfinance sector is made up of five Regional Rural Development Banks (RRDBs), four Micro-Credit Development Banks (MCDBs), 47 Financial Intermediary NGO (FINGOs) and 19 finance co-operatives which are regulated by the Nepal Rastra Bank and supervised by the Supervision Department. Under the principles of regulation, the institutions that collect deposits from the public should be regulated. But it may be uneconomical to regulate a large number of very small institutions. Besides, it is inappropriate to regulate if the central bank/supervisor cannot ensure the prudential behavior of the regulated institutions to justify public confidence in them. The present human resource of the supervision department of the NRB and the network of micro-financing institutions involved in the country does limit the supervising capacity. Too many MFIs if put under regulation with a few hundred clients will cost a lot, while with too many MFI types, it will be difficult for public or clients to determine which type are the best. In the present scenario of micro-financing in the country, there are thousands of co-operatives which are not registered with the NRB but with the Co-operative Department and supervised by it. So, it seems that there is less of a need for regulation as they are member base institutions. But since

these activities do influence the financial sector, one has to look for alternative ways to bring them to financial discipline. FINGOs are at present left out of the regulatory framework, as they lack an ownership structure, which has adverse implications for governance and reach relatively small number of clients. So, it may be advised that largest MFIs, cooperatives and FINGOs be encouraged to register as the development banks initially at the district level and GBBs could be merged with MCDBs once they go for divestment and attain better financial discipline.

In view of strengthening regulatory mechanism, NRB is formulating a National Micro Finance Policy. It has aimed to create a national microfinance development fund at the apex level where from wholesale loans can be availed to MFIs for on-lending to targeted beneficiaries. Perhaps, it is also wise to establish a separate institution outside the purview of NRB, which will do the regulatory and supervisory work to monitor and regulate the various micro-finance institutions of the country depending upon the size, capital and area of outreach of the services of such micro-finance institutions.

The weaknesses observed in the formal credit sector and the liberalization policy adopted by the government opened the scope for the entry of informal sector in the development of micro-enterprises. This informal sector came into the form of many of domestic intermediaries as well as international NGOs, which widely led to the growth of micro-enterprise development programs in the country. But the participation of semi-government, non-governmental agencies, both domestic and international donor agencies, in addition to government agencies has generated problem in designing effective modeling of the microfinance program. In spite of the expansion of such programs growing at an alarming rate, they are without an appropriate institutional build up. It has been observed that there is an absence of linking the objective with the mode of the program for poverty alleviation. It has unnecessarily generated non-targeting and off targeting at the implementation level. Even with such a number of involvements, it has been also felt that only five percent of the total potential demand for rural financial services has been met. It has impacted on achieving the goal of poverty reduction in most of the related projects including the donor-funded ones.

Recent experiences revealed that different participating agencies are experimenting with different modules in the name of sustainable microfinance development programs. The growing concern is on the card that the poverty alleviation programs that are totally dependent on foreign fund seem unlikely to sustain once the aid is phased out.

The micro-financing program has been suffering from various other issues such as incidence of overlapping of program location areas, high operating costs, high interest bearing loan and mushrooming of different micro-finance development modules. It is found that they charge as high as 25 percent to poor beneficiaries as against the commercial bank's interest rate of around 14 percent. Surprisingly, most of the micro-finance programs running in the country incur high operating costs, in some cases reporting as high as 27 percent. This has brought in a question mark on the sustainability of micro-finance program itself, which may bring higher social costs to the nation, if not handled properly in time.

This calls for building up an effective organization and management capacity to bring various micro-finance organizations under one Umbrella to follow a definite accord and handle all aspects of financial intermediation and credit access. The responsibility thrust upon to such managing and supervising institutions should be guided under one Umbrella Act so that it will help in bringing good governance to micro-finance institutions, as well as serving as a strong base to stimulate coordination among the line agencies involved in the program.

The micro-finance programs have gained popularity in recent times as both national financial institutions as well as bilateral and multilateral agencies have started to link micro-finance programs with the development programs of the nation to address poverty reduction issues. Since the operational as well as the social cost of such programs are high, especially after the termination of the project, a device and mechanism for managing loan-able funds within the banking system has to be developed. Thus, there seems to be a dire need of national policy for micro-finance programs with the setting up of the national micro-finance development corpus fund so that the fund can be utilized, as a wholesale financing to MFIs for on-lending to the poor beneficiaries. The essence of micro financing should be preserved from undermining of it by bringing micro-financing programs of multi-dimensional institutions under one Umbrella. For this purpose, the activities of whole sale microfinance institutions should be broadened from wholesale micro-financing to developing various norms in specifying the scope of different activities of institutions involved in rural micro-financing. Nevertheless, as explained earlier, the prospect for establishing a Second Tier Institution is prominent catering various microfinance service providers, which are not possible within the purview of the country's central bank.

A national consensus is, therefore, needed to come up with an appropriate broader module of the micro-financing program, which is adequately designed in accordance with the local need; people's genuine participation; their absorption capacity to income generating activities; including loan utilization capacity in terms of their educational standard and health status; and finally the self-regulated and supervisory environment.

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Annexes

Annex 1: Rural Self Reliance Fund, Nepal Rastra Bank

Details of District wise Disbursement, Recovery and Outstanding Loan (up to mid July 2007)
Saving & Credit Cooperatives & FINGOs

(Rs. In thousand)

S.N.	Districts	No. of SACCOS	No. of FINGOs	Beneficiaries House holds	Disbursed Loan Amount	Loan to be Repaid		Loan Repaid		Outstanding Loan		Bad debt
						Principle	Interest	Principle	Interest	Principle	Interest	
Eastern Dev. Region		42	7	2234	23856	15593	2279	13890	1718	9966	561	1705
1	Panchthar	2		85	1091	419	78	325	43	766	35	94
2	Jhapa	9		346	5567	2751	374	2614	320	2953	54	137
3	Sankhuwasabha	1		27	236	236	99	0	0	236	99	236
4	Morang	7	3	420	4848	2477	340	2235	280	2613	60	242
5	Sunsari	3	2	421	3098	1958	408	1521	236	1577	172	437
6	Bhojpur		1	25	75	75	36	37	7	38	29	38
7	Saptari	4	1	319	2917	2024	281	1603	181	1314	100	421
8	Siraha	16		591	6024	5653	663	5555	651	469	12	100
Central Dev. Region		88	32	4979	57025	40710	6557.368	36987	4905.368	20038	1652	3751
9	Dolkha	4		219	2493	1821	219	1821	219	672	0	0
10	Ramechhap	2		50	1088	1088	127	1088	127	0	0	0
11	Dhanusha	1		23	552	144	20	144	20	408	0	0
12	Sindhupalchok	7	2	545	6316	1758	260	1496	240	4820	20	262
13	Kavrepalanchok	14	3	885	9738	7575	1125	6732	818	3006	307	843
14	Rasuwa	1	1	79	1240	1240	140	1240	140	0	0	0
15	Nuwakot	18	3	499	6084	4872	840	4117	527	1967	313	755
16	Kathmandu	6	1	156	2376	1613	253	1450	209	926	44	164
17	Bhaktapur	2	3	282	2125	1425	439	1172	148	953	291	254
18	Lalitpur	7	7	442	5507	4313	838	3904	634	1603	204	409
19	Makawanpur	2		76	756	456	106	456	106	300	0	0
20	Rautahat		2	249	1225	1225	143	1225	143	0	0	0
21	Bara	1	1	78	510	390	69	365	50	145	19	25
22	Parsa	2		98	699	201	23	201	23	498	0	0
23	Dhading	5	1	253	2936	2032	319	1917	229	1019	90	115
24	Chitawan	16	8	1045	13380	10557	1636.368	9659	1272.368	3721	364	924
Western Dev. Region		69	12	3390	39767	22822	3602	21182	2818	18585	784	1686
25	Gorkha	8	1	333	5174	2155	341	1960	295	3214	46	195
26	Lamjung	9	1	621	3816	2981	450	2654	308	1162	142	327
27	Tanahu		1	300	300	300	90	300	90	0	0	0
28	Nawalparasi	23	4	1029	14957	8745	1373	8265	1094	6692	279	484
29	Kaski	1		53	225	225	21	225	21	0	0	0
30	Syangja	1		19	440	440	68	284	54	156	14	156
31	Palpa	12		330	5000	950	115	950	115	4050	0	0
32	Rupandehi	2	1	71	1256	896	165	912	137	344	28	26
33	Parbat	5	2	169	1834	1645	406	1147	134	687	272	498
34	Baglung	3	1	179	3256	1490	213	1490	210	1766	3	0
35	Gulmi	3		70	920	406	49	406	49	514	0	0
36	Arghakhanchi	1		92	1197	1197	152	1197	152	0	0	0
37	Kapilbastu	1	1	124	1392	1392	159	1392	159	0	0	0
Mid-Western Dev. R.		16	4	1423	10195	8069	1088	8045	1072	2150	16	26
38	Pyuthan	1		19	229	229	26	229	26	0	0	0
39	Dang	2	1	286	1966	1063	132	1061	132	905	0	2
40	Salyan		1	230	775	775	93	775	93	0	0	0
41	Banke	2		37	738	709	108	711	108	27	0	0
42	Dailekh	4		103	1109	797	93	779	82	330	11	18
43	Surkhet	2	2	553	2907	2907	347	2907	347	0	0	0
44	Bardiya	5		195	2471	1589	289	1583	284	888	5	6
Far-Western Dev. R.		10	0	202	1747	1492	288	1116	130	631	158	376
45	Kailali	2		28	520	265	43	263	35	257	8	2
46	Baitadi	1		11	132	132	14	132	14	0	0	0
47	Dadeldhura	5		70	685	685	81	684	81	1	0	1
48	Kanchanpur	2		93	410	410	150	37	0	373	150	373
All Nepal		225	52	12228	132590	88686	13814	81220	10643	51370	3171	7544

Note: The 3 FINGOs are involved in two districts so the total FINGOs shown is 55.

NEPAL RASTRA BANK
MICRO FINANCE DEPARTMENT
Progress Report of Grameen Banks & Replicating Banks
Mid January 2007

Rs in thousand

	EGBB	CGBB	WGBB	MWGBB	FWGBB	Total GBB	SB Bank	Nirdhan	Chhimek	Deprosc	Total GBR	Grand Total
No. of centres	1416	1379	1176	611	625	5207	2460	2665	1556	916	7597	12804
No of groups	11613	9492	8327	3897	3546	36875	13942	14500	6220	4594	39256	76131
No. of members	57434	43654	41139	18650	19957	180834	69053	78155	31276	21019	199503	380337
No of borrowers	52477	42674	39680	13091	13463	161385	52717	61962	25012	17267	156958	318343
General loan disbursed	5081810	2592071	3710462	966796	1055095	13406234	2730772	3182903	757530	829301	7500506	20906740
General loan repaid	4681209	2312902	3335971	860743	925488	12116313	2421415	2672952	604199	645995	6344561	18460874
General loan outstanding	400601	279169	374491	106053	129607	1289921	309357	509951	153331	183306	1155945	2445866
Other loan disbursed	1038070	283448	182958	369976	3755	1878207	541651	270538	178284	31325	1021798	2900005
Other loan repaid	778537	227816	101824	289028	3651	1400856	477372	215670	100430	27992	821464	2222320
Other loan outstanding	259533	55632	81134	80948	104	477351	64279	54868	77854	3332	200333	677684
Total loan disbursed	6119880	2875519	3893420	1336772	1058850	15284441	3272423	3453441	935814	860626	8522304	23806745
Total loan repaid	5459746	2540718	3437795	1149771	929139	13517169	2898787	2888622	704629	673987	7166025	20683194
Total loan outstanding	660134	334801	455625	187001	129711	1767272	373636	564819	231185	186638	1356278	3123550
Personal saving balance	48806	10875	5274	7783	4743	77481	18293	23352	20104	7960	69709	147190
Group fund balance	124462	103094	90812	42051	32777	393196	59245	135093	23739	0	218077	611273
Group fund loan disbursed	139058	63946	0	35542	112594	351140	0	86796	0	0	86796	437936
Group fund loan repaid	136732	59262	0	33021	108560	337575	0	84817	0	0	84817	422392
Group fund loan outstanding	2326	4684	0	2522	4034	13566	0	1979	0	0	1979	15545
Staffs	294	248	215	133	112	1002	204	310	127	66	707	1709
No.of Branches	41	28	36	23	17	145	47	45	19	16	127	272
VDC covered	262	300	277	112	93	1044	417	425	198	210	1250	2294
Districts covered	9	14	12	5	7	* 47	15	10	10	10	45	47

* =Including 3 Target Districts Under Survey (Purbanchal G.B.)

***=Total district covered by GBB and GBR are 47

Source: MFD/NRB, Kathmandu, 2007

CECI

The Centre for International Studies and Cooperation (CECI) is a Canadian INGO working in Nepal since 1987. Its mission is to combat poverty and exclusion. It helps to strengthen the development capacity of disadvantaged communities; supports initiatives for peace, human rights and equity; mobilises resources and promotes the exchange of know-how. CECI Nepal is currently implementing programmes such as *Sahakarya* Project (CIDA), Community Ground Water Irrigation Support Project - CGISP (ADB/CIDA), *Jaivik Jadibuti* Project (ICIMOD/MAPPA), *Sahakarya-PHABLES* Joint Project (Oxfam-GB), *Jana Awaaj* Project (CIDA) and UNITERRA - a Volunteer Cooperation Programme (CIDA).

SAHAKARYA

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