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MICROFINANCE IN NEPAL

Determinants of Viability, Sustainability and Outreach among Grameen, NGO, and Cooperative Microfinance Institutions

by

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MICROFINANCE IN NEPAL[1]
Determinants of Viability, Sustainability and Outreach among Grameen, NGO, and Cooperative Microfinance Institutions

Abstract

Nepal is one of the poorest countries in the world, with 70% of its population below the poverty line. Subsidized national poverty lending programs have failed to attain viability, mobilize savings and reach the poor in significant numbers. Informal institutions such as the ubiquitous *dhikuti* were ignored. During the 90s the government has created a new policy environment focusing on decentralization, poverty alleviation, economic and financial liberalization, and a differentiated legal framework for microfinance institutions (MFIs). This has paved the way for innovations such as the establishment of Grameen replicators as banks; the upgrading of *dhikuti* activities to savings and finance companies with doorstep services; and the transformation of the small farmer credit operations of the Agricultural Development Bank into profitable local MFIs cooperatively owned by their members. In the framework of a wider UNDP-supported program of the Asian and Pacific Development Centre in Kuala Lumpur on *Microfinance for the Poor in Asia-Pacific,* six MFIs were selected from Nepal and analyzed in terms of outreach to the poor, resource mobilization, viability and sustainability: two Grameen Bank replicators – one a bank and one an NGO; two NGOs sponsored under the government's Rural Self-Reliance Fund; and two cooperatives. The outreach of the NGOs was found to be insignificant while the outreach of the Grameen Bikas Bank at the regional level and of the cooperatives at the local level was sizeable. The cooperatives performed well in terms of portfolio efficiency and were found to be financially viable; the NGOs did reasonably well; while the Grameen Bikas Bank, substituting donor funds for internal resources, was lowest (though improving) in operational and financial self-sufficiency – despite a 100% on-time repayment rate. On the whole all MFIs appeared rather hesitant to utilize their newly won freedom to vigorously expand their market, mobilize internal resources, and differentiate their products and interest rates.

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1. Country overview

1.1. Macroeconomic performance[2]

Nepal is among the poorest countries in the world. It has a population of 20 million with a growth rate of 2.1%. There are about 3.2 million households of an average size of 6.2 in some 4,000 administrative units referred to as *Village Development Committees (VDCs)*, each comprising a number of dispersed villages.

Per capita income was Rs 12,092 ($212) in the fiscal year (ending mid-July) of 1995/96 of which agriculture generated 41%. During the last five years, the economy grew at a rate of 5.0% p.a.; per capita income went up by 2.9%; and the rate of inflation averaged 10.5%. The economy is projected to grow over the next five years at annual rates around 5-6% while inflation is expected to drop to rates between 5% and 8%.

At 12.4% (fiscal year July 1994/July 1995) the domestic savings ratio is low, amounting to only about half the investment ratio of 23.5%. This large gap poses a major constraint on economic stability and growth. Failing to mobilize the potential savings of the population, financial institutions lack the resources to satisfy the demand for credit; while households lack access to deposit facilities to accumulate the funds for the self-financing of their enterprises.

1.2. Poverty incidence

Over 90% of the population of Nepal live in rural areas, more than half of them in hills and mountains under precarious environmental conditions. 86% are engaged in agriculture. In 1991 the World Bank estimated that 70% are below the poverty line (of a per capita income of $ 150). With a Human Development Index (HDI) of 0.332, Nepal ranks number 151 among 174 countries (average HDI for South Asia: 0.444). Some of the HDI indicators for Nepal's low level of social development are: a life expectancy of 53.8 years; an infant mortality rate of 98 per thousand; an adult female literacy rate of 13%; and a daily calorie intake of 1,957 per capita.

While average holdings of arable land are about one hectare, the poor possess little more than the land on which their home is built: 0.14 ha in the plains and 0.05 ha in the hills (Nepal Rural Credit Review Survey, 1994).

1.3. Poverty alleviation programs

Outreach: There are five programs targeted on the poor with some outreach of significance: the Small Farmers Development Programme (SFDP) with 189,000 borrowers, accounting for about half the total outreach of poverty lending programs; Intensive Banking Program (IPB) with 85,000 borrowers; Production Credit for Rural Women (PCRW) with 27,000 borrowers; Grameen replicators comprising five Grameen Bikas Banks and two NGOs (Nirdhan and CSD) with 32,000 borrowers in 7/1995 and 48,000 borrowers as of 7/1996; plus an estimated number of 12,000 registered and unregistered savings & credit organizations and cooperatives with an overall membership of 792,000 members.Women's participation in these organizations is notably higher. In addition, there are some small programs like Banking with the Poor (BP), Rural Self-Reliance Fund (RSF) and Micro Credit Project for Women (MCPW) with a total outreach of less than 10,000 borrowers. PCRW, Grameen and MCPW exclusively target women. The majority of borrowers from SFDP, IBP and cooperatives are male heads of households acting on behalf of the family. ADBN plans to increase the share of female borrowers in SFDP to at least 40%. Average loan sizes of the various programs are between US$ 60-120, except in IBP with an average of $260.

[2] Exchange rate as of June 1996: US$1.- = Rupies (Rs.) 57.

Table 1.1: Outreach of poverty lending programs in Nepal, 1995 and 1996

Program	*Borrowers*		*Loans outstanding (in million Rs.)*
	Number	*Percent female*	
SFDP, 1/1996	188,757	22[1]	1,275
IBP, 7/1995	84,811	?	1,248
PCRW, 7/1995	26,974	100	91
Grameen replicators:			
7/1995	32,119	100	105
7/1996	48,392	100	188
12,000 savings & credit organizations and cooperatives, 7/95	792,000[2]	50+	5,385
BP, 7/1995	3,585	80	18
RSF, 7/1995	2,931	?	11
MCPW, 7/1995	1,750	100	20

[1]This official statistic is based on the percentage of all-female groups; the Project has in the past lumped together all-male and mixed groups. Hence, the actual percentage of female members is presumably higher than 22%.
[2]792,000 members, not borrowers.

The outreach of informal financial institutions, particularly nonrotating local savings and credit groups on which there are no statistics, appears to be far greater than that of the formal system. Unlike urban rotating savings groups (*dhikuti*), which have evolved into *the small businessman's self-help bank*[3], nonrotating groups mainly recruit their members from among the poorer section of the rural population. As these institutions mobilize their resources internally, there is invariably a strong emphasis on savings. Recently, finance companies have started to mobilize savings throughout the informal sector. The financial services are mostly concentrated in urban areas. One of them, the Himalaya Savings and Finance Company, employs some 600 daily deposit collectors. Major constraints to an increase in outreach of the formal sector appear to lie in their reliance on donor-driven government programs rather than autonomous savings-driven local financial intermediaries; their preoccupation with microcredit rather than microsavings and microinsurance; and their lack of financial viability.

Financial viability: There are two major factors which have rendered most government-supported poverty lending programs unviable: a historically low repayment rate; and grossly insufficient interest rate spreads. There were times when borrowers considered loan defaulting as an act of political defiance in the pursuit of democracy while the winning party felt subsequently obligated to reward its followers by waving the repayment of their loans.

As of July 1995, the repayment rate was 44% in SFDP and 41% in IBP, while arrears (amount overdue in percent of amount due) were 20% and 24%, respectively.[4] With a repayment rate of 82%, the

[3] Hans Dieter Seibel & Bishnu P. Shrestha, *Dhikuti: the Small Businessman's Informal Self-Help Bank in Nepal. Savings and Development* (Milan) vol. 12 no. 2 (1988): 183-200. Meena Acharya, Bishnu P. Shrestha & Hans Dieter Seibel, *Self-Help Groups in Nepal.* Asia Pacific Rural Finance (Bangkok) vol. 1 no. 1 (1988): 3-6. Hans Dieter Seibel & Uttam Dhakhwa, *From Informal to Formal Microfinance: The Transformation of the Dhikuti in Nepal.* Asia Pacific Rural Finance (*1997).*

[4] In the past there was usually no write-off policy in these programs.

performance of PCRW, which is targeted on women, has been much better, but still far from satisfactory. Only the Grameen replicators, established between March 1993 and July 1995, report a repayment rate of 100% as of July 1996. However, the outstanding performance of the Grameen replicators as well as of PCRW may be partially due to the recency of their origin as SFDP and IBP similarly reported repayment rates of 100% during the year of their inception (1976/77 and 1981/82, respectively), dropping rather sharply to 86% and 63%, respectively, in the following year. In subsequent years, their peaks were 63% (1983/84) and 80% (1985/86), respectively, while their lows were 39% (1990/91) and 40% (1992/93), respectively.

For the three major programs, SFDP, IBP and PCRW, the World Bank calculated their subsidy dependency during the three fiscal years from 1989 to 1992. It found wide discrepancies between actual and required cost-covering interest rates: 18.1% vs. 42.5 % in SFDP; 15.6% vs. 43.5% in IBP; and 15.6% vs. 72.4% in PCRW.

Table 1.2:Viability indicators of poverty lending programs in Nepal

Program	*Repayment rate**	*Arrears ratio**	*On-lending interest rate*		*Subsidy dependency index****
			*Actual***	*Required***	
SFDP	43.6	20.1	18.1	42.5	1.35
IBP	41.4	23.6	15.55	43.5	1.80
PCRW	82.0	?	15.55	72.4	3.66

* 1994/95
** 1991/92
*** (Required rate - average rate)/average rate *(Jacob Yaron, The World Bank)*

The remedies to the disease of unviability seem clear: insistence on, and incentives for, timely repayment; elimination of interest rate subsidies in favor of cost-covering rates of interest; and lowering of transaction costs. How this can be achieved has recently been demonstrated by ADBN in its SFDP. By transforming its sub-project offices into autonomous cooperative local financial institutions (SFCL) owned and managed by their members, the repayment rate of funds channeled by ADBN through the SFCL against a commission increased in the first four SFCL established in Dhading, one of the poorest areas in Nepal, from around 40% to 79%; the repayment rate of funds mobilized by the SFCLs from its own members was 100% (1/1996); and their administrative expenses according to project statistics were a mere 1.5% of the amount of loans outstanding.

1.4. Financial institutions and their outreach to the poor

As of July 1995, the financial sector of Nepal mobilized Rs. 68 bn in deposits (US$ 1.2 bn). Commercial banks accounted for about 90% of that amount, the Agricultural Development Bank of Nepal (ADBN) for about 9%, and the recently formalized finance companies for about 1%. Together, Grameen-type development banks, cooperatives and NGOs accounted for only 0.1% of total deposits. Commercial bank loans outstanding amounted to Rs. 46.9 bn (88%), ADBN loans to Rs. 6.6 bn (12%). Poverty-focussed credit amounted to Rs. 4.0 bn, 31% of which were handled through ADBN's Small Farmer Development Project (SFDP), the biggest single provider of poverty loans. ADBN's main business is not poverty lending, as indicated by the fact that in mid-1995 SFDP loans accounted for 18.9% of ADBN's total loan portfolio.

Data concerning outreach to the poor are mostly on credit rather than savings. The savings of the poor go largely uncollected. While the poor make up the majority of the population, their share of credit has remained minuscule, with poverty focused credit amounting to 7.5% of total bank loans outstanding. As of mid-1992, 17% of rural households reported loans outstanding from the formal and 49% from the informal sector. These proportions were 6% and 42%, respectively, among the landless. The

savings ratio of rural households was estimated at 7%. With an outreach of credit to about 20% of the poor in 1/1996, progress since the mid-1970s when the central bank first embarked on poverty lending has been moderate.

Table 1.3:Deposits and loans of banks in Nepal, July 1995

	Rs million	*Percent*
Total deposits	67,428.2	100.0%
Commercial banks	61,045.5	90.5%
ADBN	6,382.7	9.5%
Total loans	53,474.2	100.0%
Commercial banks	46,914.7	87.7%
ADBN	6,559.5	12.3%
Poverty focused credit	4,037.3	100.0%
Priority sector	2,797.1	69.3%
ADBN-SFDP	1,240.2	30.7%

There are two types of financial institutions with a considerable outreach potential to the poor that deserve detailed attention, both of recent origin: Small Farmer Cooperatives Limited (SFCL) and Grameen replicators.

SFCL: Since 1975 the Agricultural Development Bank of Nepal has built up its Small Farmer Development Programme. Major donors were IFAD (US$ 27.5 million) and ADB-Manila (US$ 30 million). By mid-1996 the program had reached 189,000 heads of households organized in some 23,000 small farmer groups. Credit disbursement and technical support were administered through 422 sub-project offices (SPOs). With repayment rates barely above 40% and loss ratios fluctuating mostly in the 20s and 30s the program incurred substantial losses. With a largely symbolic savings mobilization rate of less than 1% throughout is existence it strongly depended on donor resources.

With technical assistance from GTZ, ADBN has now embarked on a new course of institutional transformation. In July 1993, it turned the SFDP operations in four sub-project offices in Dhading, one of the poorest districts of Nepal, over to the small farmers themselves, establishing the first four SFCLs owned and managed by their members. Each of the four SFCL comprises on average 709 small farmers in 100 small farmer groups (73% of them male or mixed and 27% female) organized in turn in 11 intergroups. It appears that this transformation achieved a miracle: The SFCLs started mobilizing their own resources, which reached 20% of all loans outstanding within the first two years of their existence; the repayment rate of ADBN channeling loans (which continued unabatedly) virtually doubled; and the repayment rate of loans from internal resources jumped to 98% as of 7/1995. While the SFCLs still have quite some way to go to full autonomy, there is at least incipient evidence that there is a route of transforming the unsustainable operations of a state-owned agricultural development bank into viable microfinance institutions that cover their costs from the margin and might eventually mobilize their own internal resources.

Table 1.4: Performance of 4 SFCL in Dhading after two years of autonomy, 7/1995
[handover date: July 16, 1993]

Loans from own resources in % of all loans outstanding:	20 %
excluding handover loans:	28 %
Repayment rate of:	
ADBN handover loan:	28 %
New ADBN channeling loans:	79 %
Loans from internal resources: 7/95:	98 %
1/96:	100 %
Arrears ratio:	
ADBN handover loan:	62 %
New ADBN channeling loans:	5 %
Loans from internal resources, 7/95:	0%
Transaction costs in % of loans outstanding	1.5 %
Increase of loans outstanding from internal resources during preceding 6 months:	19.5 %

By mid-1996 the operations of thirty SPOs had been converted into autonomous SFLCs, with a total outreach of over 20,000 families (representing a population of about 130,000). While ADBN continues to establish new small farmer groups through its existing network of SPOs that are to be converted into SFCL in due course, it is expected that within six to eight years about 4-500 SFCLs will have been established with an outreach of more than 200,000 predominantly poor families (i.e.,. a population of 1.2 million). Given their low level of transaction costs and the excellent repayment performance, their viability does not appear to be threatened. However, full institutional autonomy and self-reliance (including the cessation of loan channeling on ADBN's terms), appropriate supervision and the establishment of an apex structure are among the many issues that need to be resolved if savings and credit cooperatives of the SFCL type are to evolve into a self-sustained movement with an ever-increasing deepening of financial services to the poor.

Grameen Bank replicators: In 1992 the Government of Nepal embarked on a Grameen Bank replication program, announcing its plans for the establishment of five Grameen-type rural development banks, one in each of the five geographical regions of the country. In 1996 the Development Banking Act was passed under which the five Grameen Bikas Banks have been registered. In addition there are two NGO replicators existing side by side, testing the appropriateness of a bank vs. NGO approach. The main resource base of the Grameen Bikas banks has been their share capital amounting to Rs 60 million each of which the central bank, NRB, has provided two thirds. The two NGOs were supported by international donors. In addition, commercial banks lent Rs 148.7 million to the Grameen Bikas banks and Rs 31.6 million to the two NGOs under the compulsory deprived sector credit program, totaling Rs 180.3 million which is barely less than the total volume of Grameen loans outstanding. Like the commercial banks in Nepal, the Grameen replicators are excessively liquid. Government vs. private ownership of the Grameen-type development banks has been an issue of critical debate, reflecting the fear that government intervention might interfere with sound banking practices and keep the banks from attaining resource self-reliance and financial viability.

The Grameen replicators target exclusively poor women. Starting in 1993, outreach has grown rapidly from about 12,500 in mid-1994 to over 50,000 in mid-1996. With a repayment rate of 100% loan recovery so far has been perfect. Members' savings constitute 20% of loans outstanding. Compulsory savings in the group fund are the chief instrument of internal resource mobilization, with personal voluntary savings amounting to a mere 12% of total savings. Transaction costs of the Grameen type

group approach have been substantial and are a big threat to the viability of the institutions. If this issue could be resolved and if self-reliance would replace their donor-dependency, they could continue to widen their outreach and greatly enrich the financial infrastructure accessible to the poor.

Table 1.5: Performance of 7 Grameen replicators within their first three years
(in Rs. million)

	July 1994	July 1995	July 1996
1. No. of group members	12561	34910	51437
2. No. of borrowers	10839	32119	48392
3. Loans disbursed cumulative	49.2	222.3	542.6
4. Loans repaid, cumulative	20.6	117.1	354.2
5. Loans outstanding	28.6	105.2	188.3
6. Overdue loan	NIL	NIL	NIL
7. Group fund savings	2.9	12.9	32.5
8. Personal voluntary savings	1.7	3.0	4.8
9. Members' total savings	4.7	16.0	37.4
10. Loan from group fund saving	0.409	3.4	14.3

1.5. Policy and regulatory framework

Overall policy environment: During the 90s the government has created a new policy environment focussing on democratization, decentralization and local participation, economic and financial liberalization including interest rate deregulation, poverty alleviation, and a legal framework for MFIs. While opening up to the outside world including external markets, the government also showed a new positive attitude to NGOs and their role as facilitators in the process of development at the grassroots level. The government renewed its emphasis on alleviating the plight of the rural poor including women. While poverty alleviation was considered a matter of charity in the past, it is now being increasingly realized that rural financial systems development along the rules of a market economy, with an emphasis on the viability of institutions and programs, opens up new avenues for sustainable poverty alleviation on an ever-increasing scale of outreach.

Poverty alleviation policies: Poverty has been a pervasive problem in Nepal. The government first responded to the problems of extreme rural underdevelopment at the time of absolute monarchy. In 1968, it set up an agricultural development bank (ADBN) and subsequently, 1975, established a Small Farmers Development Project (SFDP) to stimulate agricultural production by providing credit and related training and consultancy services through ADBN. Other interventions followed, among them the Intensive Banking Program in 1981, with preferential credit the principal tool to alleviate poverty. As usual at that time among governments and donors, the approach was supply-driven and top-down, resulting in the rapid deterioration of the financial health of the programs and its handling institutions. Groups were established as a grassroots channeling mechanism, without a notion of institutional autonomy as local financial intermediaries. Pre-existing self-organized savings and credit groups, many of them of indigenous origin, were ignored. To some extent, there might have been a positive impact on agricultural production; but that impact remained restricted by the failure of credit services to grow dynamically and by the neglect of savings deposit facilities.

Financial policy and regulatory framework: In recent years, the development of rural financial institutions has gained much attention in Nepal's two chief monetary and financial policy-making institutions: the Ministry of Finance and the central bank, Nepal Rastra Bank (NRB). New legal forms have been created that are of relevancy for microfinance services, among them Development Banks for Grameen replicators, Savings and Finance Companies, and Small Farmer Cooperatives Ltd. A cooperative banking act is presently under preparation. NRB is in charge of bank supervision.

The central bank, NRB, is favorably disposed towards deregulation and the licensing of MFIs focussing on the poor. To promote the establishment of banks with a local outreach, NRB has recently

differentiated equity capital requirements for rural development banks: Rs 2.5 million ($44,000) for banks working in a single district, Rs 5 million for banks working in two or three districts and Rs 10 million for those working in four to ten districts.

The financial system of Nepal has been partially liberalized in recent years. Banks and other financial institutions are free to set their own interest rates on deposits and loans. Average bank lending rates are around 18% in commercial lending and 11% in preferential lending. By comparison, interest rates in the informal financial sector are around 35% in the mountains and 43% in the plains. The average interbank rate was below 10% in July 1996; the treasury bill rate was 12.8% (up from 3.8% in January 1994). The banks' freedom is restricted by two major factors: a NRB directive limiting the spread between deposit and lending rates to 6% (except for the Grameen type development banks and NGOs); and the prevalence of subsidized credit, which includes a provision for commercial banks to allocate 12% of their loan portfolio to priority sectors in agriculture, cottage industry and services. Financial institutions are obligated to lend against collateral. An exception is made up to a certain level for loans to low income families and solidarity groups.

Deposit taking from the general public is restricted to commercial and development banks as well as finance companies. NGOs and savings and credit organizations including cooperatives with NRB permission for limited banking operations are only authorized to accept deposits from their members. Deposits collected by finance companies, cooperative credit societies and savings and credit organizations are limited to the tenfold of their equity capital. They also have to maintain a minimum of 10% liquidity of their deposit liabilities. Banks and finance companies have to adhere to capital requirements as a percentage of total assets and risk assets as prescribed by NRB.

As average transaction costs from institutional sources in rural Nepal have been estimated at 6% (at presently given terms and conditions), ranging from 1% on large loans (above Rs 50,000) to 11% on small loans (below Rs 5,000), restrictions on the margin militate against lending to small and marginal borrowers, lead to risk aversive lending and shift transaction costs to borrowers (i.e.,, eliminating customer-friendly services). They are also likely to undermine the financial viability of the banks.

One of the more interesting microfinance innovations in the Asian-Pacific region is the transformation of the sub-project offices of the SFDP into autonomous local financial institutions owned and managed by their members in the form of Small Farmer Cooperatives Ltd. (SFCL) - apparently with a remarkable impact on institutional viability and sustainability as indicated above. The significance of this experiment extends far beyond SFDP. Many government-owned agricultural development banks in the region might want to take a close look at it during an exposure program.

2. Assessment of microfinance institutions (MFIs)

Six MFIs were selected as indicative case studies:

(a) Two pioneering Grameen replicators: Purbanchal Grameen Bikas Bank (PUGBB), one of five government-sponsored Grameen type banks with legal status under the Development Bank Act; and Nirdhan, one of two NGO replicators and the first of all replicators in the field. Both are located in the plains of Nepal

(b) Two out of 49 NGOs sponsored through the governmental Rural Self Reliance Fund (RSF): Adarsha Krishak Samanbaya Samiti (Adarsha) and Vyccu Bachat Tatha Rin Sahakari Samstha (Vyccu)

(c) Two out of 233 cooperatives engaged in microfinance and registered under the Cooperative Act of 1992: the Small Farmer Cooperative Limited (SFCL) in Bhumisthan, Dhading, which is one of 53 pioneers of ADBN's new GTZ-supported strategy of transforming some 400+ SFDP sub-project offices into autonomous local financial intermediaries owned and managed by their members; and the privately organized Navajiban Cooperative Limited in Dhangadi

(Navajiban) as one out of ten commercially oriented cooperatives authorized to undertake banking functions.

Of the six cases, **Purbanchal Grameen Bikas Bank**, a government-owned regional development bank, has been singled out for a more elaborate presentation. Originally registered in 1992 under the Commercial Bank Act of 1974, it started its financial operations on August 8, 1993; as of March 1996, it fell under the newly enacted Development Bank Act. Two years after its start, its equity capital of Rs 30 million was doubled to Rs 60 million of which the central bank (NRB) held 66.75%, the government 8.25 % and each of the five state-owned commercial banks 5%. The bank has been selected here as an example of the Grameen approach geared to a disadvantaged segment of the Nepali population, namely women under the poverty line. After little over two years of operation, it attained about the same outreach as the third-largest poverty lending program of the government, Production Credit for Rural Women; it accounted for 75% of the poor women covered by the seven Grameen replicators in 1995; and it is projected to reach about half the number of households in its region of operation within the next three years that SFDP has covered nationally after twenty years of existence. Both its capital and governance structure indicate that Purbanchal Grameen Bikas Bank is a government bank. Its board of directors is exclusively recruited from government institutions: the NRB, the Ministry of Finance and the state-owned commercial banks; the chairman (so far from NRB) and the executive director (from one of the commercial banks) are elected from among the board members - with prior government approval. The Bank also illustrates the severe struggle for viability of a government-owned poverty lending institution.

2.1. Outreach

The outreach figures for the six sample institutions reflect different policies. The Grameen replicators, foremost among them the Bikas Bank with over 26,000 clients, cover a wide geographical area. The other institutions tend to be limited to a small number of villages usually under one Village Development Committee (VDC). Only informal institutions, which are excluded from the sample, tend to recruit their members from single villages. The Grameen replicators and the SFCL recruit their members from among the poor only; in addition, the former restrict participation to women. In all three program approaches, the number of savers exceeds that of the borrowers, which mostly reflects the fact that saving is a compulsory program requirement.[5] In nondiscriminating institutions, men, who are usually the heads of households, outnumber women by a wide margin. This is usually due to a policy of limiting memberships or loans to only one family member at a time, resulting in a restriction of access to credit for women's own income-generating activities. To widen outreach, program managers may be encouraged to lift that restriction; and to promote the establishment of women's own units or subunits, e.g. at the village or village group level.

[5] However half of these institutions and programs are credit-driven and borrower-oriented, namely the two Grameen replicators and, at least to date, the SFCL. Unlike some of the institutions from Indonesia where poor savers outnumber poor borrowers by a wide margin, these three institutions in Nepal fail to appeal to savers. Indeed, access to cheap donor and government funds makes it in the short run economically rational behavior to rely on external resources rather than own savings with their high mobilization costs.

Table 2.1: Outreach of six sample MFIs in Nepal, December 1995

MFI	*Borrowers*			*Savers*[6]		
	No.	*% poor*	*% female*	*No.*	*% poor*	*% female*
(a) Grameen:						
Bank: PUGBB	25028	100	100	26297	100	100
NGO: Nirdhan	1936	100	100	2131	100	100
(b) RSF:						
Vyccu	49	35	37	313	24	24
Adarsha	87	0	38	160	0	37
(c) Cooperatives:						
SFCL Bhumisthan	741	100	20	793	100	25
Navajiban	212	46	27	1661	18	22

Whether MFIs should broaden their outreach or put more emphasis on deepening their services and impact is a challenging issue to be left to their member-customers and management rather than policymakers and donors. There does not seem to be an inherent advantage of one strategy over the other.

Purbanchal Grameen Bikas Bank:[7] The Bank is located in the eastern plains. Its objective is the provision of financial services, particularly access to credit, to all women in the eastern region that fall under the poverty line.[8] The Bank has a dual delivery structure, comprising a bank structure and a member structure. As of 1995/96, the Bank consisted of a head office, six area offices and 29 branches. On average there are five branches per area office. Each branch has a staff of 6-10. The total number of staff is 256 of which 35 (14%) are in the head office. 127, or 50%, are field assistants who work directly with the women's groups in the field. Incentive schemes have not been introduced.

During its first fiscal year, 1993/94, the Bank enrolled 8,294 women; in 1994/95 14,992; and in 1995/96 another 5,667, bringing the total to 28,953. The members are organized in about 5,800 groups of five women which in turn form 827 centers of seven groups each. The Bank's growth projection until the year 1998/99 is about 81,500 members (this would equal half of SFDP's present national outreach) in some 16,300 groups and 2,000 centers.

Prospective members are attracted through public meetings and house-to-house visits. Groups of five women each are formed, and the members of three groups jointly receive one or two weeks of training, one hour per day, in the Grameen technology - reportedly with only little adjustment to the Nepali context. Five of the fifteen participants usually drop out, and the remaining ten form two solidarity groups. Reasons given for dropping out include fear of loosing property, ignorance, husband's interference and discouragement from landlords, moneylenders or politicians. As in Bangladesh, Grameen banking seems to be perceived by local authorities and leaders not just as a financial business but as a type of social revolution centering on the role of women in society.

6 Borrowers and savers cannot be simply added up to arrive at the total number of members or customers; the larger one of the two figures is usually equivalent to the total.

7 Reported figures usually pertain to one of two reporting dates, the end of the fiscal year, July 16, and the end of the calendar year, December 31. Due to differences in reporting time, there may thus be wide divergences between figures for the same year.

8 A household of five with land holdings not exceeding 0.68 ha (1.0 bigha) is officially defined as poor. Participants are mainly identified on the basis of land ownership and the quality of their housing. According to a housing indexation test in one of the poorest areas of the bank, Jhumka, 84% in a sample of 50 households were poor, 12% not so poor and 4% non-poor. Outreach to the non-poor is usually defined as *leakage* (supposedly of scarce government or donor funds earmarked for poverty lending) by Grameen replicators and not welcomed.

The Bank is very much credit-oriented, with virtually every group member becoming a borrower. There are three loan products: general loans with a one-year maturity and weekly installments accounting for 98% of all loans outstanding (1995/96), six-months seasonal loans due upon maturity, and irrigation loans. In addition, 50% of the compulsory group savings, which are not withdrawable, can be lent by the groups to their members at interest rates fixed by the group for emergency and consumption purposes. The percentage of borrowers during the three years was 83%, 92.5% and 98%, respectively. During the same time average loan size (disbursed) grew from Rs 4,400 to Rs 7,100 ($125) and average savings from a meager Rs 378 to Rs 787 ($14). The demand for loans of larger sizes outstrips the supply by far. The bank practices a system of incremental repeat loans, with a ceiling of Rs 15,000 for third-term borrowers. The total volume of loans outstanding grew from Rs 18.8 million in 1993/94 to Rs 119.3 million in 1995/96, total savings from Rs 3.1 million (16.5% of loans outstanding) to Rs 22.8 million (19.1% of loans outstanding) in 1995/96. With 92.5% of the savings accumulated through regular compulsory group savings in 1995/96, the mobilization of irregular voluntary savings of varying sizes is of negligible importance.

Table 2.2: Outreach of Purbanchal Grameen Bikas Bank, 1993/94-1995/96 (July)

	1993/94	*1994/95*	*1995/96*
Number of members	8,294	23,286	28,953
Number of borrowers	6,890	21,538	28,271
Percentage of borrowers	83.1%	92.5%	97.6%
Av. loan disbursed (Rs)	4,400	5,594	7,100
Av. loan outstanding (Rs)	2,735	3,318	4,284
Average savings (Rs)	378	462	787
Loans outstanding (Rs mn)	18.8	71.5	119.3
Savings deposits (Rs mn)	3.1	10.8	22.8
Savings/loans outstanding	16.5%	15.1%	19.1%

2.2. Financial viability and sustainability

Of the six MFIs studied in Nepal, only the two Grameen replicators are low in both operational and financial self-sufficiency which may be partially attributed to their recent origin. However, this does not explain the difference between the bank and the NGO, as both became operational in 1993. In terms of self-sufficiency, the bank performs much more poorly than the NGO: surprisingly as it is a bank; perhaps unsurprisingly as it is government-owned. However, in 1995/96, the bank's self-reliance indicators jumped from 18% to 47% and from 15% to 34%, respectively, bringing it somewhat closer to the level of the NGO. The organizations under the RSF and the cooperatives are operationally fully self-sufficient; the conventional cooperative is also financially fully self-sufficient. Vyccu, Adarsha and the SFCL have rates of full financial self-sufficiency from 71% to 84%. The on-time repayment rate is perfect, or near-perfect, among the Grameen replicators and the RSF organizations. The on-time repayment performance of Navajiban is near-satisfactory. The SFCL is a special case, as the figure of 64% conceals wide variations depending on the source of funds: the repayment rate of loans from internally mobilized resources is 100%; of loans channeled on behalf of ADBN since their institutional autonomy around 80%; and of loans handed over at the time of its establishment as an SFCL (shrunk by now to a portfolio of bad debts) around 20%.

On the whole, cooperatives appear to be the most outstanding performers while the Grameen replicators still have a long way to go to become self-reliant. Despite the recent deregulation of interest rates, the MFIs continue to charge rates of interest around and below 20%, which is usually not sufficient to cover the costs and risks of microloans. Navajiban is an exception as its average loan size (appr. US$ 1,500) is more than 25 times the size of the Grameen replicators and 6-13 times the size of loans by the other organizations.

Table 2.3:Operational and financial self-sufficiency in six MFIs in Nepal, 1995

	Grameen repl's		*Rural Self-Rel.*		*Cooperatives*	
	Bank	*NGO*	*Vyccu*	*Adarsha*	*SFCL*	*Navajiban*
Lending rate of interest	20	20	18	18	15-18	12-21
On-time repayment rate	100	100	97	100	64	92
Mean loan size (Rs. '000)	3.15	3.39	9.20	13.72	6.66	84.13
Degree of partial financial self-sufficiency (in %)	18	64*	103	96	136	127
Degree full of financial self-sufficiency (in %)	15	59*	71	84	82	113

* These data pertain to July 1996.

Purbanchal Grameen Bikas Bank: After three years of operation, the bank is still far from breaking even. In absolute terms its net loss was Rs 4.86 million (78% of total expenditure) in 1993/94; Rs 12.98 million (78% of total expenditure) in 1994/95 and Rs 10.96 million (46% of total expenditure) in 1995/96.[9] In terms of the volume of loans outstanding, the losses amount to 25.8%, 18.2% and 9.2%, respectively. In terms of total assets, the losses are 6.8%, 11.0% and 5.9%, respectively. The Bank's degree of partial financial self-sufficiency has jumped from 0% in 1993/94 to 47% in 1995/96 and hopes to achieve a 100%-rate in 1996/97. Its degree of full financial self-sufficiency has increased from 0% in 1993/94 to 15% in 1994/95 and 34% in 1995/96.

The Bank projects to become financially fully self-sufficient within three years, i.e. until 1998/99. However, the Bank ignores the fact that the value of the subsidy element has been increasing rapidly in terms of actual costs, namely from 17% in 1993/94 to 39% in 1995/96, making the bank donor-dependent and vulnerable. If the opportunity costs of the Bank's equity capital contributed by the government are taken into consideration, the dependency (and, concomitantly, lack of autonomy in decision-making) is even more pronounced. While some consider these projections as overly optimistic, other derive hope from the fact that eight of the 29 branches have reported operational profits within three years (disregarding the value of grants and soft loans). Additional indicators of performance are given in the table below.

There is a host of factors militating against viability in Purbanchal Grameen Bikas Bank. But as important as they are, there is at least one factor which so far has not undermined the bank's viability, and that is the repayment behavior of its customers. The women repay their loans; to date no loan losses have been reported. However, as groups age, the Bank, like all government programs for the poor, might experience a slackening of repayment morale.

The first factor which militates against viability lies in the bank's governance structure. Being owned by government institutions, there is no vested interest in profitability. To the contrary, the bank finds itself under political pressure to lend to the poor at low interest rates at which it cannot cover its costs. This lack of interest in the bank's viability relates not only to its owners but also to its management and staff. The branches are not run as profit centers; nor are there any employee incentive schemes. While access to cheap central and commercial bank funds may be considered an asset as it lowers the costs of loanable funds, its actual impact is the opposite, leading to a distortion of the cost structure and, presumably, a general lack of cost awareness among the bank's management and staff.

[9] Data for 1993/94 and 1994/95 are audited, data for 1995/96 are provisional.

Table 2.4: Performance indicators for Purbanchal Grameen Bikas Bank, July 1993/94, 1994/95 and 1995/96 (Rupie amounts in thousands)

	1993/94	*1994/95*	*1995/96*
Operating expenditure	6,077	14,940	19,399
Interest paid on deposits	112	404	1,057
Interest paid on soft loans:			
Amount actually paid	35	1,031	3,456
Value of payments at market rate	700	3,804	10,643
Loan loss provision:			
Actual amount	0	175	117
Value of 2% of loans outstanding	377	1,429	2,385
Total cost:			
Actual cost	6,224	16,550	24,028
Subsidy element*	1,042	4,027	9,455
Adjusted cost	7,266	20,577	33,483
Subsidy element/actual cost (in percent)	*16.7%*	*24.3%*	*39.3%*
Groups per branch	638	803	998
Groups per FA (field assistant)	82	185	233
Loan amount per FA	187	567	962
Savings per FA	31	85	188
Average salary of FA in percent of GDP/p.c.	256%	363%	440%
Loanable savings deposits	3,012	10,218	21,648
Soft loans and grants	10,000	36,111	85,518
Loans outstanding	18,846	71,459	119,262
Loss/Total expenditure	78%	78%	46%
Loss/Loans outstanding	25.8%	18.2%	9.2%
Loss/Total assets	6.8%	11.0%	5.9%
Degree of financial self-sufficiency:			
Partial	*0%*	*18%*	*47%*
Full	*0%*	*15%*	*34%*

* The subsidy element is calculated as the total of the value of payments on borrowings at the market rate minus actual soft loan interest payments (lines 5 and 4) plus loan loss provisions of 2% of loans outstanding minus the actual loan loss provision (lines 8 and 7).

The bank's delivery system is expensive - a second factor impeding viability. Salaries alone accounted for 57% to 58% of total expenditures in each of the last three years of operation; while salaries and office expenses together accounted for 98% in 1993/94, 90% in 1994/95 and 81% in 1995/96. During the three years interest expenses on savings deposits were 1.8%, 2.4% and 4.4%, respectively, of total costs; while interest expenses on borrowings grew from 0.6% to 6.2% and 14.4%, respectively. In terms of loans outstanding as recorded in the balance sheet, expenditures for salaries and office expenses were 32%, 21% and 16% during the three respective years - a declining trend. There are already signs of a decline in the dynamics of expansion indicated by the number of groups formed on average by field staff: 82 groups during the first year, 119 during the second year and only 45 during the third year, while the number of field staff grew only slightly, namely from 101 in 1993/94 to 126 in 1994/95 and 127 in 1995/96. Political interference is cited as one of the background factors, which includes changes in bank leadership parallel to changes in the political system of the country. Another factor is of course that field staff reach the limits of their capacity as they are obligated to participate in group and center meetings.

A third factor lies in the interest rate of loans which is below a genuine rural market rate. The Bank pays 7.5% on savings deposits (close to the commercial bank savings deposit rate of 8%), 6% on old soft loans (Rs 63.7 million) and 8% on its most recent soft loan (Rs 20.4 million). Under political pressure to approximate poverty lending standards, the bank charges 20% on its loans to the groups, which is only slightly higher than the commercial bank rate and a fraction of informal lending rates.

Interest rates are not differentiated according to loan product, which makes it unattractive for the bank to offer products with customer-friendly services, such as doorstep collection of instalments. This would lower borrower transaction costs substantially while of course increasing the lender's transaction costs however with the result of a net decrease in overall transaction costs! Under political pressure, the Banks finds itself unable to raise interest rates sufficiently to cover its costs. As elsewhere, this invariably leads to loan rationing, curtailing loan sizes as well as the overall lending volume. This limits the women's access to credit and thus restricts their ability to invest a sufficient amount of resources into income-generating activities with the highest rate of return. The low interest rates may be beneficial to politicians; but they certainly do not benefit the poor women. In this case, small is not beautiful. To the contrary, inadequate loan sizes tend to keep the women in poverty.

The groups are not considered as financial intermediaries - a fourth factor. Serving only as credit channels with joint liability functions, they cannot set their own interest rates on loans received from the Bank; nor can they add a margin. Given the standardization of loan sizes and compulsory savings deductions, individual transactions are all reduced to the lowest level affordable by each group member. However, there is a 5% compulsory savings deduction from every loan disbursed 50% of which the groups can lend on their own terms. This might open the door to the proper pricing of loan products provided the fields assistants do not advise against it.

Another factor lies in the bank's exclusive targeting of poor women who accept the solidarity group approach. This leaves out some wealthier community members and their potential savings deposits and others with a potential request for larger loan sizes which would contribute to the bank's economies of scale.

Closely related to this is a sixth factor: the bank's sole reliance on the group approach. This is likely to save transaction costs when banking with the poor. But it excludes bigger customers with widely diverging savings potentials and credit needs who might be better served with an individual technology.

The Bank faces a great challenge. According to the NRB/ADB Rural Credit Survey of 1991/92 only 6% of the landless and 12% of marginal farmers have access to institutional credit. The percentage of the poor with access to savings deposit facilities (not to mention collection services) is close to zero. Moreover, the fact that vast numbers of the poor need savings deposit services much more than access to credit is widely ignored. Yet it is the accumulation of savings which would strengthen the much-needed self-financing capacity of the poor. To overcome its shortcomings, the Bank would have to undergo a major transformation in order to effectively meet the challenge of serving a substantial portion of its potential market.

2.3. Resource mobilization

Of the six sample MFIs studied in Nepal, the two Grameen replicators are among the weakest in terms of internal resource mobilization. With savings constituting only 16% and 18%, respectively, of loans outstanding, they largely depend on donor funding. In case of withdrawal of external funds, they would not be sustainable. The two organizations under the Rural Self-Reliance Fund present a discrepant picture: Vyccu has savings equivalent to half the amount of loans outstanding, while Adarsha's loans outstanding are fully matched by its internal resources. Similarly, Navajiban fully mobilizes its own resources while the other cooperative, SFCL Bhumistan, still continues to serve as a channel for ADBN funds. Within the first three years of its operation, the SFCL has mobilized from its 788 members Rs 0.58 million (a mere US$ 13 per member). Interestingly, the raising of compulsory share capital contributions has been of minor importance, accounting for only 7.1% of its own resources as of 1/1996. Voluntary savings, 72.5% of resources, make up the bulk. In addition, livestock insurance, accounting for 20.4%, has contributed in an innovative way to the group's internal resources. In all MFIs, voluntary withdrawable savings have the greatest growth potential, particularly when collected through doorstep services, as recently demonstrated by the Himalaya Finance and Savings Company Ltd.

Table 2.5:Resource mobilization in six MFIs in Nepal, December 1995

	Grameen repl's		*Rural Self-Rel.*		*Cooperatives*	
	Bank	*NGO*	*Vyccu*	*Adarsha*	*SFCL*	*Navajiban*
Savings (million Rs.)	13.92	1.03	0.23	1.20	0.56	17.86
Loans outstanding (mn Rs.)	78.74	6.56	0.45	1.19	4.94	17.84
Savings/loans out'g (in %)	18	16	51	100	11	100

On the whole it is concluded that resource mobilization and the range of financial services offered by the MFIs, comprising nominal fees, share subscriptions, regular compulsory savings and, to a restricted extent, voluntary savings, is quite limited. A wider range of savings products and collection services is generally lacking. There are virtually no reciprocal products of combined savings and installment collection. Donor and government funding and the policy of interest rate subsidization of bank microloans have greatly undermined the motivation of the MFIs to mobilize their own resources. In addition, an inverse interest structure which resulted from the channeling of government funding through MFIs at preferential terms has in the past greatly impeded the mobilization of voluntary savings.

Purbanchal Grameen Bikas Bank: The Bank has been remarkably successful in mobilizing external resources. For its start it obtained Rs 24 million in equity capital from government sources which were augmented to Rs 60 million after two years. The central bank, NRB, with two thirds of the paid-in capital, is the major equity holder. The state-owned commercial banks and the government contributed the rest. In addition, the Bank has borrowed Rs 10 million in 1993/94, Rs 36.1 million in 1994/95 and Rs. 49.4 million in 1995/96. The amount of borrowings outstanding as of July 1996 was Rs 85.5 million. In the framework of the compulsory deprived sector lending program, government-owned banks supplied 46.5% of the borrowings and private banks another 50.8%. The remaining 2.6% came from the Grameen Trust in Bangladesh for the scaling-up for one of the branches.

Despite the fact that development banks are authorized by the banking law to mobilize savings from the general public, the Bank has restricted its internal resource mobilization to the group members. It offers two types of savings products: compulsory group savings amounting to a 5% deduction from every loan and voluntary savings. Little effort is being made by the bank to tap the savings potential of its members. In 1994/95 compulsory group savings accounted for 85% and individual voluntary savings for 15%. In the following year, 1995/96, the share of compulsory increased to 94% while voluntary savings fell to 6%. The future of voluntary savings in Purbanchal Grameen Bikas Bank appears bleak, with projections of the share of voluntary savings of 1.7% for 1996/97, 1.4% for 1997/98 and 1.3% for 1998/99.

During the preceding three years there was no clear trend concerning the proportion of savings deposits in terms of loans outstanding. Their share was 16.5% in 1993/94, 15.1% in 1994/95 and 19.1% in 1995/96 (*cf. Table 2.2*). There does not seem to be a policy within the Bank to step up its internal resource mobilization. To the contrary, the Bank's projections until 1999 show proportions of 10.4% for each one of the next three fiscal years.

The Bank's resource mobilization policy seems to be geared to external resources rather than internal savings. During the three preceding years, new borrowings from commercial sources amounted to 53.1%, 50.5% and 41.4%, respectively, of loans outstanding; while borrowings outstanding amounted to 53.1%, 50.5% and 71.7% of loans outstanding. For each one of the next three years the Bank has projected the share of borrowings at 93% of loans outstanding.

Table 2.6: Resource mobilization by Purbanchal Grameen Bikas Bank, July 1993/94, 1994/95 and 1995/96 (amounts in Rs million)

	1993/94	*1994/95*	*1995/96*
Paid-up capital	24.0	60.0	60.0
New commercial borrowing	10.0	36.1	49.4
New borrowings/Loans outstanding in percent	53.1%	50.5%	41.4%
Borrowings outstanding	10.0	36.1	85.5*
Borrowings outst'g/Loans outst'g in percent	53.1%	50.5%	71.7%
Compulsory savings/Total savings in percent	.	85.0%	94.0%
Savings deposits/Loans outstanding	16.5%	15.1%	18.8%

* This includes Rs 83.26 million from commercial banks and Rs 2.27 million from Grameen Trust.

Some observers have concluded that there is only one way of reversing the Bank's trend towards increased external resource dependency: privatization. While this may appear as an ideological issue to some, others have pointed out that time and again governments have been generous in supporting new poverty-lending initiatives, but sooner or later, under budgetary constraints and concerns for macroeconomic stability, have retracted their support. This has usually led to the collapse of those institutions which did not possess the foresight of preparing for the day of enforced self-reliance. This is a thorny issue for the Bank. For its government owners would have to foresee, and prepare for, their own withdrawal.

2.4. Regulatory framework

With regard to microfinance for the poor, a number of issues remain to be resolved at the policy and regulatory level in Nepal:

- the adoption of an overall microfinance systems development approach, which includes the systematic coordination of the various measures and donor contributions;
- the establishment of self-organized second-tier regulatory authorities for the various networks of MFIs, providing guidance, business representation, institution-building, supervisory and refinancing services that exceed the capacities of the Nepal Rastra Bank and the Department of Cooperatives, respectively;
- the actual implementation of differentiated, market-oriented interest rates, which would generally have to be far above the commercial bank prime rate in order to cover the costs of intermediation;
- the curtailment and, eventually, the abolishment of preferential lending programs, which distort rural financial markets and set up an unfair competition to market-oriented microfinance institutions;
- the abolishment of microloan interest rate subsidies, which undermine savings mobilization;
- a stop to all practices of using microfinance institutions as channels for programs with terms and conditions set by governments and donors to be replaced by an emphasis on internal resource mobilization which may be complemented by a system of liquidity exchange among related institutions and access to sources of portfolio refinancing at market terms;
- the promotion of innovative linkages between institutions belonging to the various financial subsectors;
- the selection and testing of successful microcredit, microsavings and microinsurance products and strategies and their dissemination throughout the formal, semiformal and informal financial sectors;
- the strengthening of the autonomy of all financial institutions including the central bank, NRB;
- the promotion of governance structures and incentive schemes which are conducive to the viability and growth of microfinance institutions;
- the privatization of government-owned microfinance institutions.

These issues will only be resolved in the best interest of the poor if there is adequate coordination and close cooperation between MFIs, their customer or members, government agencies, and donors.

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