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AN EVALUATION OF THE RURAL MICROFINANCE DEVELOPMENT CENTRE AS A WHOLESALE LENDING INSTITUTION IN NEPAL

Francesca Majorano

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Francesca Majorano

February 2007

Francesca Majorano was an intern at the Rural Microfinance Development Centre, established under an ADB-assisted Project.

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PREFACE

In 1998 the Government of Nepal, with the support of the Asian Development Bank (ADB), established the Rural Microfinance Development Centre (RMDC), a public company with the mandate to operate as a wholesale lending agency for microfinance institutions (MFIs) in Nepal. An attempt has been made in this study to assess the performance of the RMDC and its impact on the beneficiaries.

The research was undertaken between May and September 2006 using a participatory approach, which involved extensive discussions with microfinance practitioners and field visits to five project areas, where small samples of MFIs and their clients were selected and interviewed.

This study can contribute towards understanding the microfinance sector in Nepal and help improve its strategy. I would like to thank Francesca Majorano for preparing this comprehensive report and to Hari Bansh Jha, Consultant for giving this report its final form.

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Paolo Spantigati
Officer-In-Charge
Nepal Resident Mission
Asian Development Bank

CURRENCY EQUIVALENTS
(as of 15 December FY2006)

Currency Unit	—	Nepalese rupee/s (NRe/NRs)
NRe1.00	=	0.0139
$1.00	=	NRs71.45

ABBREVIATION

ADB	—	Asian Development Bank
ADBL	—	Agricultural Development Bank of Nepal
BFIO	—	Banking and Financial Institutions Ordinance
CSD	—	Centre for Self-help Development
FINGO	—	Financial Intermediary Non-government Organizations
GBB	—	Gramin Bikas Bank
MBD	—	microfinance development bank
MFI	—	microfinance institution
NBL	—	Nepal Bank Limited
NCBL	—	National Cooperative Bank Limited
NEFSCUN	—	Nepal Federation of Savings and Credit Cooperative Union Limited
NGO	—	nongovernment organization
NIDC	—	Nepal Industrial Development Corporation
NRB	—	Nepal Rastra Bank
OER	—	Operating Expense Ratio
RMDC	—	Rural Microfinance Development Centre
RSRF	—	Rural Self-Reliance Fund
SACCOS	—	credit cooperative societies
SFC	—	Small Farmers Cooperative
SFDB	—	Small Farmer Development Bank
SOCB	—	State Owned Commercial Bank
TV	—	Television
WSC	—	Women Support Cooperative

MEASURES

1 ropani	=	0.1257 acre
1 bigha	=	1.6735 acre
1 dhur	=	0.0042 acre
1 katha	=	0.0837 acre

NOTES

(i) The fiscal year (FY) of the Government ends on 15 July. FY before a calendar year denotes the year in which the fiscal year ends.

(ii) In this report, “$” refers to US dollars.

CONTENTS

ABSTRACT

A number of financial institutions licensed by the central bank, Nepal Rastra Bank (NRB), have been operating in various parts of the country, but there is no wholesale lending agency in microfinance sector. To fill this gap and to implement the Rural Microfinance Project and all microfinance components of ADB-funded projects, the Rural Microfinance Development Centre (RMDC) was established as a development bank in October 1998. Since its inception, the RMDC has been trying to enhance the capacity of microfinace institutions (MFIs). As a result of these efforts, many clients of MFIs have substantially improved their socioeconomic conditions. However, the RMDC is still facing the challenge of coordinating MFIs whose accounting and information management systems are underdeveloped. The RMDC and its MFIs have not been able to introduce computer software and still depend on cumbersome and time-consuming manual systems. The RMDC also needs to coordinate the operational activities of its MFIs. It needs to modernize both itself and its MFIs by developing software for microfinance operations. Care needs to be taken so that the MFIs will work with utmost vigor in remote areas and with the most the disadvantaged people and provide support without jeopardizing the prospect of loan recovery. Finally, the RMDC also suffers from a severe shortage of resources. Therefore, the Government and donors need to make a subsidized investment to remove its financial problem and enable it to become more effective. In addition, a second microfinance project is also needed to give continuity to the ongoing services and activities.

I. THE NEPALESE FINANCIAL SECTOR

A. Financial Sector

The Nepalese banking system is largely the result of public sector intervention. Nepal Bank Limited (NBL) started its operation in 1938 as a public sector institution with some private sector participation. Until the 1990s, the financial sector was monopolized by state-owned commercial banks (SOCBs), NBL, Rastriya Banijya Bank, and specialized institutions like the Agricultural Development Bank of Nepal (ADBL) and Nepal Industrial Development Corporation (NIDC). Together those four institutions controlled about 60% of the total assets in the banking industry until 2001.

The beginning of a private sector-led economy was made in the policies and legislation adopted after the restoration of democracy in 1990. However, the progress of reforms has been slow due to the political instability and the scarcity of private initiative. In 1992 several regional rural development banks were established under government initiative to provide microfinance services. Cooperative organizations also proliferated due to the relative ease with which they could access member deposits under the provisions of the Co-operative Act.

Reforms undertaken in the period 2000–2003 enabled the Central Bank—Nepal Rastra Bank (NRB)—to bring banking regulations in line with international standards with the support of the World Bank and International Monetary Fund's technical assistance. Deregulation of the formal financial sector was brought about on several fronts covering licensing of local private sector banks, admission of foreign players into the industry in collaboration with local investors, removal of interest rate controls, dismantling of credit allocation systems under the Priority Sector Program, and rolling back NRB refinancing programs. In the area of rural financial markets, the trend has been toward extending the regulatory framework over operations which had hitherto remained largely unregulated.

After decades of use,[1] priority sector and deprived sector lending programs stand discredited. They have not significantly enhanced credit flows to rural and microfinance sectors, and introduced distortions into rural financial markets. The Priority Sector program is now being phased out and will be completely eliminated by 2007. Currently, under the Deprived Sector program, NRB requires commercial banks to disburse at least 0.25–3% of their total loan portfolio to the poor households directly or through MFIs. However, the commercial banks are paying huge penalties to NRB or parking their funds at finance companies through microfinance banks like regional rural development banks instead of disbursing them to the MFIs. Mainstream banks, indeed, are reluctant to go directly into rural and remote areas because of the difficulties of adapting their systems, high costs and lower returns.In 2003, the Government established the Poverty Alleviation Fund, which seeks to assist CBOs and nongovernment organizations (NGOs) to organize subsidized microfinance programs with revolving fund scheme.

[1] The Priority Sector lending dates back to 1974, while the Deprived Sector Credit Program was introduced in 1990.

The Government is expected to dismantle its direct interventions in the rural finance (RF) and microfinance sectors, focus on improving the quality of existing institutions, and undertake rural infrastructure development. The recent initiatives undertaken under the Financial Sector Reforms Program include the new NRB Act (2002), restructuring of SOCBs and of ADBL, the Banking and Financial Institutions Ordinance (BFIO) (2004), the Company Ordinance of 2005, and new debt recovery laws (Appendix 1). According to the new legislative framework, MFIs are regulated by different acts according to their type of business. NGOs are regulated by the Financial Intermediary Non-government Organizations (FINGO) Act (1998), cooperatives by the Cooperative Act (1991), the rest by Section 80 of the BFIO. However, they all are under the purview of NRB, which is responsible for supervising and inspecting all institutions engaged in commercial banking.

B. Microfinance Institutions in Rural Areas

Microfinance is regarded as a most effective tool in the fight against poverty. It is often regarded as providing the services like microsavings, microcredit, microinsurance, and other support services to the poor to uplift their socioeconomic conditions. The average loan size per borrower of RMDC's partner organizations is around NRs7,600. In Nepal, a large number of MFIs have been operating and providing services in rural areas of the country in the formal, semiformal, and informal sectors as discussed below:

1. The Formal Sector

The financial formal sector comprises numerous institutions licensed by NRB including 19 commercial banks, 70 finance companies, 30 development banks (including ADBL and NIDC), 34 savings and credit cooperative societies (SACCOS), and 9 microfinance development banks (MDBs) and 47 FINGOs.[2] However, very few of them could provide their services to the rural and microfinance sectors. On the one hand, finance companies, commercial banks, and development banks have very little involvement in rural areas and microfinance, except for the state-owned Rastrijya Banijya Bank, NBL, and ADBL. On the other hand, the outreach of proper MFIs[3] is limited by the scarcity of their resources: they account for only 4% of capital, 1% of deposits, and 2% of outstanding loans to the sector. This is so because at the initial stage, the interest rate at which these institutions had to receive loans was as high as about 7%. As such, the operating costs of the institutions were high, affecting the prospects of mobilization of capital, deposits, and outstanding loans.

Rural MDBs include five Grameen Bikas Banks (GBBs) and four MDBs. The GBBs[4] were established by the Government to provide microfinance services in each of Nepal's five development regions. Their outreach and performance has been poor and, like ADBL branches and small farmers cooperatives (SFCs), their being associated with the Government meant that they were affected by conflict. Microcredit development banks[5] by contrast have shown better performance.

[2] Data refer to the end of FY2005/06. Nepal Rastra Bank.

[3] They comprise state-owned rural development banks, private and state-owned micro credit development banks (MCDBs), SACCOS, and FINGOs.

[4] Namely: Far-Western Rural Development Bank, Western (Paschimanchal) Rural Development Bank, Mid-Western (Madhya-Paschimanchal) Rural Development Bank, Central (Madhyamanchal) Rural Development Bank, Eastern (Purbanchal) Rural Development Bank.

[5] Namely: Chhimek Micro Credit Development Bank, DEPROSC Development Bank, Nirdhan Utthan Micro Credit Development Bank, Swabalamban Development Bank.

NGOs were acknowledged for the first time as partners in the development process by the Micro Credit Project for Women that used them as non-lending institutions responsible for social mobilization of groups and for imparting skills.[6] But not until the enactment of the Financial Intermediary Societies Act in 1998 that NGOs were permitted to provide financial services. Now they can acquire a limited banking license from the central bank and act as FINGOs. The first 13 licensed FINGOs were established in 2000 and have since grown considerably in number, being now 47.

Four apex institutions currently operate in Nepal: Rural Self-Reliance Fund (RSRF), Small Farmer Development Bank (SFDB), RMDC, and the National Cooperative Bank Limited (NCBL). Among these institutions, RSRF was established by the Government in 1990. It is financed through public funds, replenishments from NRB. It provides wholesale funds to SACCOS, NGOs, and Grameen replications operating in the rural areas of 46 districts, and it normally charges an 8% interest rate. Its scale of finance is limited to Rs500,000.

SFDB was established by ADBL in March 2002 but it started operations only in July 2003. The bank's main function is to provide wholesale funds to SFCs. According to an evaluation done by ADB[7], SFCB's profitability, efficiency, and productivity are weak. Loans are 80% of assets and borrowing is 73% of liabilities. Nearly 90% of SFCs loans are concentrated in livestock and agro services, both of which have poor repayment histories. Moreover, SFDB's performance is constrained by the fact that borrowing from ADBL at a 9% interest rate, it on-lends to SFCs at 12%—which is significantly higher than what they could obtain from other sources, such as commercial banks and RMDC.

RMDC was established in 1998 at the initiative of ADB and NRB, and became operational in 2000. It provides MFIs with wholesale funds, and financial and technical support to strengthen their institutional capacity. It also organizes direct support for the final beneficiaries and acts as a financial intermediary between them and national and international donors. RMDC borrows from the Government and lends to MFIs at interest rates compatible with commercial banks, which allows it to compete with them under the deprived sector lending.

The NCBL was established in 2003 under the Cooperative Act (1992). NRB approved it to carry out wholesale banking for its member cooperative societies. NCBL's principal sources of funds are capital and deposits. Its management plans to develop this body as the leading institution responsible for monitoring and supervising cooperative societies.

2. The Semiformal Sector

In the semiformal sector, there exist joint government–donor-supported projects and autonomous member-based organizations such as NGOs and cooperatives. Many cooperatives came together under the Nepal Federation of Savings and Credit Cooperative Union Limited (NEFSCUN). Established in 1988, NEFSCUN is the central apex body of community-based SACCOS in Nepal. Its mission is to promote, strengthen, and provide a forum for SACCOS to become viable community-based financial institutions. NEFSCUN is controlled and owned by its

[6] In all previous projects this role was performed entirely by Government agencies or ADBL.
[7] According to the ADB technical assistance in 2003.

members and guided by the International Credit Unions principles and values. Currently, 432 SACCOS with more than 70,000 members from 51 districts are affiliated with NEFSCUN. Local microfinance networks such as the Microfinance Association of Nepal, Microfinance Bankers Association, and the Grameen Network Association have been established in Nepal. However, they have now either disintegrated or become inactive, due to a lack of funding and leadership and the diversity and geographical isolation of their members.

3. The Informal Sector

The informal sector comprises about 20,000 informal community-based organizations such as self-help groups, rotating savings and credit associations (ROSCAs)—known as Dhukuti—and a large number of cooperatives. In addition, moneylenders, traders, and friends also provide an informal source of finance. Friends and family are the main providers of informal loans in both urban and rural areas—84.4% and 60.5%, respectively. Moneylenders play a minor role in urban areas, while they account for 33.4% of informal loans in rural areas.[8]

The total rural credit requirement in the country is estimated at NRs23.3 billion, while the total supply from the formal and semiformal sectors is NRs9.6 billion.[9] Of the aggregate supply of rural credit, nearly three quarters is from informal sources. The distribution of credit is not even: the upper and middle segments of the rural finance sector have more access to formal financial sources, while the lower segment mostly relies on informal sources. According to the World Bank (FY2006), 47.3% of the bottom quintile of the population exclusively relies on informal loans, while the percentage goes down to 24.7% in the case of the top quintile. ADBL and rural branches of commercial banks primarily concentrate on upper and middle segments; while GBBs, SFDB, private sector MFBs, and NGOs focus on the lower end. ADBL accounts for nearly two thirds of the total rural credit (by amount) from formal and semiformal sectors.

C. Microfinance Practices

In the Terai region (plain)—more densely populated and with better transport infrastructure—Grameen Bank replications as well as commercial and development banks are established, whereas in the hills and mountains, community-based organizations such as self-help groups, credit and savings associations, and cooperatives are the main providers of financial services.

First introduced in Nepal in the early 1990s, the Grameen Bank model has been adopted by a large number of organizations, mostly in the Terai region. The model stipulates that a credit system should be based on a survey of the social background rather than on a preestablished banking technique.It is based on peer groups of five members incorporated into centers of up to 10 groups. Weekly or fortnightly meetings are held to collect compulsory payments from members to contribute to the group's fund—incorporating both savings and loans. Loans are made initially to two members, then to two others, and finally to the last member. The group members guarantee each other for loan repayments. Savings products are in terms of both compulsory group fund savings, and additional voluntary savings. In recent years, several microfinance providers have

[8] Preliminary findings of a research based on the survey of 1800 households and presented in Kathmandu, 31 August FY2006.

[9] Data refer to 2002.

started to move away from the traditional Grameen model and offer additional services to clients, such as microinsurance and remittance.

Community-based models, such as that implemented by SACCOS, provide a wide range of savings and loan products to their members. They tend to serve a well-off population and the poor, with a stronger emphasis on the disadvantaged in the case of organizations established by development programs. They commonly require compulsory savings, and offer different saving products and deposits. In addition, self-help groups linked to commercial banks borrow directly from them, as happened with Rastriya Banijya Bank through the Banking with the Poor Program. Other examples of community-based models are the SCFs and the village banks. The SCFs—operative under the SFDP of ADBL—have proved to be unsuccessful. Adapted from Latin American models, it was used in Nepal with the Women Empowerment Program of Pact Nepal between 1998 and 2001. This methodology focuses on empowering large groups of people (20–40) in building their own financial institution, with a savings-first approach. Promoters like NGOs provide training to the village banks and lend fund capital to build up the external account of the village bank, which is then on-lent to members. The village bank collects repayments from members and repays its main obligation to the promoters. In parallel, the village bank members build up their internal account through savings and internally on lending.

II. RMDC AND ITS PERFORMANCE

A. Background

Though the microcredit programs have been in operation in Nepal for nearly 3 decades, most of the poor households failed to benefit from their services as MFIs providing quality services are lacking. Many NGOs, cooperatives, or even banks that worked as microfinance providers confined their activities to a limited number of poor households. Moreover, the performance of these institutions was also poor because they did not maintain even the minimum standards (Hakim 2003).

As the access of poor people in general and women in particular to microfinance was limited, they had no option but to depend on exploitative moneylenders. Only 24 % of the total institutional credit went to the poor, whereas quite a larger part of it went to nonpoor households with collateral (Hakim 2003).

Since the MFIs were able to provide only a fraction of total demand for microcredit, it was desirable to have an apex MFI which could provide wholesale fund to retail MFIs for lending to the poor households and thus play an effective role in promoting and developing the microfinance sector. It was in this context that RMDC came into existence in 1998 to implement the ADB-funded Rural Microfinance Project.

RMDC borrows from the Government and lends to MFIs at par with wholesale market interest rates of commercial banks under deprived sector lending. Originally created for lending to the five regional rural development banks and FINGOs (CSD, Nirdhan), RMDC now offers various services to a larger clientele made up of MDBs, rural cooperatives, and financial intermediary

NGOs. Because of its commitment to the development of quality MFIs, RMDC in 2005 won for the fourth time the award as best performing ADB-assisted project.

B. Objectives

The basic objectives of RMDC are to promote and develop the rural finance sector, through:

1. Channelling international and national resources to rural poor households, the landless and assetless, especially women, through MFIs;
2. Making MFIs financially viable and sustainable by providing necessary financial and technical support to start up institutions;
3. Creating and promoting a substantial number of appropriate MFIs, which could provide quality services to the unserved population in the country;
4. Supporting or undertaking research leading to innovation of microfinance practices and products; and
5. Fostering the creation of conducive policy and legal environment through organizing seminars, workshops, and interaction programs with key stakeholders.

C. The Rural Microfinance Project

The Rural Microfinance Project started in May 1999. It was funded by ADB, supervised by the Ministry of Finance, and implemented by RMDC. The term of the project, initially set at 31 December 2004, was extended to 30 June 2007. The estimated total cost of the project ($30.6 millions) is covered by ADB, the Government, commercial banks (in the form of equity in RMDC), and implementing agencies (in the form of administration costs of activities). The Government on-lends to RMDC under a subsidiary loan agreement.

The primary objective of the project is to improve the socioeconomic status of the poor and increase employment by enhancing their access to quality financial services. The activities financed include agriculture (such as livestock and vegetable production and marketing), manufacturing (agricultural tools and equipment, food processing, and handicrafts) and services (such as retail shops and trading activities).

Under the project, RMDC has access to SDR11.79 million amount of loan fund from ADB for on-lending to the poor households through retail MFIs. Moreover, under the Institutional Strengthening, and Group Formation and Strengthening components of the project, RMDC is providing technical support to MFIs and training to sub-borrowers.

D. Loan Limit and Interest Rate

Other issues posed by the project concerned the loan limit and the interest rate. Initially, RMDC could approve a maximum NRs40 million—and subsequently NRs80 million—to a single MFI at a time. This loan limit was inadequate to meet the needs of bigger partners such as MDBs. The loan limit has only recently been raised to NRs160 million. The initial lending rate to MFIs set by the project was 9.75%, much higher than the 5–7% charged by commercial banks. It prevented RMDC from disbursing its funds and conducting microfinance operations. During its life, RMDC had to put pressure on the Government twice to change the lending rate (from 6% to 4% in 2001 and from 4% to 2% in 2004) so that it could change its lending rate to MFIs to 6.5% and consequently to 5%.

E. Major Activities

RMDC operates in 47 out of the 75 districts of Nepal. Its operations are concentrated in three areas: credit program, institutional development, and support for ultimate borrowers. It closely supervises its partner organizations and contributes to disseminating microfinance best practices. Its stated goal is "reaching 500,000 poor families with credit facilities through 100 partner organizations" (RMDC Business Plan 2004). It has supported partner organizations in various forms such as microfinance operations, institutional development, monitoring and supervision, and creating microfinance-friendly environment as discussed below:

1. Microfinance Operations

RMDC, based on the set criteria it developed, it selected MFIs and approved a total loan of NRs1185.08 million for its 45 partner organizations of which nearly 83% (NRs982.60) have been disbursed until FY2006 (Table 1). Loan recovery (NRs481.75) rate is 100%. The overdue loan is zero.

Table 1: RMDC's Annual Loan Approval, Disbursement and Recovery

Fiscal Year	Loan Approved		Loan Disbursed		Loan Recovered	
	Amount (NRs million)	Annual Growth Rate (%)	Amount (NRs million)	Annual Growth Rate (%)	Amount (NRs.million)	Annual Growth Rate (%)
2000	40.00		40.00		0.00	
2001	32.10	(19.8)	1.90	(95.3)	26.67	
2002	132.66	313.3	65.95	3371.1	23.90	(10.4)
2003	116.52	(12.2)	137.05	107.8	73.42	207.2
2004	123.20	5.73	118.81	(13.3)	106.25	44.7
2005	382.77	210.7	320.66	169.89	128.29	20.7
2006	357.83	(6.52)	298.23	(6.99)	123.22	(3.95)
Total	**1185.08**		**982.6**		**481.75**	

Source: RMDC's Annual Reports

Furthermore, Table 2 shows the increase in the outreach measured by the number of partner organizations, total clients and working districts, and MFIs, staff and clients who received training. Until FY2006, RMDC provided different kinds of trainings to 138 MFIs, 8,027 staff and 281,291 clients. Currently, RMDC has 45 borrowing partners, which include 7 MDBs, 23 NGOs, and 15 cooperatives. The increase in the number of institutions and clients served required an increase in the staff of RMDC from 11 to 18 people until 2006.

Table 2: RMDC's Annual Outreach

Fiscal Year	POs	Total Clients	MFIs Trained	Staff Trained	Clients Trained	Districts
2000	2	62,136		231		14
2001	8	77,311	52	1,509	46,479	19
2002	17	165,779	62	1,483	36,359	34
2003	23	179,195	100	1,020	41,962	35
2004	28	216,002	112	1,226	40,338	39
2005	35	275,690	130	1,446	44,506	38
2006	45	368,814*	138	1,112	71,647	40
Total				**8,027**	**281,291**	

* This figure does not include the clients of five partner organizations that have only recently joined RMDC.
Source: RMDC's Annual Reports.

As mentioned earlier, the ceiling for loans provided by RMDC to its partner organizations has now been raised from NRs 80 million to NRs160 million. So far only five MFIs—Nirdhan Utthan Bank, Swabalamban Bikas Bank, Chhimek Bikas Bank, Nepal Rural Development Society Centre, and Centre for Self-Help Development (CSD)—have used over NRs80 million of loans. The repayment schedule varies according to the cycle of the loan: 2 years in quarterly instalments for the first loan, 3 years in half-yearly instalments for the second loan, and 5 years in half-yearly instalments for the third loan. In any case, a 6-month grace period is given. The amount and terms of loans are decided by RMDC on a single case basis after an adequate appraisal of the MFI's conditions.

All the interviewed partner organizations emphasized the importance of being partners of RMDC. Most of them learned microfinance practices through its support. Those that were doing microfinance before joining RMDC improved their programs, switching from the simple credit and savings model to the more effective Grameen model. Many partner organizations exclusively rely on the wholesale funds from RMDC since they have no other credit sources. In general, the partner organizations perceive the terms and conditions of loans as appropriate.

The requirements set for MFIs to become partners of RMDC and get loans are strict but appropriate. Some organizations initially faced difficulties in complying with some of its rules, especially in preparing the business plan and achieving 90% recovery rate. Those organizations that had been doing microfinance with different models encountered more problems and had to internalize the new mechanisms. However, partner organizations declared that after overcoming these problems, they were satisfied with their improvements.

Most MFIs adopt the policy of moving their staff from branch to branch and from area to area every 2 or 3 years. It is a reasonable practice that helps preventing preferential treatments and close relations between microfinance staff and clients.

2. Institutional Development

The institutional development is paramount for the successful implementation and expansion of microcredit programs, sustainability of MFIs, and overall development of the microfinance industry in the country. However, the Microfinance Project was designed to make RMDC a wholesale lender for existing MFIs. Capacity building support only represented a secondary activity. But as most of the existing MFIs in 1999 had inadequate institutional capacity and poor performance and RMDC had very few potential partners, it had to change its role from lender to promoter and shift its focus from lending to capacity building.

RMDC provides on-site consultancy services to existing MFIs, and promotes the establishment of new ones. It also provides training and technical support not only to its partner organizations but also to a much larger group of institutions. Its institutional capacity-building training program covers areas such as awareness building, orientation, and skills development. So far, 138 MFIs have received training, and 38 have been developed from scratch. The main purpose of the service is to help MFIs establish good microfinance operational systems and develop their staff. Training has been provided on a variety of issues, such as: PWR/PRA techniques for identifying target groups; pre-group training, basic account, financial reports, business plan, operational manuals, auditing, monitoring and supervision, management information, financial analysis and delinquencies management, credit operation management, and branch management.

Partner organizations receive support from RMDC not only for their staff, but also for their clients. It strengthens borrowers' groups and improves their income-generating skills. Such training programs vary according to the needs of the beneficiaries and include different subjects, such as literacy, gender sensitization, health awareness, skills development, and microenterprise management.

In view of the increasing number of poor families in urban areas, RMDC has been encouraging institutions to provide microfinance services in such areas as well. The main source of funding for institutional development operations in the rural and/or urban areas is a grant received from the Government of Nepal under the Rural Microfinance Project.

According to Table 3, RMDC had trained 8,027 MFIs staff until FY2006. Its training program proved useful to introducing and updating operational systems, identifying the weaknesses of the organization, learning how to plan and design operations, reaching operational and financial sustainability, and guaranteeing quality service to clients. Courses on financial analysis, MFI management, business planning, auditing, and management information system are the most appreciated, along with on-the-job training for field staff and exposure visits. However, RMDC has no training center of its own and as such it uses the training facilities available in the country (Hakim 2003).

Table 3: Capacity-Building Support for MFIs Staff

Fiscal Year	Number of Participants
2000	231
2001	1,509
2002	1,483
2003	1,020
2004	1,226
2005	1,446
2006	1,112
Total	**8,027**

Source: RMDC's Annual Reports.

The focus of RMDC on capacity building has proved to be the key to successful programs and well-performing and sustainable MFIs. It is committed to develop quality and efficient MFIs.

In addition to training MFIs staff, RMDC also provides MFIs' clients pre-group training, refresher training, leadership development training, and income-generating skills development training in areas like horticulture, livestock, and handicrafts. As Table 4 indicates, 281,291 MFIs clients participated in training programs organized by RMDC, which is more than the target of microfinance project (270,000).

Table 4: Capacity Building Support for MFIs Clients

Fiscal Year	Number of Participants	Annual Growth Rate (%)
2000	0	
2001	46,479	
2002	36,359	(21.8)
2003	41,962	15.4
2004	40,338	(3.9)
2005	44,506	10.3
2006	71,647	60.98
Total	**281,291**	

Source: RMDC's Annual Reports.

3. Supervision

The partner organizations regarded RMDC's supervision very important. It not only provides them with an assessment of their performance and consequent suggestions for improvement, but also gives an example of how monitoring and supervision should be carried out in each organization.

The audit department of RMDC visits each partner organization at least twice a year. Besides, its credit department also visits each partner organization twice a year for regular inspections, as well as each time a new loan is demanded. They spend a whole day checking records in all the branches and cross-checking the smooth operation of programs in the field. Additionally, RMDC requires its partner organizations to produce monthly reports, on which it gives feedbacks. The partner organizations are grateful to it for such controls and timely feedbacks, from which they continuously learn. However, due to the lack of adequate number of staff, RMDC is encountering difficulties in providing supervision services to its partner organizations effectively.

4. Conducive environment

Promoting a microfinance-friendly environment, spreading best practices between MFIs, developing the market, and carrying out studies are among the major activities of RMDC. Its contribution to the development of the microfinance industry is well acknowledged. It interacts with a wide range of institutions at the grassroots and higher levels—government and nongovernment, and national and international—through seminars, workshops, and interaction programs. Its contribution is noted for educating the policy makers, politicians, top government officials and professionals of development fields on essentials of microfinance and its importance for poverty reduction.

RMDC does not impose on its project organizations any restriction or condition regarding the lending rate to the clients, microfinance model, or selection of clients. However, by disseminating and suggesting best practices, RMDC homogenizes the operations and systems of its partner organizations.

Exposure visits are probably the most common and effective instruments to disseminate best practices. A large percentage of the staff of partner organizations benefited from exposure visits and on-the-job training in Swabalaman Bikas Bank, considered one of the best-performing MFIs in Nepal. Moreover, exposure visits to Bangladesh are often organized for MFIs' directors and managers.

RMDC produces quarterly newsletters both in Nepali and English with articles related to microfinance issues in Nepal and other parts of the world, which are distributed to all partner organizations as well as to other actors of microfinance.

RMDC goes for best practices and lobbies and works with government and donors to improve the legal and institutional frameworks in Nepal. It advises the Government on regulations and policy. Under its recommendation, the Financial Intermediary Act has been changed, allowing MFIs to accept savings from clients and requiring them to renew their license every 3 years rather than every year. More recently, the central bank has allowed development banks to expand their operation to five additional hill districts and has backed the possibility of creating a fund that would be invested in shares of MFIs. According to RMDC—the promoter of the initiative—the fund will represent a profitable and safe investment option for commercial banks and even foreign investors, which is a step toward commercialization of MFIs. This might increase MFIs equity base that will allow them to increase their borrowings and speed up operations.

F. Financial Performance

RMDC's financial performance partly depends on the financial performance and potentiality of its partner organizations. Deliberately and rightly, RMDC chooses its partners according to their performance, keeps them under strict controls, and continuously trains them to improve their financial management. Consequently, RMDC's partner organizations have reached a very satisfactory level of performance. Their operational self-sufficiency was 127.7% in FY2006.

RMDC has been making profits since the first year of its operations and has increased the profitability every year, demonstrating cost control and efficiency. Table 5 contains some performance indicators calculated for FY2006.[10]

The operating expense ratio (OER) is the most commonly used indicator of efficiency. The figure depends on the loan size: tiny loans are more expensive to make than large loans. For this reason, MFIs usually have OERs above 10% while commercial banks, well below 5%. With regard to this indicator, the performance of RMDC appears noteworthy: its OER is 2.31%. This is largely due to lower staff costs in RMDC.

Despite the excellent repayment rate of its partner organizations, RMDC has been increasing its loan loss reserve by 1% each year, reaching 4% in FY2006. In addition to reducing the amount of profits subjected to taxation, this provision benefits RMDC's fallback position and reputation.

Table 5: RMDC's Performance in FY2006

Efficiency ratios	**%**
Financial expense ratio	3.73
Loan loss provision expense ratio	1.69
Staff expense ratio	1.74
Operating expense ratio	2.31
Staff expenses to total operating expenses	75.59
Portfolio quality ratios	
Current repayment rate	100
Cumulative repayment rate	100
Past due rate	0
Loan loss reserve ratio	4
Profitability ratios	
Yield on portfolio	4.91
Return on assets	1.17
Return on equity	10.21
Operational self-sufficiency	158.82
Other ratios	
Outstanding loan to total assets	43.13
Average outstanding loan per partnership organization	14,310,112

Source: RMDC's Annual Report.

[10] These as well as the following indicators have been calculated on the basis of provisional balance sheet, cash flow statement and profit & loss account. Therefore, they should only be taken as rough indicators.

G. Sustainability

RMDC does not receive any grant for its operating costs. In such cases, the critical question is: Would the institution be able to maintain itself and grow, should continuing subsidies be no longer available? To determine this, normal financial information must be adjusted to reflect the impact of the present subsidies. Three subsidy-adjusted indicators are in common use: Financial Self-sufficiency, Adjusted Return on Assets, and the Subsidy Dependence Index, which is presented in table 6.

Table 6: Financial Sustainability

Indicator	Value (%)
Financial Self-Sufficiency	103.000
Adjusted Return on Assets	0.095
Subsidy Dependence Index	Negative

Source: Consultant's Compilation.

RMDC receives a huge amount—almost NRs27 millions—of subsidies in the guise of grant-fixed assets and credit funds. High inflation, which consumes more than eight million each year, erodes the value of its equities. It currently receives soft loans at 2% interest rate from the Government. However, concerns have been expressed about the ability of RMDC to continue its operations and expand its outreach once the Rural Microfinance Project is terminated in June 2007. In the event of this support terminating, it would have the choice between borrowing from the commercial sources and taking public deposits. RMDC is preparing to tackle this phase and become sustainable by making appropriate arrangements. The continuation of the credit program will be guaranteed by the revolving nature of its fund. Moreover, as long as the deprived sector lending program is not phased out by the central bank of Nepal, RMDC will be able to get loans from commercial banks at an interest rate of about 3%, which might then be lent to MFIs at 5% or 6%.

As for the costs of capacity-building activities, RMDC is currently seeking approval from ADB and the Government of Nepal to open a fund with the unutilized resources originally allocated to external consultancies. The interest from such a fund could finance the institutional support to MFIs. RMDC has also increased transfers from annual profits to the Microfinance Development Fund, which was established to channel resources to develop the microfinance sector. The fund currently amounts to NRs3.5 million. Moreover, RMDC is seeking alternative sources of funding among international organizations. Finally, the increase in the number of partner organizations and loan size will provide RMDC with increased interest income from loans.

H. Comparison between the Microfinance Sectors in Bangladesh and Nepal

There are two major differences between the microfinance sectors in Bangladesh and Nepal: their compositions and the role of the governments in them.

The microfinance sector in Bangladesh is composed of organizations which are homogeneous in terms of type—mostly in the guise of NGOs—but different in terms of dimensions. There are at least 1,000 NGOs/MFIs (MRRU 2005). The top 20 NGOs/MFIs mobilize over 85% of total savings, disburse 87% of outstanding loan, and get huge amounts of the funds from donors as well as from Palli Karma Sahyak Foundation (PKSF). Three very large MFIs alone cover 65% of the sector's savings, and 70% of outstanding loans. The Nepali microfinance sector by contrast is made up of cooperatives, banks, NGOs, self-help groups, etc. and is not dominated by big actors—despite there being MDBs who are bigger in terms of operations and outreach. Despite those differences, both countries are characterized by a large number of small institutions, many of which are weak or technically insolvent. They lack the capacity to fulfil basic reporting requirements and therefore they cannot access funds from donors and national wholesale lending institutions.

The microfinance sector in Bangladesh has a longer history than its Nepal counterpart and has developed almost spontaneously, without direct government support or intervention. Only under the pressure of microfinance actors did the Government get involved in promoting consolidation of MFIs and achieving economies of scale in their operations. The main instrument for achieving such goals has been the apex institution PKSF and the Microfinance Research and Reference Unit (MRRU) established in the Bangladesh (Central) Bank to help formulate uniform policy guidelines for the microfinance sector. Recently, microfinance practitioners have lobbied the Government to create a regulatory framework which to them would mean recognition and support. It has taken 5 years to formulate and pass a new ordinance that will establish a regulatory body made of government officials. Although its features are not yet completely clear and public, the new ordinance is not expected to lead to major changes for MFIs. For example, the NGOs/MFIs will not be required to transform into pure financial institutions, but will be allowed to keep their NGO structure and social programs. The scope for development in Bangladesh where population density and accessibility of rural areas do not represent a constraint or additional burden on transactions costs is, however, very different from what it is in Nepal. The perceived need for the Government of Nepal to address the apparent failure of the market to provide much needed financial services in rural areas was hence greater. The Government has implemented many microfinance projects and urged private sector commercial banks to participate in the development of the sector through the priority- and deprived-sector lending programs. However, direct intervention has not been accompanied by a facilitation role: the Government did not consider the needs of the microfinance sector when it developed the current financial regulations. As a consequence, MFIs face problems as they are growing and, at a certain stage of development, tend to transform into bank.

I. Learning from PKSF Experience

It seems that RMDC has much to learn from the experience of well-established organizations like PKSF of Bangladesh in obtaining huge amounts of soft loans from the Government and international donors at most concessional terms.

PKSF is more directly involved in grassroots activities because it takes decisions regarding the programs together with its partner organizations. It sponsors separately rural microcredit, urban microcredit, microenterprise loan, seasonal loan, and microcredit for the hardcore poor, “prime” project. In addition to program differentiation, PKSF classifies its partner organizations into three categories: OOSAs (small organizations operating in small areas), POOSPOs (OOSAs with the potential for qualifying to BIPOOL category) and BIPOOLs (big organizations operating in large areas). The terms and conditions of loan are different for the different categories: OOSAs and POOSPOs are charged 4.5%, while BIPOOLs which are supposed to be more efficient are charged 7%; in both cases, it is a declining system.

PSKF avails huge amounts of soft loans at 1% interest rate and grants from the Government and international donors (World Bank, ADB, International Fund for Agricultural Development, United States Agency for International Development), and will continue to avail them because its role is recognised and strongly supported as part of the national poverty reduction strategy.

PKSF has already provided half of its partner organizations with financial management system software to maintain their account information systems more efficiently. It often makes its premises available for meetings on microfinance issues, encourages visits from practitioners from other countries, and publishes a wide range of materials.

PKSF could be a good model for RMDC for its further growth. RMDC needs to develop software for microfinance operation. Besides, it needs to expand its operations, increase the number of partner organizations, and differentiate the services to meet the needs and conditions of different actors. RMDC also needs to overcome the big constraint represented by lack of funds; in this context, it could benefit from greater support from the Government and the donors for its crucial role in the fight against poverty and for the development of the microfinance sector and the economy in general.

III. THE IMPACT OF THE RURAL MICROFINANCE PROJECT

A. Methodology

This section is based on the observation and analysis of five MFIs in the hills and the Terai districts, including Balambu of Manushi, Kathmandu; Women Support Cooperative of Balajù, Kathmandu; Swabalamban Bikas Bank of Bhimphedi, Makawanpur; Swabalamban Bikas Bank of Dhalkebar, Dhanusha; Forward of Duhabi, Sunsari; and Harakpur of Jeevan Bikas Samaj, Morang. Different types of institutions with different levels of operations and areas of work were chosen to give the most comprehensive picture. The main source of information was primary data collected during field visits to six communities. The research tools used were consultations with workers and directors of MFIs, focus group discussions with microfinance clients and semi-structured interviews with some of them. Information on the clients was also gathered from the records kept by each of the institutions visited.

B. Characteristics of the Selected Partner Organizations

Table 7 summarizes the main characteristics of the five selected MFIs. The MFIs were founded at different times, but all have exclusively women clients. PGT and skills development training are most common among these MFIs, but some MFIs like Manushi, Women Support Cooperative

Ltd. and Forward provide additional services in health, hygiene, and various other areas. POs working in urban areas evidently have better market opportunities than those operating in rural and remote areas. However, they find it difficult to move to more remote areas and establish cooperation and agreement with other MFIs working in the same area. More information about the services provided by the selected partner organizations, their profile, and performance is available in Appendix 2.

Table 7: Main Characteristics of Selected Partner Organizations

Name, District and Year Founded	Brief Description	No. of Members (Mid July FY 2006)	Nonfinancial Services	Relative Degree of Economic Opportunities
Swabalamban Bikas Bank 2002	Development bank, all women members Inherited microfinance operations from CSD RMDC's PO since 2002	61,739	PGT and skills development Training	Hills centers more remote but still served with basic infrastructure
Manushi Kathmandu 1991	NGO, all women members.Started microfinance operations with RMDC, in 2003	3,049	PGT, skills and enterprise development training, health and sanitation	In Kathmandu City, good opportunities for industry and trade, and schooling and infrastructure available
Women Support Cooperative Ltd. Kathmandu 1999	Cooperative registered, all women, self-promoted, started microfinance in 2002, RMDC's PO since 2003	2,263	PGT, training for skills development, women's rights, gender and development, literacy, informal education, nutrition health and hygiene, childcare centre	3/4 of centers are located in rural areas of Kathmandu where market opportunities are quite low; urban centers are better off
Forward Sunsari and Morang 1995	FINGO, all women members started microfinance operations in 2002 when became RMDC's PO.	13,939	PGT, training for skills development, irrigation, health, women empowerment, etc.	Opportunity of employment in industry in Biratnagar, and of trade in towns
Jeevan Bikas Samaj Morang 1998	FINGO, all women members. Started microfinance operations in 2002 when became RMDC's PO.	10,096	PGT and skills development Training	Remote villages, close to the border with India (factor for migration)

CSD = Centre for Self-help Development, FINGO = Financial Intermediary Non-Government Organization, NGO = nongovernment organization, PGT = pre-group training, PO = partner organization, RDMC = Rural Microfinance Development Centre

Source: Consultant's Compilation.

C. Major Impacts

Drawing conclusions on the impact of microfinance programs on the beneficiaries is difficult as the outcomes depend on the actions undertaken by the loan users, location, and drift of events. Yet an effort has been made to assess the impact of the project on the beneficiaries in terms of savings and investment, loan utilization, improvement in the conditions of the poor, and women empowerment.

1. Savings and Investment

Voluntary savings, which are often withdrawn to pay loan instalments in dull seasons and to meet unexpected household expenses, are still very small. Women value the possibility of frequent but small deposits in the program. They perceive savings as a means to protect income from their husband's demands. Among the compulsory savings, center fund savings represent a good instrument for households to reduce vulnerability and consumption volatility and increase their ability to face external shocks. Clients get loans against these savings in case of emergencies. However, the amount of such loans is often pretty low and not tailored to meet the specific needs. The majority of people enjoying microcredit use it for petty trading or other small activities. Often market constraints on the expansion of such activities contribute to restricting poor women's move from survival activities to expanding businesses.

2. Loan Utilization

Table 8 summarizes the information on the use of loan money, profits from the business, and savings made by 23 of the project beneficiaries interviewed. It was gathered that the traditional activities like agriculture and livestock breeding are still the most common. Businesses are found more frequently near the cities, where markets are larger and transport services are available. Agricultural products are often sold at low prices; only a few communities grow cash crops such as mushrooms and sell them in a niche market with higher profits.

Many clients used the loan money at some point to build or renew their house. Other common expenses are on education and daily household needs. Despite the fact that negligent business practices, inept cash flow management, or overspending have been found only in rare cases, ploughing profits back into their business was also limited. The main cause for lack of profit reinvestment is the lack of surplus after meeting all necessary household expenses and paying back the loan.

Table 8: Uses of Loans, Profits, and Savings

Use	Loans Number of Clients	Profits Number of Clients	Savings Number of Clients
Business	9	2	
Livestock	11	2	
Agriculture production	8		
Family enterprise[1]	3	1	1
Assets purchase/repair	4	4	4
Social purpose[2]		2	4
Pay-off loans[3]	3	3	4
Education	1	6	3
Medical purpose	3	1	7
Daily living expenses		6	1

[1] Enterprise of a family member other than the client
[2] Social purposes include funeral and wedding expenses, helping friends, festivals
[3] Pay-off loans refers to previous loans from other sources as well as instalments of the program loan
Source: Consultant's Compilation.

Clients faced temporary repayment problems, as Table 9 suggested. Although most respondents mentioned business income as the major source of repayment, many admit that it is not always sufficient. In difficult periods, savings are used—both savings deposited in the program and those kept in the house—or credit is taken from relatives and friends. There has been no case of distress sale of assets to repay a loan. In few cases, the only source of repayment is the income from the husband's or son's activity—what is called "other activities."

Table 9: Sources of Repayment of Loans

Source	Number of Clients
Income from enterprise	10
Savings	4
Borrowing from other sources	4
Other activities	4

Source: Consultant's Compilation.

Reasons for repayment problems can be various but seasonality has been found to affect all kinds of economic activity. Agriculture and livestock are clearly seasonal. Also, businesses such as tailoring are seasonal, with higher incomes during festivals. The only activity that seems immune to income fluctuation is food retail.

On average, the income of the households increased by 3.7 times; but in some cases, it shot up to even seven times their value at the time the clients joined the program. Very little information is available on assets other than land and livestock, but the observation of visited households suggests that the clients often have a substantial number of objects, including expensive electric facilities. Housing condition of the clients improved in many cases although not always, thanks to the program: there is evidence of borrowing from other sources to build or improve the house.

As far as the activities are concerned, the most common change is the establishing or expanding a small business. In a few cases, families buy small land plots that free them from having to work as daily labor in others' fields. However, clients still have very small plots of land. The reasons for that is unequal distribution of land. Big landowners and moneylenders easily buy or appropriate the land of small farmers facing difficulties (Appendix 3).

3. Targeting the Poor

Microcredit programs seem to be successful throughout the country, but more successful in the Terai plains than in the hills. This is due to the favorable access the Terai area enjoys to a market where borrowers get immediate returns for their products. But this is not the sole reason. Since MFIs need regular interactions and relations with their clients, they go for easier modes of transportation, which the Terai area offers. Moreover, the Terai also provides better efficiency in their operation and fund management, which the donor agencies demand. The targeted clients are all poor. Microfinance in general is supposed to target the poor and the poorest. In Nepal, the Central Bank requires MFIs to serve households with a maximum annual income of NRs5,500 per capita, considered as a poverty threshold. Many MFIs have introduced additional criteria that put a ceiling on assets: a maximum of 15 *ropani* of land in the hills, and of 1 *bigha* (equal to 13 ropani) in the terai.

4. Women Empowerment

Microfinance programs aim at women empowerment and contribute to it in different ways. The women treated their savings as a means of building up an asset base and gaining a certain independency from husbands. Women's participation in the program changed their lives: before they used to spend their days sitting idle and sometimes going to the field as laborers; now they have their own business and are more independent from their husbands.

Over 400,000 clients of RMDC's partner organizations are women. Women's increased access to microfinance services enabled them to make decisions about savings and credit use; it gave them know-how to set up microenterprises, and increased their incomes. This helped their social and political empowerment as well, though these are not the primary goals of microfinance programs.

Self-confidence and greater influence in household decision making is one of the major outcomes of the program. One respondent recounted how she gained confidence in interacting with strangers. She used to hide in the house when she saw faces; now she is no longer afraid. Another respondent stated how she used to fight with her husband because of financial problems, and how they treat each other now more respectfully.

The clients who attended literacy classes mentioned that the ability to read and write, even only their names has enhanced their levels of self-confidence; as a result, they are less hesitant to voice their opinions and speak in public. Individual women who gain respect in their households act as role models for other women and spark off a wider process of change in the community's, and men's, perceptions.

IV. CONCLUSION AND RECOMMENDATIONS

A. Conclusion

RMDC has made significant contributions to promoting and developing the microfinance sector in Nepal. It developed 38 MFIs from scratch, supported 8 for institutional strengthening, and provided potential institutions with exposure visits to best practices and gave these basic orientation training. It has cultivated professionalism in its partner MFIs, through intensive capacity-building programs. Besides, it has cultivated strong commitment for financial sustainability among its partner organizations. As a result, its partners' staff and institutional capacity has improved substantially. Its partner MFIs have proved that without donor supports or subsidies, they can sustain on their own.

Through seminars, workshops, and interaction programs, RMDC has been educating the policy makers, politicians, top government officials, and professionals of development fields on the essentials of microfinance and on its importance for poverty reduction and women empowerment. It advises the central bank and the Government formulate appropriate policies and regulations on microfinance.

RMDC's loan repayment rate with its partner organization is 100% from the very beginning. This has been possible due to close supervision after loan disbursement and institutional development supports. Microfinance services of its partners have reached the poor and the poorest families.

All clients (over 400,000 clients) of RMDC's partner organizations are women. Besides economic progress, the women clients have also improved their confidence, leadership, decision-making power, and entrepreneurial skills after participating in the microfinance program. In this respect, RMDC's microfinance program could also be said to be an inclusive program, as all deprived communities and races have been served by its partner organizations.

However, RMDC has been facing challenges, such as coordinating MFIs. It has to reckon with the lack of efficient accounting and management. Both RMDC and its partner organizations[11] do not have computer software and depend upon manual systems, which are cumbersome and time consuming. Many MFIs are still at an earlier stage of development, with gaps in their systems, financial management, leadership, staff development, and organizational structure. They still lack adequate subsidized capital, and qualified and experienced staff. Some MFIs are also weak in business planning, financial discipline, and staff management. They limit the saving collection and make it difficult to create new centers and achieve targets as in business plan. Quite often, they shy of working in remote areas and network with similar organizations.

[11] Except for two big organizations, Chhimek Bikas Bank and Nirdhan have their own software.

B. Recommendations

The above indicators or achievements show that RMDC has been moving ahead on the right track as a leading microfinance organization. However, there is still a wide scope for improving the situation at various levels.

- RMDC should contribute more to promoting and developoffing the microfinance industry in Nepal with support from the Government and donor agencies. It should work for providing microfinance services in the districts not yet covered by MFIs especially in the hills and mountains, and for intensifying its services to the poorest in the areas where the services are there already.

- RMDC should manage funding to develop software for microfinance operations for its own office and for its partner organizations. The purchase of its own building would represent proof of long-term commitment to operate as an apex institution.

- More support is necessary to involve a larger number of weak MFIs whose staff members are often not adequately qualified. To meet this need, RMDC should increase both the capital channelled into training and the number of its staff employed in such activity. Its intervention is required also to coordinate the operations of its partner organizations.

- MFIs should give up their reluctance to work in the most remote areas and continue to support the poor and the poorest. Besides, programs should also be designed for the small entrepreneurs just above the poverty line who are not covered by the formal financial sector.

- Along with skills development, social programs should be implemented and integrated with microfinance. Given the difficulties to cover the cost of social programs with their own funds, MFIs should explore opportunities of partnership with NGOs and funding from donor agencies. MFIs should also attract funding from commercial sources. Increasing the size of operations is also fundamental to achieve scale advantages, reduce costs, and improve performance.

- A system of data collection could be designed and regular screening of targeted communities carried out to track the evolution of the living conditions of the clients, identify the impact of microfinance programs and eventual new needs.

- A second microfinance project should be initiated to give continuity to the ongoing services and activities.

NEPAL'S FINANCIAL REGULATIONS

The current legal and policy framework consists of the old priority sector and deprived sector systems, and the more recent initiatives undertaken under the Financial Sector Reforms Program. The new initiatives include:

- the new NRB Act (2002) and the ongoing modernization of its operations;
- the restructuring of SOCBs and of ADBL;
- the BFIO (2004);
- the Company Ordinance of 2005, replacing the Company Law Act of 1997, and reform of accounting and auditing to bring them in line with international standards; and
- the new debt recovery laws, including modernization and establishment of commercial courts and a secured transaction register.

The new NRB Act that replaced the 1995 Act specifies NRB's objectives as: (i) the formulation of effective policies to achieve monetary and price stability; (ii) development of a secure, healthy, and efficient payment system; (iii) regulation, supervision, and inspection of banking and financial institutions; and (iv) promotion and achievement of a credible banking and financial system. Hence, NRB's functions have been narrowed down to include mainly those functions relating to macroeconomic management. The new Act prohibits NRB from purchasing the shares of any central bank or financial institution,[12] and eliminates NRB responsibility for bailing out MFIs and its role as lender of last resort. However, NRB maintains the power to direct licensed institutions with respect to interest rates, margins, and allocation of credit among sectors. Moreover, the supervision and inspection of the banking and financial system has become a burdensome task for NRB, since all institutions engaged in commercial banking under the Commercial Banking Act and other financial institutions operating under other laws have been brought under its purview. Despite the removal or restriction of many refinance programs, NRB still plays a developmental role through a special fund, the RSRF which operates with a regime of below market rates. NRB's refinancing role through the RSRF has been strongly criticized as an obstacle to the steady development of other apex institutions and the market orientation of the rural finance and microfinance sectors. The justification for continued operation of the RSRF is based on the need for serving weak institutions that cannot conform to the eligibility criteria of RMDC. The continued presence of such provisions is perhaps an admission by policy makers that Nepal's financial system is not ready for full liberalization owing to a lack of physical infrastructure and other limitations which require continued direct government involvement. The challenge is for a full withdrawal of NRB from the rural finance and microfinance sectors, and the consolidation of private institutions. However, the authorization by NRB of many small and weak institutions is unlikely to bring about the desired change, and creates the risk of multiplying institutions that would place an intolerable burden on the regulator.

The privatization of SOCBs—to be realized between 2002 and 2007—and restructuring of ADBL are likely to strengthen their urban bias and lead to far-reaching adverse repercussions on the rural finance sector.

[12] That would bring it into conflict of interest situations of player and referee in the financial field.

The BFIO has been introduced as a single Depository Act encompassing all financial institutions to solve problems like weak governance, cross-ownership of financial institutions without adequate regulatory control, lack of transparency, inadequate disclosure, poor accounting and auditing, and lack of proper enforcement—all of them arising due to limitations in the Commercial Bank Act of 1974 and the Company Law Act, and weaknesses in the accounting and auditing profession. The BFIO unifies five separate banking laws under a single umbrella act and strengthens NRB's supervisory powers over the financial sector. It helps streamline and modernize the licensing process, precisely defines what a bank is and identifies clearly the role of NRB in the establishment, operation, and closure or liquidation of banks. It also improves the governance of banks by clearly specifying the duties and responsibilities of promoters, directors, and management; and provides for greater accountability and transparency by tightening up on provisions governing accounts, audits, and disclosure. MFIs—except NGOs regulated by the FINGO Act of 1998, and cooperatives regulated by the Cooperative Act of 1991—are regulated by Section 80 of the ordinance that prescribes the financial transactions in which a class D institution could engage.[13]

The Company Ordinance of 2005 aims to foster private sector participation and labor market flexibility, thanks to the establishment of the Accounting Standards Board, the Auditing Standards Board, and the Institute of Chartered Accountants Nepal. The reforms for capital markets and for accounting and auditing are relevant for the rural finance and microfinance sectors, and should have a salutary impact on the standards of reporting among licensed rural MFIs.

While NRB is responsible for supervising the 34 licensed cooperatives, the remaining are under the responsibility of the Department of Co-operatives within the Ministry of Agriculture and Cooperatives. There is a general consensus that the Department of Co-operatives is ill equipped to perform the required supervisory function. Moreover, the cooperative legislation contained in the Cooperative Act of 1991 is outdated and provides an easy avenue for the wrong type of players to enter the field of savings and credit, and build significantly large operations without being subjected to any form of regulation and supervision. Primary society should remain small in terms of members and area of jurisdiction to ensure member participation in activities, accountability of directors and officials, and peer support and pressure to achieve better loan recovery.

[13] These include grant of short-tem loans to groups or individual members who have continuously maintained fixed deposits for a period to be prescribed by NRB; obtaining a loan or donation from a licensed financial institution or donor; acceptance of deposits from members with or without interest; undertaking social mobilization and provision of technical and skills education.

SELECTED MFIs, THEIR SERVICES AND PERFORMANCE

Among the selected MFIs, only Swabalamban Bikas Bank was operating microfinance before joining RMDC. It is perhaps one of the best-performing and developed MFIs in Nepal, and is often chosen by RMDC as best practice to be followed by the other partner organizations. The other four organizations became MFIs only at the initiative and with the support of RMDC. Table A2.1 compares the services provided by them.

Table A2.1: Services Provided by Selected Partner Organizations

	Swabalamban Bikas Bank	**Manushi Cooperative**	**Women Support**	**Forward**	**Jeevan Bikas Samaj**
Types of loan	General 25% interest Seasonal 25% interest Center fund 18% interest Microenterprise with collateral Foreign employment 25% interest Education25% interest	General 10% flat interest Seasonal 10% flat interest Center fund 8% flat interest	General 12.5% flat interest Seasonal 12.5% flat interest Center fund 12.5% flat interest	General 24% interest Seasonal 24% interest Center fund 12% interest JFPR loans	General 24% interest Special 24% interest Project 24% interest Domestic
Types of compulsory savings	Center fund 5% of loan amount Group NRs10	Center fund 5% of loan amount Group NRs25 Interest 8%	Center fund 5% of loan amount Group NRs 15–50 Interest paid 8%	Center fund 5% of loan amount Group NRs10 Joining fee NRs25	Center fund Group NRs10
Types of voluntary savings	Personal Welfare Fund Education Pension scheme (10 or 15 years) Festival	Personal	Personal	Personal Welfare Fund Child	Personal Welfare Fund Daughter education fund
Insurance	Life (member and husband) Housing Livestock	Life (member and husband)		Life (member only) Housing	

Source: Consultant's Compilation.

Most of them use PWR to identify target households, allow only one woman from each family to be member, organize clients in groups of five members and centers of eight groups maximum, apply group liability, charge similar annual interest rates (18–25%) and have similar repayment schedules, similar ceilings for loans, similar interest rate paid on savings (6–8%). RMDC played a role in homogenizing the services of its partner organizations: it did not impose any rule, but it promoted the dissemination of best practices, adopted by the partner organizations according to their capacity. The following table presents a comparative performance of selected partner organizations.

Table A2.2: Comparative Performance of Selected Partner Organizations

	Manushi	WSC	JBS	Forward	SB Bank	All POs
Staff Productivity Ratios						
No. of center per field staff	13	7	21	18	19	14
No. of members per field staff	339	206	561	465	506	400
No. of borrowers per field staff	273	139	469	408	392	329
Amount of loan outstanding per field staff in NRs	1,776,913	953,989	1,912,566	2,130,077	2,643,775	2,525,515
Percentage of field staff to total staff	82	79	46	52	63	61
No. of center per branch office	118	41	55	46	57	55
No. of members per branch office	3,049	1,131	1,442	1,161	1,543	1,543
No. of borrowers per branch office	2,458	764	1,206	1,019	1,195	1,272
Amount of loan outstanding per branch office in NRs	15,992,221	5,246,940	4,918,026	5,325,193	8,063,515	9,742,782
Financial Efficiency Ratios						
Staff expenses	592,106	526,132	1,346,375	2,548,163	18,967,880	79,855,695
Total operating expenses	1,438,143	1,314,824	4,261,652	7,585,523	47,430,203	253,939,765

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	Manushi	WSC	JBS	Forward	SB Bank	All POs
Financial expenses in NRs	585,209	436,321	1,188,062	2,527,291	17,692,662	78,900,977
Staff expense to total operating expense	41%	40%	32%	34%	40%	31%
Cost per client in NRs	472	581	422	544	768	688
Portfolio Quality Ratios						
Cumulative repayment rate	100%	99.65%	100%	99.86%	99.82%	99.45%
Past due rate	0%	1%	0%	0%	0%	2.7%
Other Ratios						
Operational self-sufficiency	154.85%	161%	134.36%	142.39%	160.5%	127.77%
No. of member dropout	458	197	409	319	42,252	1,077
Borrower to member	81%	68%	84%	88%	77%	82%
Amount of loan outstanding per borrower in NRs	6,506	6,863	4,075	5,222	6,746	7,658
Amount of savings balance per member in NRs	2,220	2,521	967	1,069	2,371	2,067

JBS = Jeevan Bikas Samaj, PO = partner organization, NRs = Nepalese Rupees, SB Bank =Swalamban Bikas Bank, WSC = Women Support Cooperative.
Source: Consultant's Compilation.

The good performance of SB Bank and the wide range of services provided are in part due to its long history: despite being established only in 2002, SB Bank took over the operations that CSD had started in 1996. It inherited well-performing centers and branches—already close to their break-even point and further improved the number and quality of services, and expanded to two new districts.

Forward and Jeevan Bikas Samaj carry out more limited microfinance operations. However, their short experience has to be considered. They started proper microfinance only in 2002—when they became partner organizations of RMDC—replacing the credit and savings model with the Grameen one. The process of adaptation has not been easy for them and for their clients. Given these conditions, their performance is very satisfactory and their growth rate very high. If they continue getting support from RMDC, they will surely be able to expand and enhance their services.

Manushi is an NGO that has been focusing for 15 years on enterprise development and fair trade, including commercialization of traditional Nepali products in different countries around the world. These activities have yielded great results and allowed the organization to be self-sufficient and sustainable. The microfinance program was added only in 2002 with the aim of providing basic financial services to poor women in urban areas and assisting them in their economic and social empowerment. The range of services provided has been limited and the outreach low—mainly because operations have been restricted to Kathmandu city—but an expansion phase is planned for the next years.

Women Support Cooperative (WSC) is a cooperative aimed at empowering women initially though training and education, and later through economic activities as well. In this perspective, it adopted microcredit with loan from RMDC. Despite operating microfinance for 4 years, WSC still faces problems in managing this activity and in expanding its operations in rural areas.

MICROFINANCE PROGRAMS AND THEIR IMPACT

Table A3 provides information on four variables of project beneficiaries' livelihoods. Unfortunately, much of the data are missing. MFIs keep different and sometimes incomplete records on their clients at the time of selection, but the files of the interviewed clients could not be found.

Table A3 : Impact of Microfinance Programs on Beneficiaries' Income, Assets, Housing Conditions and Activities

	Monthly Income		Assets		House conditions		Household's activities	
Client	Before	After	Before	After	Before	After	Before	After
1		8,800			Stones/mud, straw roof	Stones/ cement, tin roof	Husband as labor on road	Agriculture for sale, husband as labor
2		10,500	6 ropani of land, 1buffalo, 1 goat, chickens	6 ropani of land, 2 buffalo, 3 goat, chickens		3 floors, tin roof	Husband as driver, livestock	Agriculture for sale, livestock, husband and sons as drivers
3		3,000	4 ropani of land	4 ropani of land	Brick/mud, straw roof	Brick/mud, straw roof	Husband in agriculture, son as labor	Son in agriculture she sells
4		8,000				Stones/cement		
5		12,500	½ bigha of land, 1 bicycle, 1bed	1 bigha of land, 1 shop, 3 goats, TV, radio, DVD player, cupboard, fan, watch, decorations	Bamboo/ mud, straw roof	Stones/cement, tile roof, water tap, toilet	Agriculture	Agriculture livestock, retail shop
6		6,500	5 dhur of land, 2 chairs, 2 beds	5 dhur of land & 10 katha of others'	Bamboo, straw roof	New		Livestock, husband and son as labor

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	Monthly Income		Assets		House conditions		Household's activities	
Client	**Before**	**After**	**Before**	**After**	**Before**	**After**	**Before**	**After**
7		17,000	1 katha of land, 4 chairs, 2 beds, 1 watch	1 katha of land, 1 radio, watch, furniture	Bamboo, straw roof	New	Book shop, husband as teacher	Book shop with telephone, fax machine, photocopy machine; husband as teacher
8		7,500	10 dhur of public land, 1 radio, 1 watch, 2 chairs	10 dhur of public land, 1 radio, 1 watch, 4 chairs, 2 tables, 1cupboard	Cement, tile roof	New	Tailor shop, 1 sewing machine	Tailor shop, 3 sewing machines
9		8,500		10 dhur of land, shop		Cement, tin roof	Husband in factory	Tailor shop, husband in factory
10		5,800		1.5 katha of land				Hotel, furniture shop
11		8,500		1 katha of land, TV, fan, decorations, 2 bikes		Bamboo, straw roof but big	Labor in field, husband in municipality	Livestock, husband in municipality
12		9,500		No land, 4 chickens			Husband as labor in field	Husband in bike-repairing shop, livestock
13		8,400		10 dhur of land, 1 ox		New, tin roof		Husband as labor in field, vegetable sale
14		10,000	10 katha of land borrowed, 2 ox, 1 buffalo, 2 goats	10 katha of own land, sharecropper in land, 2 oxen, 1 buffalo, 2 cows, shop, shed for animals	2 houses with straw roof	House with tin roof, shop with straw roof	Labor in field	Retail and tea shop

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	Monthly Income		**Assets**		**House conditions**		**Household's activities**	
Client	**Before**	**After**	**Before**	**After**	**Before**	**After**	**Before**	**After**
15		9,000	2 goats	10 dhur of government land, 5 katha in sharecropping	1 house with straw roof	New house with straw roof	Labor in field	Livestock, husband and son as labor in field, agriculture for family
16		3,000	15 dhur of land, 7 goats, 2 cows, 1 bicycle	15 dhur of land, 10 goats, 2 cows, 2 bicycles	3 houses with straw roof	in field, livestock		Only husband as labor in field, livestock
17	2,100	11,400	1 ropani of land, 2 chickens, 4 goats, 1 radio, 3 chairs, 1 table, 2 beds	3 ropani of land, 1 TV, 1 radio, 1 cupboard and furniture	Tile roof	New house of bricks/ cement with concrete roof, old house with tile roof, 3 floors each	Agriculture	Shop
18	2,500	8,500	2 cows, 1 goat, 1 radio, 1 watch, 3 beds	½ ropani of land, furniture, TV	Bricks/ mud	Bricks/ mud, tile roof, 2 rooms and 1 kitchen	Labor in field	Agriculture, husband as carpenter
19	3,000	4,500	4 aana of land, 1 cow, 1 watch, 1 bed	4 aana of land, 1TV, 1 radio, furniture	Bricks/ mud, tile roof	Bricks/ mud, tile roof, 1 bedroom and 1 kitchen	Livestock, husband in service	Livestock, husband in service (temporary)
20	2,250	11,500	3 aana of land, 1 TV, 1 watch, 1 bed	Rented shop, 3 annana of land, 1TV,1 radio, 4 chairs, 2 tables, 3 beds.	Bricks/ mud, tile roof	Bricks/ mud, tile roof, only 1 room	Agriculture, husband in service	Retail shop/ Restaurant

Note: 20 dhur = 1 katha; 20 katha = 1 bigha; 13 ropani = 1 bigha
Source: Interviews, Observation, Client Records that MFIs keep.

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