



Best Practices in Nepal and Regional Standards in Microfinance



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Introduction

Though historically known as a peaceful and stable country, Nepal is currently facing a deteriorating law and order situation due to Nepal Communist Party Maoist activities. Most financial institutions are hesitant to serve the rural areas due to recent attack from Maoist. This threat is particularly worrying to commercial banks that have branches in rural areas and handle large sums of money on a day-to-day basis.

Nepal is one of the poorest country in the world and the poorest in the South Asia region with 38% people below poverty. Rural economy is based on agricultural activities (80% of total population is engaged in agriculture¹) that have very few opportunities for the growth of overall economy of the country. Around 58% of the total population in Nepal lives in hilly areas and most of the people in this area are poor, and have limited opportunities to improve their economic well-being. In recent years, microfinance has been recognized from development workers that it is also an effective tool for the reduction of poverty in the country. This has come about with an increasing realization that, in order to be successful both in outreach and sustainability, microfinance must move out of the traditional low equilibrium, welfare mode of much NGO activity and become a professional service. A number of the leading microfinance institutions (MFIs) in Nepal have started to move out of the traditional moulds of activity based on the Grameen Bank Financial System (GBFS) of Bangladesh, Saving & Credit Cooperatives (including SFCLs), Village Bank model, Self-help Groups-based financial services. As a result, there has been a considerable amount of innovation not only in the design of financial products/services and delivery systems employed by MFIs, but also in other operational practices that includes:

- Institutional strengthening including good governance
- Streamlining of operations for cost reduction
- Offer of customer friendly financial products
- Management information system
- Human resource management policy (manual) with staff incentive system in place

Microfinance Programs/Models in Nepal

The microfinance arena has matured and received wide support from the Nepali government while attracting worldwide recognition for its accomplishments and innovations. Listed below are a brief summary of various programs, projects,

¹ Source: Agriculture Statistic Division

models, legal initiatives and other miscellaneous components of microfinance in Nepal.

I. Grameen Bank Model

Both the government and private sector organizations began replicating Grameen Bank Financial System, Bangladesh in Nepal in 1990 and have since been developed in all five-development regions.

The typical methodology is that peer groups of five unrelated members are self-formed and incorporated into village centers of up to eight peer groups. Attendance at weekly meetings and weekly savings contributions, group fund contributions and insurance payments are necessary. Savings must be contributed prior to receiving a loan and must continue for the duration of the loan term. The group fund is managed by the group and may be lent out within the group. Group members mutually guarantee each other's loans and are held legally responsible for payment by other members. No further loans are available if all members do not pay their loans on time. No collateral is required. Weekly meetings include self-esteem building activities and discipline enforcement.

Loans are made to individuals within the group by the local loan officer at the weekly/fortnightly meetings. However, only two members receive their loans initially. After a period of four to eight successful installment payments, two more members receive their loan. The final member receives her loan after another four to eight successful installment payments. The methodology typically provides pre-credit orientation but minimal technical assistance. Loan appraisal is performed by group members and center leaders. Branch staff verifies information and make periodic visits to client businesses.

Besides Nirdhan Utthan Bank Limited (NUBL), other significant Grameen replication/adaptation programs are:

- Regional Grameen Bikas Banks - 5
- Self-help Development Bank Limited
- Deprosc Development Bank Limited
- Chhimek Bikas Bank Limited
- NRDSC (an NGO involved in microfinance)
- Women's Cooperative Society
- NERUDO (an NGO involved in microfinance)
- TRWS (an NGO involved in microfinance)

II. Community Based Models

These generally include **Savings and Credit Organizations (SCOs)** that commenced with other development activities and ended up mobilizing the members' money to disburse loans. Some choose to register as formal Savings and Credit Cooperatives while others choose not to but continue providing

microfinance services in the community. This model has proven to be more effective in the hills and mountains.

III. Small Farmers Development Program (SFDP) and Small Farmers Cooperative Limited (SFCL)

This program was started by the Agricultural Development Bank Nepal with technical assistance from various bilateral and multilateral organizations. This is a group-based program targeting people with less than 0.5 hectares of land or per capita income not exceeding Rs. 25,000. The program is in the process of transforming from a development program to more sustainable Small Farmer Cooperatives.

IV. Productive Credit for Rural Women/Micro-credit Project for Women

Initiated in 1982, the Productive Credit for Rural Women (PCRW) program aimed to develop skills, income and status of women in rural areas. This program evolved into the Micro-credit Project for Women (MCPW), which involved banks, NGOs and Financial Intermediaries to increase the chance of the project becoming viable.

V. Village Banking Model

Initiated in Nepal in 1999 as a microfinance component of the Women's Empowerment Program of USAID implemented through Pact Nepal in partnership with local NGOs, Saving & Credit Cooperatives, Microfinance Development Banks. Village Banks (VBs) are community managed credit and savings associations established to provide access to financial services in rural areas, build a community self-help group and help members accumulate savings.

A Village Bank consists of its membership and management committee, which receives training from the sponsoring MFI. The MFI lends capital (external account) to the bank, which then on lends the money to its members. First loans are typically small, repaid weekly/fortnightly and short-term. The members' accumulated savings determines subsequent loans. Internal accounts are established with their own terms and interest rates. Regular meetings are held to collect savings deposits, disburse loans and attend to administrative issues.

VI. Financial Intermediary Non-governmental Organizations (FINGO)

In the 1990s, Nepal Rastra Bank began providing limited banking licenses to NGOs active in the microfinance arena. It allowed NGOs to borrow funds from local and foreign institutions to on lend to credit groups. The Act was revised in August 2002 to allow FINGOs to mobilize members' savings.

VII. Development Bank

A Development Bank is an equity-based company registered under the Company Act 1997 and provides the financial services under the Development Bank Act of Nepal, 1996. The Act allows MFIs (includes NUBL) licensed as development banks to:

- a) Mobilize deposits from regular clients in addition to lending to them.
- b) Be supervised and regulated by the Central Bank to enforce banking standards.
- c) Lend to a wider range of clients graduating from group-oriented programs and accept collateral for potentially larger and diverse loan products.

Best Practices

Based on various model discussed above, a great diversity of strategic approaches and operational practices are going on. But the common practices could be summarized as follows:

- **Strategy to cover poor:**
 - Most of the above mentioned programs/models have the client selection criteria that focus the poor households.
 - Starts with small loans
 - Provides repeat loans
- **Management practices:**
 - Committed to the Provision of Microfinance Services: MFIs are committed at the highest levels of management to the delivery of financial services to the entrepreneurial poor and to micro and small business owners who lack access to traditional sources of capital. Developed the business plan and dedicated the financial and human resources needed for implementation.
 - Maximization of efficiency of operations: MFIs have streamlined their lending procedures and developed accurate loan approval, disbursement and collection methods for maximum efficiency.
 - Thorough training of field staff: MFIs either have established training wing within their organization that regular organize training events or using external people to train the staff for microfinance best practices and operating procedures.
 - Affiliation with Networks: SCOs, Microfinance banks, FINGOs are taking membership with network organizations and are getting regular opportunities to learn/share with regional microfinance partners through practitioner forums and associations.
- **Institutionalization:**
 - Formal personnel rules in place for human resource management
 - Formal Accounting and loan tracking manual in place
 - Internal audit and external audit system in place
 - Loan and saving manual in place
 - Client and staff capacity building process in place

- **Vision for Growth:**
 - Outreach expansion: Most of the MFIs are now aware of being financially viable that ultimately require a reasonable number of clients to be served. In this regard, MFIs are deepening their program within the existing working area.
 - Branch expansion: SFDB/SFCL, Grameen replicates have developed their capacity to serve large number of clients through the opening of new branches.

- **Managing costs:**
 - Operating costs are being kept low and tightly managed by ensuring that each unit/branch is managed as a separate cost centre that must reach certain performance targets. Similar targets are set for individual staff and, although basic staff compensation packages are low, there are incentives built in to reward individuals that meet and surpass these targets (i.e. in terms of number of clients served, loan portfolio managed, repayment rates, etc.).

- **Charging appropriate interest rate:**
 - All programs are charging an appropriate interest rate to cover their cost (operating cost, financial cost, loan loss provision and inflation). A few government-sponsored programs (Banking with the Bishesheor, Mahila Jagriti Program) are not charging appropriate interest rate. These programs have very few numbers of clients at the moment. In case of SCOs administrative cost, especially personnel, is low because of volunteer basis support from the members and they have relatively small size of loan portfolio that normally could not generate enough interest income to cover the cost.

- **Offer of customer friendly financial products:**
 - The financial services offered by a MFI must be designed in response to the needs and capacities of the clientele, and not just be down-market versions of services provided to better-off clients. Terms and conditions of savings and loan products should respond to the particular needs of the client group. In this regards, MFIs have started continuous market research for product refinement/innovations.

- **Management information system:**
 - All models/programs are using either manual or computerized information systems. They follow generally accepted accounting principles (GAAP) so that they could produce reports on time. MIS produces the report that requires submitting regulatory authorities.

- **Risk Management:**
 - Establishment of Emergency fund or Social security fund by several MFIs

- Linkages with Deposit Insurance & Credit Guarantee Corporation for livestock insurance
- Loan repayment funds and savings collections are immediately disbursed in the field to prevent from robbery or attack from external people
- Public audit/interaction meetings/borrowers' workshops are conducted to motivate people for timely repayment of loan

Practices in Nirdhan Utthan Bank Limited

History

In April 1991, Nirdhan registered with the Government as a tax-exempt NGO and with the Social Welfare Council of Nepal.

Nirdhan started its operations with the Siktohan Village Development Committee (VDC) in Western Nepal near the Indo-Nepal border in March 1993 with one manager and one credit officer. Within five months, by July 1993, Nirdhan had 6 staff, 155 clients and an outstanding loan balance of US\$ 8,750.

Nirdhan obtained a limited banking license from the Central Bank of Nepal in 1994, which permitted Nirdhan-NGO to mobilize voluntary savings but only from its clients. By July 1996, Nirdhan had established eight branch offices with 79 employees serving 4,481 active loan clients. In July 1999, Nirdhan expanded into four regional offices and 21 branch offices with 170 staff serving 15,382 active loan clients.

In November 1998, Nirdhan NGO registered Nirdhan Utthan Bank Limited (bank for the upliftment of the poor) as a joint stock company. In April 1999, The Central Bank granted a license for NUBL to undertake banking activities under the Development Bank Act of 1996. In July 1999, Nirdhan NGO transferred all microfinance operations to NUBL. Shareholders of the bank are Nirdhan NGO (the parent organization), Himalayan Bank Limited, Nabil Bank Limited, Everest Bank Limited, The Grameen Trust Bangladesh, private individuals and Bank employees.

Geographical Coverage and Target Market

NUBL has received authorization from the Nepal Rastra Bank to operate within the 10 districts of Banke, Dang, Kapilvastu, Rupandehi, Nawalparasi, Palpa, Chitwan, Bara, Parsa, Rautahat and Palpa. NUBL currently operates in all 10 districts except for Dang.

Since its inception, NUBL has been exceptionally committed to serving the population below the poverty line and is widely recognized in Nepal for serving the poorest clients of MFIs in Nepal. NUBL employs a specific targeting strategy, using land ownership, housing, and income barriers for its general loan to ensure that new clients are below the poverty line.

The client selection criteria of the bank are as follows:

- Women having less than 0.25 hectares of irrigated land or less than 0.5 hectares of un-irrigated land per five-person family.
- A house that does not have cement walls or ceiling (pucca house).
- The member being a permanent resident of the bank working area.
- No family member is employed in the formal sector.

- No current loans from other financial service providers.
- A family per capita income less than US\$ 56.00.

Financial services

NUBL provides varieties of loans that could fulfill the demands of clients. It collects the feedback and the needs of clients through borrowers' workshop, public interaction meeting, guardian meeting, conducting focus group discussion session using market research tools developed by Micro-Save Africa. Based on findings of these activities, NUBL refines the existing products and if necessary, designs new products. The financial products that NUBL currently offers are as under:

I. Loan products

Nirdhan Utthan Bank Limited (NUBL) starts to provide *General loan* after the group members formally recognized by the concern officer. This loan is provided only for any income generating activities. After the regular repayment of General loan up to first six months, the client can access the Seasonal agriculture loan. Once the 1st loan cycle of General loan completes, the clients are eligible to access either Seasonal business loan or Tubewell-Sanitary loan. Housing loan is for those clients who have successfully completed two General loan cycles. Micro-enterprise loan is accessible after the two loan cycles completion of General loan. NUBL has a policy that one client will have a maximum of two loans outstanding at a time.

Products	Max ^m limit Rs.	Max ^m limit US\$	Loan period
General loan*	30,000	407	3 to 12 months
Seasonal agriculture loan	3,000	41	1 year
Seasonal business loan	10,000	136	6 months
Tubewell/sanitary loan	6,000	81	2 years
Housing loan	15,000 to 50,000	203 to 678	2 to 5 years
Micro-enterprise loan (Collateral based)	100,000	1,355	Up to 5 years
Emergency loan	10,000	136	2 years

* 1st year max. –Rs. 12,000, 2nd year Rs. 15,000, 3rd year Rs. 20,000, 4th year Rs. 25,000 and 5th year & onwards Rs. 30,000.

II. Saving products

NUBL offers two types of savings products. They are as follows:

Products	Source
Group Fund Saving (Compulsory)	1. 5% of loan except in Housing, Emergency and Micro- enterprise loan. 2. Weekly saving @ Rs. 2/week
Personal Saving	Voluntary

The bank pays 6% interest rate on daily balance method in both savings. The clients have access to *Group fund saving* for non-income generating purposes like medical treatment of family member, purchasing of school dress, books, and copies for children, and for other social needs. Withdrawal from this saving account needs to be approved by the concerned group. Two members in each group can take loan from the *Group fund saving* at a time. In case of *Voluntary saving*, a member can open her account with a minimum of Rs.10.00. In the center meeting clients can deposit their money and the collector (Field Assistant) records the respective saving amounts in the passbook. They can withdraw whatever amount they want from this account.

III. Micro-Insurance Services

The financial service that is gaining increased attention is a category of products that address clients' needs for risk management. The low-income households are highly vulnerable to economic shocks caused by events such as death of family member, illness, destruction of valuable asset, or a disabling injury. NUBL is increasingly recognizing that new financial services - in particular, targeted savings, emergency loans and insurance - can respond to households' need to reduce their vulnerability, while at the same time improving the results of their existing credit and savings portfolios.

The bank has currently one emergency fund scheme designed to help her family in case of death of the member. Under this scheme, the second time and above loanee has to pay Rs. 25.00 at the time of each *General Loan* disbursement. In case of death of a member (client), her guardian gets the following benefit.

1 st year member	Rs. 15,00.00
2 nd year member	Rs. 2,500.00
3 rd year member	Rs. 3,500.00
4 th year member	Rs. 4,500.00
5 th year & above member	Rs. 5,000.00

Premium of micro-insurance scheme is centralize and kept as a fund namely **EMERGENCY FUND**.

Since February 2003, NUBL has been working in collaboration with National Life & General Insurance Company (a formal insurance company). The insurance product is being pilot-tested in two branches. Under this scheme the clients together with their husband and parents can purchase insurance policy. This is a yearly renewal product which provides double benefit if the policyholder is dead

by accident. During the pilot test a number of clients and their husband/parents are participating. NUBL will replace its EMERGENCY FUND schemes if this product attracts the people. It will be decided after the evaluation of pilot testing activities. The premium and benefit is as follows:

Premium	Benefit	Remarks
Rs. 70	Rs.10,000	Rs. 20,000, if death occurs by accident
Rs. 140	Rs.20,000	Rs. 40,000, if death occurs by accident
Rs. 280	Rs.40,000	Rs. 80,000, if death occurs by accident

Management practices

Commitment to serve the poor: The mission statement of NUBL is to extend financial services and social awareness to the poor in under-served and un-served areas of Nepal in a sustainable manner. This is a guiding principle to serve the poor for NUBL.

Streamlining of operation: NUBL has developed various manuals for smooth operation of microfinance services. They are:

- a) Operation manual, it explains: i) Target group identification process, group formation process ii) Compulsory group training and group recognition process iii) Roles and responsibility of group chairperson, secretary, members and center chief iii) Center management iv) Roles and responsibility of loan officers (Field Assistants) v) Field supervision & monitoring process, forms and formats.
- b) Loan and saving manual, it explains: i) The process and procedures for loan application, loan recommendation and loan approvals. ii) Loan term, maximum amount, repayment frequency, grace period, interest rate iii) Saving products, interest payment procedure, withdrawal procedure
- c) Financial procedure manual, it explains: i) Budget preparation and implementation process. ii) Decision-making authorities for expenditure in branch, area and head office level. iii) Capital expenditure (Fixed assets) purchase committee in branch, area and head office level with their role & responsibilities. iv) Salary & allowance at different level and travel order & approval process. v) Advance payment and collection procedure vi) Depreciation rate for different categories of fixed assets, method of depreciation, write-off process for unusable assets, vii) Auction process and procedures,
- d) Personnel manual: i) Staff category ii) Recruitment policy, roles and responsibility of recruitment committee, staff promotion, reward criteria iii) Holiday allocation iv) Retirement process, gratuity allocation v) Staff punishment process, types of punishment
- e) Internal audit manual: i) Internal audit management- planning, direction, control and reporting process ii) Internal audit process and procedures iii) Ensuring audit compliance

Management information system: NUBL uses FINMAN software in each and every office. This software has both accounting and loan tracking system. It has the facility of data integration of branch, area and head office. It produces financial (income statement, balance sheet, Nepal Rastra Bank reports, daily cash book, portfolio at risk statement etc.) and non financial (group number, center number, number of loans disbursed, number of loans outstanding, number of loans at risk, staff-wise number of clients, borrowers, groups, center etc.)

Institutional capacity building: i) NUBL has separate training department to conduct in-service training for its staff. ii) NUBL sends staff to participate different types of training, workshops, and seminars to update their knowledge in microfinance industry. iii) NUBL has strategic alliance with Plan International, Save The Children US, CGAP, different Networks (CASHPOR, INAFI, Save The Children Microfinance Network, Grameen Trust, CMF Nepal, Microcredit Summit Campaign). Staff get opportunities to participate trainings, workshops seminars and NUBL receives news letters, publications etc. from these organizations.

Comparison of South Asian MFIs and Grameen replicate of Nepal in terms of performance

The Grameen replicates have significant numbers of clients that they play major role in microfinance industry in Nepal. The table below compares the performance standards of 7 Grameen replicates:

S.N.	Particular	Unit	South Asia (medium)#	South Asia (small)#	Grameen Replicate (Nepal)	NUBL January 2004
A	Outreach and productivity					
1	Average loan portfolio per loan client	US\$	97	153	101	95
2	Average number of loan clients per staff	No.	195	129	150	141
B	Profitability and sustainability					
1	Adjusted return on assets (Adjusted net operating income after taxes/Average total assets)	%	-2.5	-7.3	-1	1
2	Operational self-sufficiency	%	129.1	77.2	104.1	112.0
3	Financial self-sufficiency	%	94.1	57.4	100.2	111.0
C	Income					
1	Yield on portfolio	%	21.9	16.2	16.8	17.0
D	Operating expense					
1	Operating expense ratio (Adjusted operating expense/Total assets)	%	9.1	9.8	11.9	5.0
E	Portfolio quality					
1	Portfolio at risk > 30 days	%	5.6	14.8	5.7	5.9
F	Efficiency					
1	Adjusted operating expense/loan portfolio	%	14.3	13.7	20.5	11.8
2	Cost per borrower	US\$	13	21	22	11

Source: 1. Microbanking Bulletin, Issue No.8

2. Annual report of respective Grameen replicates: Grameen Bank Biratnagar, Grameen Bank Janakpur, Grameen Bank Butwal, Grameen Bank Nepalgunj, Grameen Bank Dhangadhi, Self-help Development Bank Janakpur and Nirdhan Utthan Bank Limited

3. Monthly Progress Report of Grameen replicates

Note: 1. Microbanking Bulletin classifies MFIs as small, medium and large according to the size of their loan portfolio.

2. South Asia (medium) includes AKRSP Pakistan, Basix India, BURO Tangali Bangladesh, FWWB India, NUBL Nepal, SEEDS Sri Lanka and SHARE India

3. South Asia (small) includes Grama Vidyal India, IASC India, KASHF Pakistan, SIFFS India, Swyam Krushi India

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