Workshop : Innovative ways of Reaching and Benefiting the Most Poor and Most Vulnerable People

Making Micro-Finance Work in Remote and Rural Areas With Low Population Densities

A Paper prepared for the

Micro-Credit Summit + 5

10-13 November 2002.
Hilton Hotel, New York, USA

GPO Box No: 20933
Bisalnagar, Kathmandu, Nepal

Tel:977-1-432947,977-1-434041
Fax:977-1-432947
E-mail :cmf@mos.com.np
Web site: www.cmfnepal.org

By

Ms Namrata Sharma, Managing Director, Centre for Micro-Finance (CMF) Nepal

Table of Contents

Acronyms

ADB/M	=	Asian Development Bank, Manila
ADB/N	=	Agricultural Development Bank, Nepal
CECI	=	Canadian Centre for International Studies and Cooperation
CGB	=	Central Grameen Bank
Chimek	=	NGO involved in Micro-Finance
CMF	=	Centre for Micro-Finance
CSD	=	Centre for Self-Help Development
DEPROSC	=	Development Project Service Centre
DICGC	=	Deposit Insurance and Credit Guarantee Corporation
DVN	=	Development Vision Nepal
EGB	=	Eastern Grameen Bank
FINGO	=	Financial Intermediary NGOs
FS	=	Financial Services
FSS	=	Financial Self-Sufficiency
FWGB	=	Far-western Grameen Bank
GBFS	=	Grameen Bank Financial System
GBRs	=	Grameen Bank Replicators
HMG	=	His Majesty's Government
IBP	=	Intensive Banking Program
ICIMOD	=	International Centre for Integrated Mountain Development
IFAD	=	International Fund for Agriculture Development
LGP	=	Local Governance Project
MCPW	=	Micro-Credit Project for Women
MD	=	Managing Director
MEDEP	=	Micro Enterprise Development Program
MF	=	Micro-Finance
MFI	=	Micro-Finance Institutions
MWGB	=	Mid-western Grameen Bank
NERUDO	=	An NGO involved in Micro-Finance (GBR)
NGO	=	Non-Government Organisation
NLSS	=	Nepal Life Standard Survey
NRB	=	Nepal Rastra Bank
NUBL	=	Nirdhan Utthan Bank Ltd.
OSED	=	Occupational Skill and Enterprise Development
OSS	=	Operational Self-Sufficiency
PAF	=	Poverty Alleviation Fund
PAPWT	=	Poverty Alleviation in Western Terai
PCRW	=	Productive Credit for Rural Women
PDDP	=	Participatory District Development Program
RFP	=	Rural Finance Project
RMDC	=	Rural Micro-Finance Development Centre
RRN	=	Rural Reconstruction Nepal (NGO)
RSRF	=	Rural Self-Reliance Fund
SCCs	=	Saving and Credit Co-operatives
SCOs	=	Saving and Credit Organisations
SDC	=	Swiss Agency for Development and Cooperation
SFCL	=	Small Farmer's Cooperative Ltd.
SFDP	=	Small Farmer Development Program
SIP-P	=	Small Industry Promotion Project
SNV	=	Netherland Development Co-operation
TEVT	=	Technical Education and Vocational Training
TLDP	=	Third Livestock Development Project
TRWS	=	NGO involved in Micro-Finance (GBR)
USAID	=	United State Agency for International Development
UNICEF	=	United Nations International Children’s Emergency Fund
VB	=	Village Banks
WCS	=	Women's Cooperative Society
WEP	=	Women's Empowerment Program
WGB	=	Western Grameen Bank

Making Micro-Finance Work in Remote Mountainous and Rural Areas with low Population Densities

1 Background

1.1 Country context

> *"Community mobilisation is not easy and not cheap...However [in the context of Nepal] there are no alternatives with a proven track record in providing services to the poor and spurring local development...community involvement remains the most promising approach for poverty alleviation."*
>
> (Poverty at the Turn of the 21st Century: Nepal Country Report, World Bank, 1998)

According to the same 1998 World Bank Report, over 50% of Nepal's 22 million people lives below the defined "poverty line" of $1 per day in purchasing power." Per capita income was estimated at $200 in 1995, which placed Nepal near the bottom of the list - the ninth poorest country in the world, the poorest outside of Africa" (World Bank, 1998, p.5).

58% of the total population in Nepal lives in hilly areas characterized by difficult geographical terrain. Most of the people in these areas are poor, and have limited opportunities to improve their economic well-being or lift themselves from the continuing cycle of poverty (ADB's Rural Credit Survey in 1995 indicated that over 90% of farm households in hill districts have no access to institutional finance and rely upon the informal sector to meet savings and credit needs.)

Unlike the *Terai* (plain) region, much of the hilly region is without roads or other important infrastructure. Communities which are situated closer to roads achieve better comparative advantages than those far away from it, though on the whole, there is limited access to formal financial services everywhere. In some areas people have to walk a day or two to reach a Bank.

1.2 MF in the hills of Nepal

All areas of the hills have economic activities at different magnitudes irrespective of the extent to which they function on a subsistence level. Despite unfair and exploitative situations, people for centuries have made use of the financial services offered by local moneylenders as well as by traditional revolving fund schemes.

A large number of savings and credit schemes are emerging in several hilly areas since early 1990s. Some of them are promoted by government program and NGO/INGOs while some have emerged out of their own initiatives. The community or user groups manage most of these schemes and member's savings are the sole capital with or without matching or revolving fund from outside. Although many of such schemes are running without much problem, they are not equipped with required capacities to scale up their operations so as to meet the needs of their clients. More than 12,000 savings and credit organizations (SCOs) exist in Nepal, including more than 360,000 clients (there is no study showing the percentage of people below the poverty line out of this number). SCOs play a vital role in providing access to financial services in remote and deprived communities of Nepal. However, at present, many of these SCOs are dependent on the promoting organization for their management and operation. It is not possible for the promoting organization to plan, implement and monitor the SCOs activities forever. For the sustainable development of the SCOs, the member must eventually be able to take responsibility and run these activities by themselves.

The National Savings and Credit Development project (SACRED), which laid the foundation of the Center for Micro-Finance (CMF), conducted a Best Practices study in year 1997 with 25 savings and credit co-operative organizations (SACCOs) working in both *Terai* and hills. Findings of this study affirmed that community based SACCOs are viable and potentially important players in the micro-finance sector in Nepal. Compared to other highly subsidized credit programs and institutions, SACCOs are a cost effective approach to providing financial services to those sectors of the population that have little or no access to formal banking institutions.

Another dominant model of MF services in Nepal is the Grameen model. Though the Grameen model may embody many efficient poverty reaching qualities, there is evidence that it may be too costly to be replicated in the Hills unless supported heavily from outside. Limited scale of operation and scattered population may limit the chances of meeting financial viability and self-sufficiency.

For many MFIs in Nepal it has been a challenge to provide financial services to people living in Hill districts. It has become a challenge even to the largest Grameen replicating development banks and NGOs to extend financial services to the poor living in Hill districts. Many promoting agencies have been working on developing a sustainable MF model for the hill regions. There are some savings and credit cooperatives both externally promoted and as well as self promoted working in the hill districts providing financial services to the poor living in these districts. Thus, since financial services are proven tools in alleviating poverty, there is clearly an urgent need for increased access to financial services in the hills.

2. Micro-finance Development in Nepal

2.1 Status of Institutional Development

The history of formal Micro-finance in Nepal goes back to the inception of Small Farmer's Development Project (SFDP) in 1975, when Agriculture Development Bank/Nepal (ADB/N) started a collateral fee group based lending to the poor in plain and hill areas of Nepal. The priority sector credit program started in 1974 as policy directive of Nepal Rastra Bank (NRB), the central bank of Nepal, also had some component of micro-finance services. Later when this program was reconstituted as Intensive Banking Program (IBP) it has emerged as very strong program. In the following years, NRB directives were further modified and commercial banks in Nepal were and are required to lend 12 percent of their loan portfolio to priority sector and 3 percent (within that 12 percent) to deprived sector. The limit per person for the purpose of deprived sector lending was set a maximum of Rs.30,000 (around US$ 385 at current exchange rate). This policy has become a very encouraging for Micro-finance development in Nepal.

Donor supported program such as Production Credit for Rural Women (PCRW), Micro-Credit Project for Women (MCPW), Third Livestock Development Program (TLDP), Community Groundwater Irrigation Sector Project (CGISP), Rural Finance Project (RFP), Village Banking (VB), etc. also started at various districts of Nepal.

A very strong and powerful model in the world Micro-finance scenario, called Grameen model of Bangladesh, was replicated by HMG/N and private sector since 1990s. After inception of MCPW (Asian Development Bank (ADB/M) sponsored and implemented government program) many NGOs entered into the micro-finance field as a partner of MCPW. A Financial Intermediary (FI) Act, providing opportunities for NGOs to perform micro-financial services in Nepal, was promulgated in 1998. This law allows NGOs to function as a lending institution. Recent revision in the Act allows Financial Intermediary NGOs (FINGOs) to mobilize savings (not deposit) from among the group members. After incorporating the saving services FINGOs are expected to engage in providing Micro-finance services like a bank.

2.2 Establishment of Apex Institution/Wholesale Funds

Various MFIs are considered to be constrained with on-lending fund (although there are many smaller and few MFIs, especially SCOs having excess funds). To boost such services the government of Nepal started a fund in 1991 called 'Rural Self Reliance Fund' (RSRF), under the aegis of NRB, with a view to provide wholesale on-lending fund to co-operatives and FINGOs working in the field of Micro-finance. By July 2001, this fund has provided funds to 156 institutions (48 NGOs and 108 SACCOs). Another strong apex institution was created in 1999 as part of Asian Development Bank’s Rural Finance Project called Rural Micro-finance Development Centre (RMDC), established as a development bank with initial loan of US$ 20 million from that bank. Its main aim is to enhance micro-finance sector by providing wholesale funds to MFIs, providing training to MFI personnel and clients, and developing awareness and policy in this field. It has slowly started its operation. By mid-June 2002, it has provided fund of Rs.105 million to 17 institutions and helped providing training to the clients and staff of MFIs.

2.3 Establishment of The Centre for Micro-finance (CMF)

Establishment of CMF as a focal point in the field of Micro-finance in 1998 can be stated as a step towards capacity building of the MF sector. CMF’s aim is to strengthen the MF sector through research, training and consultancy services to the MFIs and national and international agencies working towards strengthening the MF sector in Nepal and Asia region. It also aims at shaping Micro-finance policies by conducting national seminars on policy issues, developing linkages and helping MFIs as per their requirements. CMF was initiated as a project implemented by the Canadian Centre for international studies and Co-operation (CECI) Nepal with financial support from USAID and Ford Foundation. As a need was felt by the MF sector in Nepal to continue the work commenced by CMF, it was then registered as a private company in 2000. CMF is now run by the local Board of Directors.

Table 1: Status of Major Micro-finance Service Outreach
(as of July 15, 2001)

S. No.	Institutions	Members (in '000)	Borrowers (in '000)	Cumulative disbursement (Rs. in '000)	Outstand-ing loan (Rs. in '000)	Group saving balance (Rs. in '000)	Repayment rate in (%)
1.	SFDP	115	115	6,310,000	1,040,000	54,400	39.00
2.	SFCL	61	61	NA	778,287	166,445	74.00
3.	PCRW*	67	67	360,000	168,000	NA	64.0
4.	EGB	49	46	2,376,877	324,391	95,573	97.50
5.	CGB	28	26	354,800	163,372	34,485	100.00
6.	WGB	37	36	1,038,869	270,431	61,708	99.70
7.	MWGB	18	16	531,983	106,558	33,970	93
8.	FWGB	18	13	663,305	103,258	31,001	75
9.	NUBL	35	31	737,904	174,859	38,431	97.20
10.	CSD	38	32	800,874	178,969	47,209	100.00
11.	DEPROSC	6	4	59,338	19,957	2,686	100.00
12.	Chhimek Samaj	7	4	72,169	30,919	5,010	95.5
13.	NRDSC	3	2	4,410	3,724	392	100.00
14	Priority Sector lending (RBB and NBL)	130	130	N.A.	N.A.	N.A.	N.A.
	Total	612	583	13,314,529	3,362,725	571,312	
15	Informal Groups (SHGs)	240	120	-	480000	400,000	95%
16	SCCs	320	160	-	320000	300000	95%
	Total	560	280	-	800000	700000	

Source: Shrestha, S.M, 2002 (upto No. 13) and rest CMF estimates.

3. Developing a Micro-finance Model for Hills and Rural Areas with Low Population Density

3.1 Background

Politically Nepal is divided into five regions, fourteen zones and seventy-five districts. It is a landlocked and mountainous country. About eighty-seven-percentage land is covered by the hills with difficult geographical terrain and low populations densities. Fifty eight percent of the total population lives in hills and most of them are poor.

Although there are various models of Micro-finance active in Nepal, most of them are concentrated in plain areas. There is limited access to formal financial services in the hills. In some areas people have to walk a day or more to reach a Bank or to get services from MFIs.

Even though financial services have been proven to be useful to alleviate poverty, there still is an urgent need for increased access to financial services in Hills. Though Grameen Bank model embodies efficient poverty reaching qualities, it is too costly to be replicated in the Hills unless supported heavily from outside. Limited scale of operation and scattered population limits its chances of meeting financial viability and self-sufficiency. SACCOs have proven to be effective means of providing financial services in a cost effective manner in the hill districts though their outreach and number are limited and they are not focused on poor.

It is believed that financial services in the hills may require a broader mix of products and methodologies if they are to build the outreach and portfolios required for financial sustainability. However, it is also felt that only financial service may not be enough to establish a sustainable delivery mechanism in the hills. A social component therefore is necessary. The social component should comprise identification of poor clients, group formation, client training and organizational management, while the financial component comprises saving collection, loan disbursement, supervision and repayment, as well as record keeping and reporting.

In A study conducted by CMF recently termed as Review of MF services in the hills of Nepal (accessible from CMF) the following models are suggested as appropriate models to be considered while developing a MF model in the hills :

3.1.1 Federation of SCOs:

As mentioned above there are more than 12,000 SCOs promoted by government programs and NGO/INGOs, and self-promoted. These SCOs are active in providing limited Micro-finance services in remote villages of Nepal. FINGOs also could use this model by promoting group of up to 40 people for saving and credit operation. One field worker of FINGO can handle a large number of people as in the case of modified Grameen approach. There is no evidence of similar model available in the literature review process. Therefore, a kind of pilot project could be developed and tested before going for mass scale implementation.

In the first Phase, SCOs often have a lot of enthusiasm and do most work on a voluntary basis. Generally, the executive committee members take on nearly all the responsibilities. The president will take charge of all primary group activities; the secretary will record minutes; and the treasurers will maintain accounts and other records. At the outset, despite their important contribution of time and effort, even the executive committee members may see only small changes in their day-to-day life. Moreover, benefits are shared equally among the members, regardless of the involvement in the SCO. Consequently, this situation may decrease the motivation of the active members. Eventually, this situation is likely to result in a decrease in the activeness of the executive committee, which will affect the group as a whole. Thus these small isolated savings groups have little chance of being a viable institutions. Given this situation, the solution is to:

– provide the secretary or treasurer with some remuneration and/or

– seek to hire professional (usually part-time) staff to ease their work load.

However, unless the SCOs have a large membership and capital base, their income is likely insufficient to cover the cost of hiring even part-time staff, or providing even nominal remuneration for executive committee members.

Secondly, as the SCOs grow, so will be its needs for more complex and demanding system to maintain books of account, tracking loans, etc. In response to these needs, professional staff such as an experienced accountant may be necessary for the SCO to become sustainable.

3.1.1.1. Working Modalities of Federative Model

In the federative model two or more SCOs in a given cluster discuss together and form the federation of the SCOs. The village based SCO is called the unit/branch of the federation. Each unit/branch sends their representative(s) to the new federated savings and credit organization. In this process, the SCOs that formed the federation will remain functional as "units/branches" and will lose neither their existing decision-making structure, nor their name. These units/branches elect representatives to sit on the Board and other committees of the federated SCO. In case of FINGOs, they need to promote SCOs and then federate these SCOs. FINGOs can act as catalysts, coordinator guide, fund provider, supervisor etc.

(h) Management of Savings and Credit in Federated SCOs

In the federated SCO, the members of distant villages come together to form one cooperative organization. For the members of far-off branches, one or more hours walking to attend meetings and make monthly savings deposits may not be practical. Similarly in the credit delivery, the time it takes to walk to submit an application and get the loan may not be practical. To manage the federation successfully there must be a simple and effective system for savings collection and loan disbursement. There are ample examples of such activities in various areas and countries, which need to be further explored and developed for application in local context.

All branches of the federated SCO organize their monthly meetings one day ahead of the federation meeting, where they will collect savings, loan applications and loan installments, then the representatives of each branch can bring savings, loan applications and loan installments when they come to attend the meeting of the federated SCO. In the federated SCO office they collect savings and loan installments and take receipts and registered loan applications. Then Board of the federated SCO decides on loans and other maters at the monthly meeting. When the representatives return to the branch, they disseminate the information on the loan decision. Those whose loan application is accepted can visit the federation for loan. When a loan application is rejected, the representative will be responsible to explain the reasons for the Board's decision to the loan application.

(i) Decision on Loans

Loan applications are first screened and approved or rejected by the monthly branch meetings, where they keep minutes. The Executive Committee or President of each branch sign the loan application, thereby guaranteeing the loan and accepting accountability as a group for repayment. The representative brings the loan applications accepted by the primary groups to the federation where the final decision on the loan applications is made. Assuming the loan policy is clear, this is likely to be an approval process, rather than through second-tier review.

(j) Monitoring of Loan

There will be one loan supervisory committee in each branch. Its role is to supervise the loan, which will be again supervised by the supervisory committee at federation level. Alternatively, the cashier/manager may also supervise loans.

(k) Records and Book-Keeping

All records are kept by the cashier/manager at the federation level and all the transactions take place in federation. The branches maintain the minutes of their decisions. If the branch has other activities besides savings and credit they should maintain separate records and make decisions separately. To run the federation successfully books and records must be maintained regularly and at least once a year a General Assembly must be held and members are provided details of accounts during that assembly.

(l) Security of Funds

All the members must be confident that their money is safe in the federated SCO. For this purpose, there must be transparency in fund management and decision-making as well as clear recording, book-keeping, reporting and transfer of information from the federation level to the branches (usually via the branch representatives sitting on the Board of Directors, but also during the General Assembly). Registration also helps to increase confidence among the members. Especially right after federating, the federated SCO must communicate to the primary groups that the money collected as savings will return to them as loans, so as to avoid the impression that money is being siphoned off from the branches for using outside of their community.

(m) Management Information System (MIS)

MIS systems must be designed in such a way that members of the branches can understand the decisions and other activities of the organization. Passbooks must be filled out regularly. Loans must be decided promptly and those whose loan application is rejected must be provided reasons promptly. Representatives of the respective group play a key role in the management information system. Once the MFI grows it needs to computerise its information system to generate required information on timely basis.

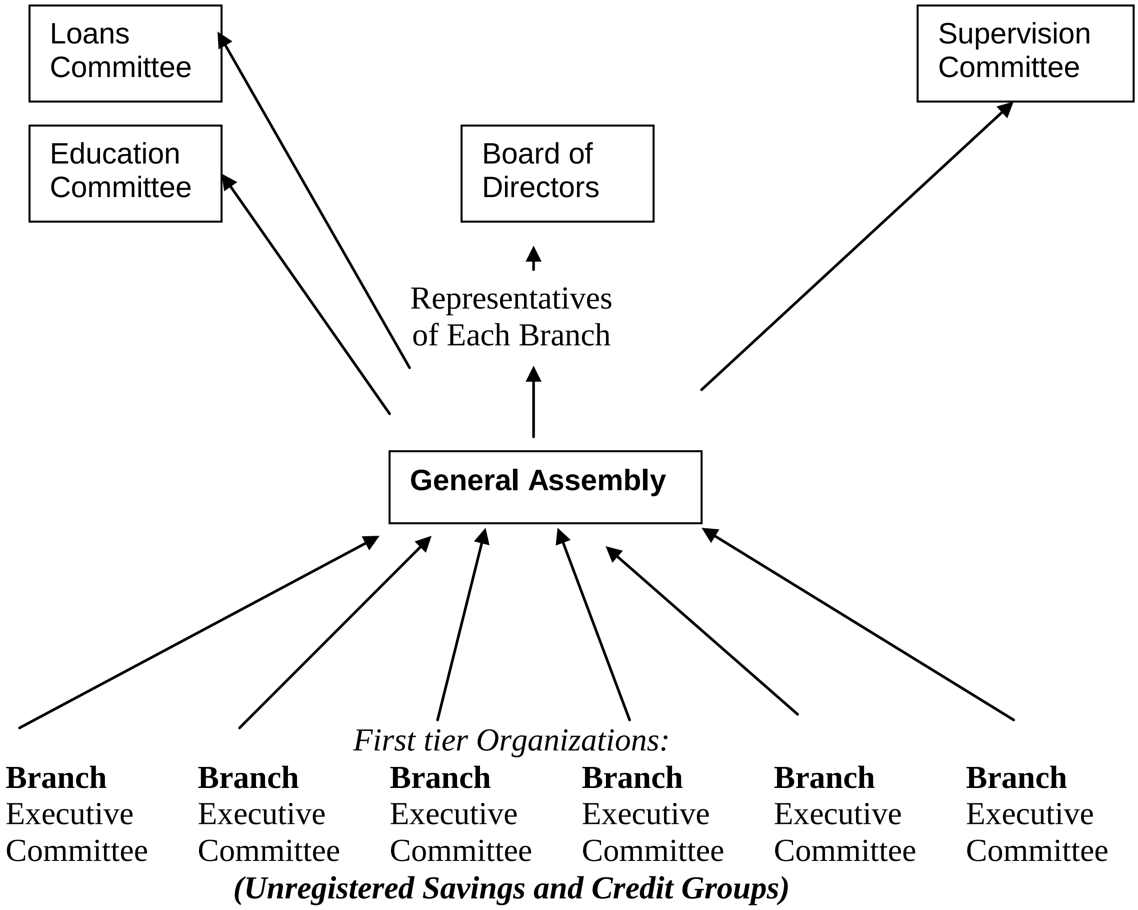
(n) Cost of Operation

Cost of operation of the federation can be borne by placing small percentage of margin in between saving plus wholesale borrowing and the lending rate of SCOs. It could be 3-4 percent in the beginning and as the business grows, it could be reduced. The cost must be maintained at low par for long-term viability. Beside that the members also need to pay a small amount of fee to the federation. Donor agencies may contribute toward meeting cost of initial years administrative expenses but need to be very careful in helping them to achieve self sustainability in few years time. All promotional activities must be supported by developing linkage with network, I/NGOs and governmental agencies.

Table 2: Structure and Roles in the Federative Model

	Branches	**Federation**
Structure	Each branch has: - A branch committee (formerly the Board of the SCO) - Monthly meetings and one annual meeting prior to the federation AGM	The federation has: - Board of directors, comprising representatives from each unit/branch - Annual General Assembly - Executive Committee, Supervisory Committee, Loans Committee and Other committees - Staff and an office - Legal registration as a cooperative society
Role	1. Select representative(s) for federation 2. Collect savings 3. Discuss, approve and send loan applications to the federation Board or Loans Committee 4. Guarantee and supervise the loan of its members 5. Formulate the savings policy in the primary group 6. Implement the rules and policies of the federation 7. Implement the activities of the Federation	1. Forms the Executive Committee from the representatives of the SCOs 2. Provides loans 3. Formulates the yearly planning of the federation and monitor its implementation 4. Keeps the books and records of the SCOs and the federation 5. Audits the books of the SCOs and the federation 6. Develops linkages and networks 7. Formulates policies

Figure 1: Organizational Structure of the Federative Model



In case of FINGOs instead of branch their could be different SCOs.

3.1.1.2 Advantages and Disadvantage of Federation

(a) Advantage

The importance of federating small SCOs can be summarized as follows:

- Federation of SCOs help for the financial viability of SCOs.
- Federative model is helpful for getting legal identity.
- Increase outreaches on membership and area.
- Strengthen on networking and linkages.
- It is costly to provide services such as training, exposure visits and follow up due to the smaller scale of activities (i.e. lack of economies of scale for promoting agencies). Technical assistance is essential to ensure growth and institutional sustainability, but will only be cost-effective in larger SCOs.
- Accumulation of capital and increase fund.
- No necessary to keep books and account in each SCO.
- Leadership development and hierarchical decision-making structure.
- Suitable for difficult geographical area or in the low population densities area.
- Proper management of the SCO.
- Easy to communicate and coordinate.
- This is sustainable and manageable organization system for member base organization.
- Primary SCO does not loose their identity.
- Increase the confidence of SCOs that they can do a lot after joining in federation.
- SCOs can exchange their ideas and experiences in regular basis after federation.
- Create employment for local people.

(b) Disadvantages

- Primary SCO loose their freedom.
- Conflicts may arise between federation and primary SCO.
- Dependent on representative
- Delay in decision-making
- Delay in getting loans.

A crucial element in federation is maintaining trust and confidence in the new larger organization. To do, so it is important to get off on the right foot by ensuring the SCOs and their members are fully aware and take part in the decision on which model they wish to adopt. Training activities should allow participants to understand how the system works in federative model and to map out what they want their organization to look like. Top-down imposed federation is unlikely to be successful when working with community-based organizations.

3.1.1.3 Conditions for Federation

Following conditions must be met to federate the SCOs in the wards of the Village Development Committee (VDC) or more than one VDCs.

- The SCOs in the given areas have managed savings and credit activities for at least one year.
- There must be more than two groups in one geographical location and the distance from one group to another must be in general within one hour walking distance.

- The majority of the SCO members are open to discussing federation, even though they may find this prospect challenging. Generally, this means they have some awareness of the importance and necessity of federation.

3.1.2 Modified Grameen Model

Grameen model of micro finance has been invented by Prof. Yunus in the late seventies and has been successfully replicated through-out the world as one of the poverty alleviation program. In Nepal, it is replicated in several *Terai* district through regional development banks and NGOs. In this model lending is made on group guarantee and the center and field worker assists group in conducting Micro-finance activities. The branch directly supervises the client, group, center and field staff. All the transactions are centralized in the branch level. In its working modalities, in the original form, a branch can be viable only in densely populated area with the facilities of road and market. Thus the model has not been replicated yet in the hill of Nepal where people live in scatter village and cluster and no any substantial initiation and innovation has been made in Nepal to modify the original Grameen model and replicated in the hill of Nepal.

The modified Grameen model as a hybrid of Grameen and federated SCOs can be developed and can be replicated in the hill and remote place of Nepal in a cost effective way. As explained in the federative model, the representative of the branch SCOs meet once in the month. In their monthly meeting they collect monthly savings, loan installment and decide on loan application. In the Grameen system field worker of MFI does all this work, which increase the operation cost. In the federative model of SCO, the field worker of the MFI will be present in monthly regular meeting of federated SCO. In the meeting he/she will assist and supervise the SCOs board and staff to carry out the savings and loan activities. But the SCO board and staff do most of the micro finance work such as savings collection, loan sanction, installment collection and loan supervision. The MFI provide wholesale funding and technical assistance related to micro finance to the federated SCO. The SCO will implement the other credit plus activities through linkages and networking with network, I/NGOs and governmental organization.

In an average one federation can manage 10 SCOs and 300 members. In the first year one field worker can manage three federations but in the following year once the federation become capable to manage their own work the field worker can move to other federation. The tentative plan of number of federation that a field worker can mange is shown in the following table:

Table:3

Year	No. of Federation	No. of Members
First year	3	900
Second year	4	1200
Third year	5	1500
Forth year	6	1800
Fifth year	6	1800

In the long run when these federated SCO become fully capable to manage Micro-finance business, there is no need for the MFI to have a field worker. Experience has shown that federations need outside technical support for three years. Once federations become fully capable they can approach MFIs for wholesale fund independently. The field worker will move from old federation to new federation, which needs more external support. The modified Grameen model not only provides financial services in the hill of Nepal but also answers the question of financial sustainability of existing Grameen replicators. In the modified Grameen model men and women both could be members in the federative SCOs.

3.1.3. Micro-Enterprise Finance as a step beyond the two models mentioned above:

The federative model and modified Grameen model both can be entrusted to enter into micro-enterprise finance. Micro-enterprises could be defined as small business where there are one or more person employed apart from self-employment and there is some value addition. In this case the need for a higher level finance may be required. But MFIs cannot jump to it at one go and start financing such enterprises. It helps the process of gradually scaling up of Micro-finance activities, retaining good clients and help MFIs sustainability. Therefore, its modalities could be as follows;

- After at least 3 cycle of loans if members are matured and come above the poverty line (after careful assessment) these members could be recognised as prospective clients in this field.
- They must have demonstrated capability of handling micro-enterprises.
- In this case a part of the collateral would be the project and the other part would be group assurance. In case of higher level finance (above Rs.50,000.) The asset of the project also should be considered as collateral.
- Some form of micro-insurance product could be developed to ensure safety from project failure to MFI and clients.
- Loan amount should increase gradually i.e. if limit of loan to members is Rs.30,000, micro-enterprise loan may start from Rs.40,000 and in each cycle an increase of Rs.10,000 could be considered. The increase should also be examined and checked by income and employment generation.
- There should be a maximum limit (Rs.100,000).
- If competition is felt between similar enterprises, they could be merged. The key institutions (HMG, Grameen Bank, NGOs, INGOs etc.) who are promoting micro-enterprise finance should facilitate such activities until formal financial institution (Banks, Development Banks and Finance Companies) consider them viable and commence financing them.

In all these activities both women and men could be the clients.

4. Principles, Practices and Parameters for Designing Suitable MF Models for the hills:

Based on a recent study conducted by CMF; International experience shared by different organizations through a virtual conference; and CMF's work in Community Health Development Project (CHDP) Surkhet, Technical support provided to COPADES, Lamjung, Impact Assessment of (SACCOS) Project of CMF being implemented in Kavre, Dolakaha, Ilam and Tanahu and several studies conducted by CMF in different hills of Nepal, CMF would like to propose the following as some of the most important points to consider while designing MF models for the hills in Nepal.

4.1. Suitable Products for Remote Clients

To determine the right product, one must know precisely what type of savings and credit products will be convenient and opportune for the client and which delivery mechanisms are feasible. Promoting organization should consider who is saving, why they are saving, and from what types of sources. In determining product design, we should remain aware that clients have a range of options for financial services, each with advantages and disadvantages and serving a particular need. The objective of the poor is to maintain this choice to better manage risk and ensure timely access to financial services. Yypes of products depend also on characteristics such as: geography, market opportunity, development and stability of the financial market and inflation. Remote places especially need innovation of new financial products and a delivery mechanism in order to meet the particular needs of a remote and isolated population. Some tips are mentioned below to design the appropriate products for a remote population.

4.1.1 Criteria for Suitable Products

- ***Small Amounts:*** The people may have ability to deposit very small irregular amounts on a regular basis. Very poor people may be excluded by a high compulsory savings requirement. Similarly loan products should be small and should match with income generation activities and other needs of particular region.

- ***Liquidity:*** Small savers, because of their low disposable income, may place a higher premium on liquidity than others in order to smooth their life cycle needs. The poor often need voluntary services that allow them to save when they have money and withdraw when they don't. The poor do not want to withdraw savings (which is equity for them) as long as they can get other financial services such as emergency loans and micro insurance.

- ***Returns:*** Small savers are also looking for and are sensitive to returns on savings. Access to savings is very important to the poor. But if they have alternative options for savings, then returns are very important. The cost of loan to the loanee must be lower than that provided by other informal financial sources.

- ***Delivery system:*** Delivery system must be secure and convenient. Very poor people may not have the time to come to an office to deposit savings and take loan. Some may only participate if services are available near their home or work. Convenience can mean collecting deposits and installment in the evening when cash is available and before it is lost to wasteful expenditure. The poor are best served by easy deposits through group methodologies or mobile personnel near their home or work and more difficult withdrawals and loan taking, for example from an office. This helps them with the discipline not to withdraw and take a loan except for real needs or opportunities.

- ***Introduction of product range:*** Community-based cooperatives that start by offering compulsory savings services and a range of loan products can grow the capacity - skills, MIS, etc - to deliver a range of financial services as per member's needs. Where there are plenty of economic opportunities, a range of products may mobilize more savings needed for on lending. Remote areas may have less economic and investment opportunities and cooperatives there may have excess liquidity. In those areas, compulsory savings with some restricted flexibility is more appropriate. In some areas the poor may have a high demand for festival products, Children education, etc.

- ***Range of products:*** Financial products offered should be oriented toward the actual needs of the client and be adequate for the type of activity in which they are engaged. Whether the type of products and delivery system are appropriate or not will depend greatly on local needs, culture and context. Market research should determine what products are most appropriate locally.

- ***Confidentiality***: Remote poor savers, especially women, also seek confidentiality with regard to their savings. They prefer that their husbands or neighbors not know how much is in their account. This is one reason that they prefer voluntary instead of mandatory savings.

4.2 Promotion of Micro-finance Services in the Remote Places

Only appropriate products are not enough for the remote poor. The poor must understand the importance of thrift (forgoing expenditure and safekeeping the savings) and loan. After members join and see the benefits, this will spread quickly by word of mouth. The poor should be made aware that their money could be properly utilized by acquiring loans for investment or by depositing it in a safe place. Promotion should focus on the concept of "investing" to change the future rather than only on "saving" to earn interest. Any poor person if taught to invest will never leave his/her money lying around. Thus, the poor have the capacity to save and repay loans if an appropriate promotion mechanism is applied. Changing the mentality of the poor requires convincing, not imposing. The poor are human beings and will save if financial organizations take good care of them, by visiting their homes, offering good personalized services, and fulfilling their promises.

Many MFIs do not create incentives for savings. Methods to promote larger amounts of savings include: Prizes, interest rates, insurance tied to minimum savings balance, access to larger loans, linking a client's loan size to his or her savings balance and demonstrated trustworthiness.

The right tools for promotion depend on the local culture and infrastructure for disseminating /distributing promotional tools. The infrastructure will also determine the cost and time frame. In a program operating in remote areas, promoters who are young, speak the local language and are known and trusted by the local people would be best. The promoter should contact community authorities, introduce the services, and set up a service promotion meeting with them.

4.3 Collaboration With Other Stakeholders

The problems of remote rural areas include: low profitability of agricultural activities, poor physical infrastructure, low social cohesion, illiteracy, far from a market, little or no mobility, no regular income, low population density, mismanagement, lack of supervision capabilities in the Central Bank, dependency on donors and poor savings culture. A more integrated development approach may be more appropriate than only financial services. A coordinated initiative between government, donors, financial institutions and MFIs can address some of the causes of limited outreach on both the demand and the supply side of MF. Collaboration between government ministries, the Central Bank, MFIs, Commercial Banks, NGO's and Donors may be the only way to constructively address the technical and long-term challenges of reaching the poor and remote people with accessible, flexible and affordable financial services. Governments, in particular the Central Bank, must create conducive conditions without handicaps and obstacles that allow MFIs to develop and integrate into the mainstream financial system e.g. bank- linkages program. A dedicated apex support institution that provides training; capacity building services, networking, centralized supervision and advocacy will accelerate orderly development of micro finance. The government should focus on building the infrastructure facilities.

4.4 Staff Cost

Salaries and facilities must be modest. Field staff must come from the same socio-economic level as the clients. Employing local staff can be a key to managing staff costs. Savings and Credit Cooperatives can cover their full costs from the beginning by relying on volunteer boards for management. As the cooperative starts to generate revenue, it pays for a part-time bookkeeper whose hours and pay increase as the capital and portfolio of the cooperative grows. One way to compensate volunteer management committees is to pay them a small stipend from the profits of the Cooperatives.

The cost of forming and nurturing savings groups depends on: the distance of villages, number of groups possible in a village (population of the village especially of the poor), the time of meeting, the means of transport, the periodicity of the meeting, the salary structure of the organization, the age of the groups, how much the promoting organization tries to build groups' capacity, and whether the group takes up social issues in addition to savings and credit. Weekly meetings encourage regular savings of surplus cash but cost more.

If the cooperative meets monthly, one staff usually handles 20 to 30 groups with a total membership of 300 to 900 persons. In a simple office, one staff can manage 1000 to 2000 accounts with 50 to 150 transactions per day. Monthly instead of bi-monthly or weekly meetings reduce the cost but this may have a negative impact on loan repayment.

Spontaneous replication of groups/cooperatives is a real though localized phenomena that can greatly cut the costs of group formation. The question is whether these spontaneous groups, trained by others are adequately strong to be sustained. Alternatively, strong group leaders can be recruited and trained as MFI promoters at a fraction of the cost of using less local or more educated staff.

When groups cannot keep their own records, the cost of staff time to do this for them makes it prohibitive to serve more remote areas. Options to avoid this expense include: upgrading their very simple records; teaching record-keeping as part of a literacy curriculum for entire groups; and training groups of treasurers and other group officers. In case individual trained members leave, training should be extended to more than one member to ensure sustainability, to avoid mistrust when some members do not understand practices and to strengthen internal control.

4.5 Internal Controls

MFIs need to proactively shape an institutional culture in which honesty is among its core values. Most fraud is detected by co-workers, not auditors. Therefore, MFIs should create a work environment in which members/employees are encouraged to and rewarded for reporting suspected fraud. MFIs could actively recruit new staff from places with high moral authority and should screen to ensure that they are hiring upstanding citizens. New staff training should demonstrate a fraud zero-tolerance policy. Staff members should be immediately terminated if they commit fraud. Clients should be educated to demand an official, pre-numbered receipt whenever staff collects money. Savings and credit cooperatives maintain internal control by using receipts and updated passbooks. Staff or depositors should verify whether a deposit is properly recorded or not. There is also room for fraud in situations where a paid staff person collects from the group in the field and deposits funds in the office.

4.6 Cross Subsidization

While focusing on poorer customers, a cooperative will still attract better off customers for cross-subsidization. Also, poor clients who become wealthier over time should remain with the Cooperative. In order to maximize their revenues, MFIs should try to hold onto clients who become wealthier. Cross subsidies should be used carefully because poorer clients could eventually be excluded from financial services if they are not as profitable.

4.7 Interest Rates

Interest rates and fees should be set as per the characteristics of the financial product. Interest rates on loan and savings with longer-term maturities should be higher. Similarly loans for emergency purposes and health purposes should have lower interest rates and lower maturity periods. Interest rates must cover all the financial, operational and other costs of the cooperative. Generally, in savings and credit cooperatives board members fix the interest rate in the context of the local environment and this decision must be approved by the general assembly.

References:

Most of this paper is based on the study of *Micro-Finance Services in The Hills of Nepal – Sharma, Uprety, Simkhada* CMF 2002

Can be downloaded from CMF website www.cmfnepal.org.np