

Seibel, Hans Dieter; Kumar, K.C.Bijay

Working Paper

Das nepalische Mikrofinanzsystem: Formelle und nichtformelle Finanzinstitutionen im Spannungsfeld zwischen Armutsbezug und wirtschaftlicher Tragfähigkeit

Working Paper, No. 1998,3

Provided in Cooperation with:

University of Cologne, Development Research Center

Suggested Citation: Seibel, Hans Dieter; Kumar, K.C.Bijay (1998) : Das nepalische Mikrofinanzsystem: Formelle und nichtformelle Finanzinstitutionen im Spannungsfeld zwischen Armutsbezug und wirtschaftlicher Tragfähigkeit, Working Paper, No. 1998,3, Universität zu Köln, Arbeitsstelle für Entwicklungsländerforschung (AEF), Köln

This Version is available at:

<https://hdl.handle.net/10419/23673>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.



Universität zu Köln
Arbeitsstelle für Entwicklungsländerforschung
University of Cologne
Development Research Center

Working Paper No. 1998-3

Hans Dieter Seibel & Bijay Kumar K.C

**Microfinance in Nepal:
Institutional viability & sustainability
and their compatibility with outreach to the poor**

**Das nepalische Mikrofinanzsystem:
Formelle und nichtformelle Finanzinstitutionen
im Spannungsfeld
zwischen Armutsbezug und wirtschaftlicher Tragfähigkeit**

Universität zu Köln
Arbeitsstelle für Entwicklungsländerforschung
Bernhard-Feilchenfeld-Str. 11, 50969 Köln
Tel.: 0221-470.4078, Fax: 0221: 0221-470.5195

University of Cologne
Development Research Center
Bernhard-Feilchenfeld-Str. 11, D-50969 Cologne
Tel.: ++49-221-470.4078, Fax: ++49-221-470.5195

seibel@uni-koeln.de

**Microfinance in Nepal:
Institutional viability & sustainability
and their compatibility with outreach to the poor**

**Das nepalische Mikrofinanzsystem:
Formelle und nichtformelle Finanzinstitutionen
im Spannungsfeld
zwischen Armutsbezug und wirtschaftlicher Tragfähigkeit**

Project proposal to:
Projektförderungsantrag an:
DFG - Deutsche Forschungsgemeinschaft
(German Research Council)

by

Prof. Dr. Hans Dieter Seibel
University of Cologne, Germany
Universität zu Köln

in cooperation with:
in Zusammenarbeit mit:

Prof. Dr. Bijay Kumar K.C.
Kathmandu University

Kathmandu – Cologne, May 1998

Contents / Inhaltsverzeichnis

1	Overview	Übersicht	1
1.1-1.7	Proposal data	Antragsdaten	1
1.8	Summary	Zusammenfassung	2
2	State-of-the-art and own contributions		3
2.1	State-of-the-art		3
2.2	Own contributions		6
3	Objectives and working program		8
3.1	Objectives		8
3.2	Methodology and working program		12
4	Budget	Beantragte Mittel	15
4.1	Budget for German research team	Deutsche Personal- und Sachkosten	15
4.2	Budget for Nepali research team	Personal- und Sachkosten des ausländischen Kooperationspartners	16
5	Prerequisites	Voraussetzungen für die Durchführung	16
5.1	German research team	Zusammensetzung der Arbeitsgruppe	16
5.2	Nepali research team	Zusammenarbeit mit ausl. Wissensch.	17
5.3	Relationship to Nepal	Auslandsbezug	17
5.4	Equipment in Cologne	Apparative Ausstattung in Köln	17
5.5	Regular budget	Laufende Mittel für Sachausgaben	18
6	Declarations	Erklärungen	18
7	Signature	Unterschrift	18
8	Annexes	Verzeichnis der Anlagen	19

1. Overview / Übersicht

1.1. Applicant / Antragsteller:

Hans Dieter Seibel, Prof. Dr. phil.
Development Research Center,
Dept. of Social Sciences, University of Cologne
Bernhard-Feilchenfeldstr. 11, 50969 Köln
Tel. 0221-470.4078, Fax .5195
E-mail: Seibel@uni-koeln.de

Cooperating partner / Kooperationspartner:

Prof. Dr. Bijay Kumar K.C.
Dept. of Finance, Kathmandu University
P.O. Box 380, Patan Dhoka, Lalitpur, Nepal

1.2. Topic / Thema:

Microfinance in Nepal:
Institutional viability & sustainability and their compatibility with
outreach to the poor

Das nepalische Mikrofinanzsystem:
Formelle und nichtformelle Finanzinstitutionen im Spannungsfeld
zwischen Armutsbezug und wirtschaftlicher Tragfähigkeit

1.3. Topic-in-brief / Kennwort:

Microfinance in Nepal / Mikrofinanzsystem Nepal

1.4. Discipline and area of specialization / Fachgebiet und Ausrichtung:

Sociology of development/Microfinance
Entwicklungssoziologie/Mikrofinanzwesen

1.5. Expected duration / Voraussichtliche Gesamtdauer:

2 years / 2 Jahre

1.6. Proposed project period / Antragszeitraum:

1.10.1998 – 30.9.2000

1.7. Expected project start / Voraussichtlicher Forschungsbeginn:

1.10.1998

1.8 Summary

How to develop in third world countries a sector of viable financial institutions with sustainable financial services for the whole populace including the poor? During the 90s an answer to that question is being sought in the field of microfinance, which comprises formal and nonformal financial institutions in cooperative, communal or private ownership as well as governmental and nongovernmental national financial institutions with microsavings, microcredit and microinsurance services. The crucial issue in the current debate is the compatibility of outreach to the poor and institutional viability and sustainability. It is claimed that institutions reaching the poor are not viable, while viable institutions ignore the poor. However, there are exceptions to this rule, also in Nepal. What is their secret of sound banking practices?

The project is geared to a study of the system of microfinance in Nepal concerning (a) the economic viability and financial sustainability of various types of institutions with microfinance services; (b) their outreach to the poor; (c) the compatibility of outreach and viability; and (d) the impact of the policy and legal framework on that compatibility.

With support from the German Research Council, DFG, the project proposal was jointly prepared in April 1998 in Kathmandu with the project partner, the private University of Kathmandu, in cooperation with the central bank, Nepal Rastra Bank, the agricultural development bank ADBN and GTZ. These institutions plan to cooperate closely in the execution of the proposed project, expecting from the project management a catalytic role. It is expected that through the project, scholars of the Dept. of Finance of University of Kathmandu (as well as graduate students) will be enabled to analyze MFIs, coordinate research of participating institutions, provide financial management training and contribute to both the outreach and sustainability of MFIs in Nepal.

Zusammenfassung

Wie entsteht in Entwicklungsländern ein leistungsfähiger Sektor wirtschaftlich tragfähiger Finanzinstitutionen mit einem nachhaltigen Angebot von Finanzdienstleistungen für die gesamte Bevölkerung einschließlich der Armen? In den 90er Jahren wird die Antwort auf diese Frage zunehmend im Bereich des Mikrofinanzwesens gesucht. Dieses umfaßt formelle und nichtformelle Finanzinstitutionen im genossenschaftlichen, kommunalen oder privaten Eigentum sowie nationale staatliche und nichtstaatliche Finanzinstitutionen mit Dienstleistungen für Kleinsparer, Kleinkreditnehmer und Kleinversicherungsnehmer. Im Mittelpunkt der gegenwärtigen Diskussion steht die Frage nach der Vereinbarkeit von Breitenwirkung bzw. Armutsbezug und institutioneller Tragfähigkeit: Institutionen für die Armen seien nicht tragfähig, tragfähige Institutionen dagegen nicht auf Arme ausgerichtet. Allerdings gibt es Ausnahmen von dieser Regel, darunter auch in Nepal, deren Geheimnis effektiver Finanzpraktiken zu ergründen ist.

Ziel des Vorhabens ist daher die Untersuchung des nepalischen Mikrofinanzwesens unter besonderer Berücksichtigung (a) der institutionellen Tragfähigkeit und Nachhaltigkeit der verschiedenen Institutionen mit Mikrofinanzdienstleistungen; (b) ihrer Breitenwirkung und Ausrichtung auf die Ärmere; (c) der institutionenspezifischen Vereinbarkeit von Armutsbezug und wirtschaftlicher Tragfähigkeit; und (d) der institutionellen Rahmenbedingungen, die die Vereinbarkeit beeinflussen.

Der Projektantrag wurde im April 1998 mit Unterstützung der DFG gemeinsam mit dem Partner, der privaten Universität Kathmandu, unter Beteiligung der Zentralbank Nepal Rastra Bank, der Agrarentwicklungsbank ADBN und der GTZ ausgearbeitet. Die genannten Institutionen erwarten von dem Projekt eine Katalysatorrolle und beabsichtigen, bei der Durchführung ihrer Forschungsaktivitäten im Bereich des Mikrofinanzwesens eng zusammenzuarbeiten. Von dem Projekt wird eine nachhaltige Qualifizierung der kooperierenden nepalischen Wissenschaftler erwartet. Sie sollten befähigt werden, eigene Untersuchungen über das Mikrofinanzwesen

durchzuführen, die Untersuchungen der beteiligten und weiterer Institutionen zu koordinieren, ein Ausbildungsangebot in Finanzmanagement zu erstellen und zur Verbesserung der Breitenwirkung und der institutionellen Tragfähigkeit der Mikrofinanzinstitutionen beizutragen.

2. State-of-the-art and own contributions

2.1 State-of-the-art

Financial systems development, the Asian financial crisis, and microfinance

Since the seminal works of McKinnon (1973) and Shaw (1973), the important role of the financial sector in development has increasingly gained recognition. No financial sector study in Asia can at present ignore the financial crisis:

- **its root causes:** hazardous, politically instigated lending; inadequate internal resource mobilization; unhedged foreign exchange exposure; and, above all, inadequate regulation and supervision;
- **and its impact on the poor and near-poor,** who, due to soaring inflation rates, lose their savings; and due to the illiquidity of financial institutions, lose what little access to credit they had.

The devastating effects of the recent financial crisis in East and Southeast Asia have lent additional emphasis to **the crucial question** of,

- how to create and prudentially regulate viable financial institutions with sustainable financial services, protecting at the same time the savings of depositors and preventing moral hazard in lending.

This question pertains not only to banks which are at the core of the formal financial sector; but also to microfinance institutions which tend to be ignored in the current discussions on crisis resolution and crisis prevention by national governments, regulators and international agencies such as the IMF.

Key concepts

In the context of the proposed study, our focus is on the microfinance sector:

- **microfinance** is defined as a sector of formal and nonformal financial institutions providing microsavings, microcredit and microinsurance services to the microeconomy, thereby allocating scarce resources to microinvestments with the highest marginal rates of return. In a narrow sense, microfinance institutions (MFIs) are small local financial institutions. In a wider sense, they may also comprise national or regional banks with microfinance services for small savers and borrowers.

The market of microfinance is the microeconomy:

- the **microeconomy** includes such target populations as microentrepreneurs, small farmers and the landless, women and the poor.

All this bears on **two core issues**, institutional viability and sustainability – terms which are frequently used interchangeably:

- **viability** refers to the extent to which an institution covers its costs, has its loans repaid, and makes a profit;
- **sustainability** refers to the extent to which an institution, in addition to being viable, mobilizes its own financial resources internally (equity, savings, reserves from profits) instead of depending on government or donor resources. (Getubig et al. 1997; Seibel 1996).

In the case of microfinance, **a third core issue** is added, outreach to the poor:

- **outreach** refers to the extent to which all segments of the population, including the poor, have access to financial institutions and their services

The compatibility issue

Outreach, viability and sustainability - these are thus three key themes of concern to scholars, policymakers and technical experts.

- The **core issue** is: are they compatible, or can economic viability and financial sustainability only be achieved at the expense of outreach to the poor; or increased outreach to the poor at the expense of viability and sustainability?

Theoretical review

A brief review of different theoretical approaches to development that bear on financial systems development and microfinance is in order.

Modernization theory, the dominant approach to development during the 1950s and 60s, has generally failed because of an inherent dilemma. Ignoring indigenous institutional foundations of national and local economies, governments and donors set out to transfer Western institutions of a market economy to the developing countries— but the transfer was to be designed and implemented by central state planning institutions. The resulting institutions turned out to be state institutions, such as state hospitals, state schools, state-owned enterprises, and state-owned banks. Based on a restrictive banking law, government banks were established, including development banks with subsidized targeted credit programs. The evolution of these institutions into economically viable financial intermediaries between savers and investors was prevented by repressive monetary and interest rate policies.

The same applied to state-controlled cooperatives and donor-induced credit groups. Their self-help character, the essence of which is savings mobilization, was shattered by subsidized credit channeling of external resources at conditions and for purposes determined by governments and donors. Approaches inspired by **socialistic ideas** led to the establishment of mono-tier banking systems which have meanwhile collapsed or been transformed. Both approaches have in common a quantitative orientation to economic growth, rather than a qualitative orientation to structural development. Suggesting a cultural *tabula rasa* before the onset of modernization, both rejected building on indigenous economic structures and institutions, which thus remained in the so-called informal financial sector outside of governmental control.

In contrast to these two perspectives, **ethnologists** have studied indigenous financial institutions as a core element of indigenous economies, among them local institutions of various origins: private moneylenders and deposit collectors, rotating and non-rotating savings- and credit associations and other types of solidarity and self-help groups (e.g. guilds and neighborhood-associations with savings and credit transactions). They mobilize their own resources, are adapted to their market, rely on their own resources, and offer to the bulk of the population, particularly the poorer sections, access to financial services. However, they do so only to a limited extent and within the confines of segmented local markets.

The **Information and Transaction Cost Approach** (Meyer & Cuevas, 1990), which is part of the New Institutional Economics (NIE), is appropriate for the analysis of the economic efficiency of financial organizations, or the inefficiency of government-owned development finance institutions. Government ownership and various forms of government intervention aggravated the pervasive problems of asymmetric information, adverse selection and moral hazard, which are key concepts of this approach (Llanto & Chua 1996). NIE provides a basic theoretical perspective for the analysis of long-term development processes of a country's financial system, with the institutional framework (policy and legal environment) as its focus (North 1990).

Shortcomings

Theoretical interests in financial systems development in the McKinnon tradition as well as the multilateral interventions by The World Bank and the International Monetary Fund are geared to the

formal financial sector. Their approach is top-down, with governments as partners. The bulk of the poorer part of the population and their demand for adequate financial services remains out of their sight. As a result, reform measures fail to take the financial needs of the poor into account; their self-help efforts, e.g. in the form of savings- and credit associations or private deposit collection, are ignored; and suitable legal forms for small local financial institutions are lacking, thereby preventing the upgrading of local MFIs and self-help institutions. They remain small and isolated instead of transforming themselves into village banks, people's banks or local savings banks, with their own apex organizations for liquidity exchange and access to sources of refinance by the central bank.

The emergence of microfinance

Changes began in the mid 80s and gained momentum after the Microcredit Summit of February 1997 in Washington. The interest in viable institutions and in their sustainable outreach to growing numbers of the poor has converged in a new field: microfinance. The World Bank, largely ignorant of microcredit and microsavings well into the early 90s, also discovered microfinance, „an area of priority in the fight against poverty“ (Deschamps & Lambert 1997: 29), and initiated, in June 1995, the establishment of CGAP, the Consultative Group to Assist the Poorest. The growing interest in microfinance has resulted mainly from two market failures: the inability of governmental development banks to provide financial services to the bulk of the poorer population and cover their costs; and the inability, or unwillingness, of commercial banks to offer financial products with pricing and conditions commensurate to the transaction costs, risks and term requirements of the small-scale business. Over the past two years, communication on microfinance has spread like wildfire. There have been four major channels of communication:

- book publications (Albe & Gamage 1996; Bouman & Hospes 1994); Conroy et al. 1995; Count 1996; Garson 1996; Hulme & Mosely 1996; Krahnert & Schmidt 1994; Rutherford 1996; SEEP 1995; Seibel 1996; Todd 1996 a, b);
- specialized journals such as Asia Pacific Rural Finance (Bombay & Bangkok);
- international conferences such as the Microcredit Summit, Washington DC, 2/1997, and Bank Poor '96, Kuala Lumpur, 12/1996;
- and finally current discussions via the internet, especially among the participants of the Development Finance Network (DFN) operated by the Department of Agricultural Economics and Rural Sociology of The Ohio State University.

There are two important **studies of microfinance in Nepal**: an extensive study of rural finance (ADB & NRB 1994); and a study of six specific microfinance institutions and their role in poverty alleviation (Pant & Dhungel 1996). Other recent studies are by Gupta (1994) and Uphadyaya (1995).

Donor dependency, adverse selection, and moral hazard

The focus of the discussion in microfinance has frequently been on institutions and groups, among them the Grameen Bank, that (i) have an exclusive focus on the poor; and (ii) have been assisted by governmental and non-governmental donors and are sustained by sizeable equity contributions and subsidies to their running expenses. In many cases, this donor dependency has had negative effects on the selection of customers or members (*adverse selection*) and the repayment rate (*moral hazard*). As noted in the current literature and in the discussions among the DFN participants, most of these institutions are not sustainable; and their viability and self-reliance are not in sight, at least not if their customers are the poor. As World Bank authors Deschamps & Lambert (1997: 22) noted in a particular country study:

„an appropriate mix of performance and outreach has still not been achieved by local initiatives in microfinance: when sustainability is in sight, outreach is limited, but when outreach is potentially large, sustainability considerations appear to have been neglected.“

Cases of institutional viability

Yet virtually all informal financial institutions cover their costs right from their beginning. There is also a number of semiformal and formal institutions which are profitable from an early time on and which mobilize their own resources. An example is Bank Shinta Daya in Indonesia, a small rural bank with some 30,000 customers, which is not donor-financed. (Seibel & Parhusip 1/1998). An excellent example of a viable national institution is government-owned Bank Rakyat Indonesia. It provides a rapidly growing number of customers of the poorer sections of the population with microfinance services (2.49 million borrowers and 16.17 million savers as of December 31 1996), mobilizes its resources internally, and makes a profit from microcredit. There are a number of such cases which show that, many negative examples notwithstanding, outreach and viability may be compatible.

The compatibility of outreach to the poor and institutional viability

In the framework of the ongoing discussion on microfinance, our research interests focus on the following issues:

- How can microfinance institutions be viable and, at the same time, provide financial services to the poor, combining viability and outreach?
- What types of microfinance institutions, with which kind of property and governance structure, are suitable providers of financial services to the poor?
- What are sound (or *best*) practices of increasing outreach and lowering transaction and information costs? (What are appropriate savings, credit and insurance products and suitable terms and conditions? What are effective ways of mobilizing internal resources? What is the impact of tied credit (tied to savings or commodity marketing)? What is the impact of exclusive targeting of women or the poor on outreach and viability?)
- What are the effects of the institutional framework (monetary and interest rate policy, property rights, legal forms, supervision) on outreach, viability and sustainability?

Given the preliminary evidence that in the long run only viable financial institutions can sustain and increase their outreach, our concern thus focuses on the compatibility of outreach to the poor and institutional viability; and on the factors which influence this compatibility. At the same time, with the East- and Southeast-Asian financial crisis lurking in the back, we will examine what lessons have been learned, and what precautions are being suggested, of how to improve the health of financial institutions banking with the poor and their regulatory environment.

2.2 Own contributions

2.2.1 Preparatory studies

The proposed research project is based on some preparatory studies of nonformal and formal financial institutions in Nepal, combining basic and applied research orientations:

1988: research on endogenous informal financial institutions and possible linkages with banks:

Meena Acharya, H.D. Seibel & Bishnu P. Shrestha: Self-Help Groups in Nepal. Asia Pacific Rural Finance (Bangkok) Vol. 1 No. 1, 1988: 3-6; pp 1-5 in: B.R. Quinones, Hg., Self-Help Groups as Informal Financial Intermediaries. Bangkok, APRACA Publications 1992;
Meena Acharya, H.D. Seibel & Bishnu P. Shrestha: Promotion of Linkages between Banks and Self-Help Groups in Nepal. Bangkok, APRACA Publications 1990;

H.D. Seibel & Bishnu P. Shrestha: Dhikuti: The Small Businessmen's Informal Self-Help Bank in Nepal. Savings and Development (Mailnad), Vol. 12, No. 2, 1988: 183-200

1995: a brief study on the transformation of an indigenous rotating savings institution:

H.D. Seibel & Uttam Dhakhwa: From Informal to Formal Microfinance: The Transformation of the Dhikuti in Nepal. Asia Pacific Rural Finance (Special Issue on Grassroots Finance) 12/ 1997: 98-101; H. D. Seibel & H. Schrader: From Informal to Formal Microfinance Revisited: The Himalaya Finance and Savings Company in Nepal. Draft paper, 4/1998, Kathmandu & Cologne

1995/96: studies of the transformation of the Small Farmers Development Program of the Agricultural Development Bank of Nepal into autonomous local financial institutions:

H.D. Seibel & Mohammed Mortuza: Small Farmers Development Project: Rural Financial Systems Development in Nepal. Eschborn, GTZ 1995;

H.D. Seibel & Guenther Ketterer: Small Farmers Development Project: an Evaluation. Eschborn, GTZ 1996

1996/97: secondary analysis of six case studies of microfinance institutions in Nepal:

H.D. Seibel: Microfinance Capacity Assessment in Nepal, in: I. Getubig, J. Remenyi & B. Quinones, Ed.: Creating the Vision. Microfinancing the Poor in Asia-Pacific: Issues, Constraints and Capacity-building. Asian and Pacific Development Centre, Kuala Lumpur 1997, pp 79-88; H.D. Seibel, Harihar Dev Pant & Dipak Dhungel: Microfinance in Nepal: an Assessment of Microfinance Institutions Banking with the Poor. Economics and Sociology Occasional Paper No. 2368, Rural Finance Program, Dept. of Agricultural Economics, The Ohio State University, Columbus, Ohio, revised January 1998

Preparatory studies of a more general nature are presented in:

H.D. Seibel: Financial Systems Development and Microfinance: Viable Institutions, Appropriate Strategies and Sustainable Financial Services for the Microeconomy. Roßdorf, TZ-Verlag 1996.

H.D. Seibel: Upgrading, Downgrading. Linking, Innovating: Microfinance Development Strategies – A Systems Perspective. Economics and Sociology Occasional Paper No. 2371, Rural Finance Program, Dept. of Agricultural Economics, The Ohio State University, Columbus, Ohio, June 1997

H.D. Seibel: Microfinance Strategies: Strategies for Developing Viable Microfinance Institutions with Sustainable Services – The Asian Experience. NENARACA Microcredit Conference, Amman, 1-3 June 1998

2.2.2 Project preparation

This project proposal is based on the application of July 7, 1996, and the additional statement of February 18, 1997, and goes back to the suggestion of the main committee of the DFG (letter of September 29, 1997), „to work out, in a first step, the detailed structure of the financial market and the interconnections between its segments.“ The background of the original proposal was an agreement between Prof. H. D. Seibel, Director of the Development Research Center of the University of Cologne, and Prof. Dr. Bijay Kumar K.C., Director of the Dept. of Finance, Kathmandu University, reached during a visit to Nepal in April 1996, to jointly plan and carry out a project on the transformation of informal indigenous financial institutions (*dhikuti*). Uttam Dhakhwa, team leader of the GTZ technical assistance project to the Small Farmers Development Project of ADBN, was instrumental in initiating this cooperation.

In March/April 1998, the German Research Council DFG supported a project preparation journey (approval letter dated 26.2.1998) to Nepal with the following objectives:

- participative project preparation together with the cooperating partner, Prof. Dr. Bijay Kumar, University of Kathmandu
- contacting persons and institutions who are interested in the results of the study or who may participate in the study in direct or indirect ways; among them co-authors, heads of relevant projects and staff of various financial institutions including the central bank
- collection of information and material from partner and other institutions (including Central Bank, banks, non-governmental institutions, GTZ and Asian Development Bank/DAI)
- participatory research planning including research question, hypotheses, objectives, methodology, work plan and costs

The main issues discussed in preparation of the project proposal included:

- **institutional viability and sustainability** of the different institutions providing microfinance services in Nepal;
- their **outreach** and orientation to the poorer sections of population, including microentrepreneurs, small farmers and the landless, and women;
- **compatibility** of outreach to the poor and institutional viability & sustainability in various types of MFIs
- **sound practices** and financial products of institutions banking with the poor (terms and conditions of loan contracts; microsavings, microcredit and microinsurance products; technologies of lower transaction and information costs; instruments of internal resource mobilization; ties between savings and credit; exclusive vs. inclusive banking with women and the poor; ownership and governance structures)
- **institutional framework** (monetary and interest rate policy, property rights, enforcement of claims, legal forms of MFIs, MFI inspection and supervision) and their effects on outreach, viability and sustainability.

On April 7-8, 1998, a project preparation seminar was held at the GTZ office in Kathmandu. Minutes of the seminar were jointly prepared (**Annex 1**) and signed by the research teams from the universities of Cologne and Kathmandu, the central Bank Nepal Rastra Bank, the agricultural development bank ADBN and the representatives of two GTZ Projects (**Annex 2**).

The project proposal as given below (chapter 3.1) was presented to the Governor of Nepal Rastra Bank Satyendra P. Shrestha and to Deputy Governor Prafulla K. Kafle, to the General Manager of ADBN Devendra P. Shah, and the Director of the GTZ office in Kathmandu, Peter Rhode. These organizations expressed a strong interest in the project and its catalytic function, expecting a synergy effect on their basic and applied research activities in the field of microfinance.

Lists of organizations and persons contacted (**Annex 3**) and of documents and materials collected (**Annex 4**) are attached. A report on the the project preparation journey was presented to DFG on 4 May 1998.

3. Objectives and working program

The following objectives are presented as jointly prepared and approved by the participants in the project preparation seminar on April 7-8, 1998, in Kathmandu (**cf. Annexes 1-2**).

3.1 Objectives

3.1.1 Project goal

The participants agreed on the following **research project goal**:

Factors of viability & sustainability, outreach, and their compatibility between are determined among MFIs and their interlinkages in Nepal

This research project is to contribute to the following **development goal**:

Viable MFIs provide sustainable financial services to low-income people

3.1.2 Target group

The research project is geared to the following **units of research**:

an intermediate target group of microfinance institutions and financial institutions with microfinance services (as the direct units of research); and

the MFI market segment and ultimate end-user target group of low-income people including small farmers, small and microentrepreneurs, women and the poor (as the indirect units of research).

3.1.3 Proposed results

The following **proposed results** are to contribute to the attainment of the project goal:

- (1) An analysis of the financial sector and its segments is carried out in terms of institutional sustainability and outreach on the basis of existing data
- (2) An analysis of linkages between the main financial sector segments with an outreach to low-income people is carried out
- (3) A network of participating organizations is established
- (4) A coordinated approach of MFI data collection and analysis is worked out
- (5) Staff from participating organizations is trained in the application of the instruments of MFI data collection and analysis
- (6) Participating institutions are assisted in the collection and analysis of data on MFI sustainability and outreach with the instruments jointly elaborated (*Result 4*) by trained staff (*Result 5*)
- (7) Results of the study are evaluated
- (8) Results of the study are disseminated

3.1.4 Proposed activities

The results are to be attained through the following activities:

- (1) **An analysis of the financial sector and its segments is carried out in terms of institutional sustainability and outreach on the basis of existing data**

Analyze sustainability and outreach of:

Commercial banks and their priority sector programs

*Agricultural Development Bank and SFDP

*Development banks (Grameen bikas banks)

Savings and finance companies aiming at low-income people

*Cooperatives incl. SFCL

NGOs

*Self-help groups (incl. induced and indigenous SHGs [dhikuti])

Moneylenders

(* = special emphasis)

- (2) **An analysis of linkages between the main financial sector segments with an outreach to low-income people is carried out**

Describe and analyze linkages and their effect on flow of resources, viability and outreach between the following segments:

ODA-driven linkages:

Donors	Government NRB	Commercial banks ADBN	Bikas banks Priority-sector programs: SFDP IBP, BP (PCRW) MCPW, LGP PDDP, RSRF	Small groups SFCL Coops.
--------	-------------------	-----------------------------	---	---------------------------------------

NGO-driven linkages:

INGOs		NGOs	SHGs
-------	--	------	------

Isolated institutions and their potential for linkages:

Finance & savings companies	SHGs Dhikuti
--------------------------------	-----------------

- (3) **A network of participating organizations is established**

Establish a task force

Establish criteria of participation

List potential organizations
Select participating organizations
Carry out workshop of participating organizations
Agree on contributions by participating organizations
Conclude agreements of cooperation

(4) A coordinated approach of MFI data collection and analysis is worked out

Collect instruments of MFI financial monitoring and evaluation from CGAP, WOCCU (*PEARLS*) and others
Acquire existing software for MFI financial monitoring and data analysis
Adapt instruments to the requirements of the Nepali environment
Test and revise instruments

(5) Staff from participating organizations is trained in the application of the instruments of MFI data collection and analysis

Train project research staff from participating universities
Train students preparing dissertations or theses in the context of the project
Train research staff from other participating organizations
Select and train trainers from participating organizations

(6) Participating institutions are assisted in the collection and analysis of data on MFI sustainability and outreach with the instruments jointly elaborated (*Result 4*) by trained staff (*Result 5*)

Analyze outreach:

Statistical analysis of target groups/market segments:

Overall size of market acc. to social categories and geographical areas

Customers: savers, borrowers, insurance customers (outreach)

Collect and analyze data on MFIs:

Liabilities: equity, deposits, borrowings, soft loans, grants

Assets: loan portfolio

Income and expenditure statement, profit and loss calculation

Repayment performance:

Repayment ratio

Loss ratio

Arrears ratio

Portfolio at risk

Analyze viability and sustainability:

Viability: Operational self-sufficiency ratio

Sustainability: Full-financial self-sufficiency ratio

Self-reliance: Subsidy-dependency index (Yaron)

Describe financial products of different MFIs including microsavings, microcredit and microinsurance products and their effect of viability and outreach to specific market segments

Compare the efficiency of individual and group financial technologies

(7) Results of the study are evaluated

Analyze the effects of the political and policy environment (including the legal framework and MFI supervision) on sustainability and outreach (up to and after 1990)

Analyze the effect of ownership and governance on sustainability and outreach

Analyze the time frame in which different MFI achieve sustainability

Analyze the effect of fixed and pretermimed vs. flexible and market-oriented target group definitions of MFIs on sustainability

Analyze the effectiveness of minimalist (*finance only*) vs comprehensive (finance combined with other services and support) approaches

Analyze sound (*best*) microfinance practices that contribute to the compatibility of sustainability and outreach, differentiated according to ecological environments (plains, hills and mountains) and target groups

Analyze sound microfinance practices in nonmonetized, marginal areas

Prepare a special report on recommendations by participating organizations for the development of microfinance in Nepal

Draw lessons for financial crisis prevention

Prepare framework for follow-up study of organizational sustainability (incl. people's ownership and governance, indigenous organizational principles and management practices, individualist vs. social value orientation, transparency, supervision)

(8) Results of the study are disseminated

Carry out joint workshop upon the conclusion of the study in Nepal

Coordinate reports of participating organizations

Prepare final report in Germany jointly with a researcher from Kathmandu University

Publish final English-language report jointly in Germany and Nepal

Prepare various articles for publication in scholarly Nepalese, German and international journals

Prepare newspaper articles in Nepali with concise development messages

3.1.5 Assumptions:

Participating organizations contribute personnel and resources.

3.2 Methodology and working program

3.2.1 Methodology:

Secondary data analysis

There is a wealth of primary quantitative data and reports with qualitative information on MFI in Nepal. Numerous organizations regularly produce monitoring data on the MFIs under their jurisdiction. However, data collection and analysis is neither coordinated nor standardized. The main methodology of the proposed project is therefore a secondary data analysis and evaluation under the auspices of the central bank NRB and in close cooperation with institutions which generate such data, which for the purpose of this cooperation, form a network (cf. *Result 3*, to be supervised by NRB). This will be complemented by selected case studies and, as need arises, by

some primary collection of MFI balance sheet, outreach and performance data. A MFI Data Schedule previously used by the applicant and revised in Kathmandu is included as **Annex 5**.

The development of the methodology is to proceed in the following steps:

- (1) Collecting instruments of MFI data collection and ratio analysis:
CGAP, SEEP/Calmeadow, PEARLS, CARE (Savings & Credit Sourcebook)
- (2) Standardizing instruments:
First draft in Cologne
Test and revise with participating organizations (POs) in Nepal
 - Standard instrument
 - Special modules for different types of MFIs
 An MFI data collection sheet previously used by the applicant in previous studies and revised during project preparation in Kathmandu is given in **Annex 5**.
- (3) Descriptive and qualitative analysis of existing data and reports
- (4) Quantitative analysis of data on MFI sustainability and outreach by participating organizations
- (5) Case studies of MFIs

An example of the proposed methodology, combining quantitative analysis and qualitative assessment, may be found in Seibel, Pant & Dhungel 1998 (abstract cf. **Annex 6**).

Sampling

An overview of financial institutions was prepared for the project preparation seminar and reviewed (but not finalized) during the project preparation seminar:

Financial Institutions, Schemes Offered and Market Segments Served

<i>Financial Institution</i>	<i>Scheme</i>	<i>Market Segment</i>
Commercial banks	comm. banking	
	poverty lending: IBP etc.	small farmers and women
ADBN	comm. banking	
	developm. banking	comm. farmers and development projects
	Microfinance/SFDP	small farmers (incl. women)
Development Banks	Grameen	poor and very poor women
	private development banks	
Finance Companies	commercial finance	small and medium enterprise
	savings mobilisation	middle and lower income people
Insurance Companies	commercial	urban small and medium enterprise
	individual	middle income people
	micro insurance	
Cooperatives (reg.)	with limited banking function	urban employees and small entrepreneurs
	SFCL	small farmers and women

Pawnshops (registered)	registered cooperatives	urban employees and micro entrepreneurs
	commercial	urban lower income people
NGOs	social	urban lower income people
	wholesale	near poor and poor SHG
Unregistered Cooperatives/SHG	retail	near poor and poor SHG
	dhikuti	urban small entrepreneurs
	ASCRA	rural poor
	secondary financial functions	mix
Moneylenders	social insurance groups	urban and rural poor
	agricultural trade	small farmers
	non-agric. trade	small and micro entrepreneurs
	general	labour income people

Project participants will not be able to utilize all data generated on the financial system, nor is all information equally relevant with regard to the project goal. On the basis of a preliminary assessment, participants suggested to place a major emphasis on the Grameen-type development banks, cooperatives, among them SFCLs (which resulted from the transformation of ADBN's small farmers credit project SFDP into autonomous local financial institutions – cf. **ANNEX 7**, for illustrative purposes), finance companies with microfinance activities (particularly HFSC – cf. **Annex 8**), and, to a limited extent, on the poverty banking programs of commercial banks, NGOs and indigenous savings and credit groups (*dhikuti*).

3.2.2 Working program and time schedule

<i>Month</i>	<i>Activity</i>
--------------	-----------------

Cologne University:

1	Preparing instruments of data and ratio analysis
2	

The participating institutions and universities:

4	Prep. conference, contacting participating institutions, selecting research staff
5	Training of researchers
6	Testing of instruments

The research teams:

7	Data collection	Data analysis	Preparing preliminary reports by teams
8			
9			
10			
11			
12			
13			
14			
15			
16			

The teams from Cologne and Kathmandu University:

17	Review of preliminary contributions, preliminary summaries for workshop
18	Final workshop with part. institutions, preparing outlook for follow-up project
19	Writing of the final report by university research teams
20	
21	
22	
23	
24	

References

Acharya, Meena, H.D. Seibel & Bishnu P. Shrestha, 1988:
 Self-Help Groups in Nepal. Asia Pacific Rural Finance (Bangkok) Vol. 1 No. 1, 1988: 1-5.
 Reprinted in: B.R. Quinones, Hg., Self-Help Groups as Informal Financial Intermediaries. Bangkok, APRACA Publications 1992

---, 1990:
 Promotion of Linkages between Banks and Self-Help Groups in Nepal. Bangkok, APRACA

ADB (Asian Development Bank) & NRB (Nepal Rastra Bank), 1994:
 Nepal Rural Credit Review. 4 Bde. Kathmandu, NRB

Albe, Alana, & Nandasiri Gamage 1996:
 Our Money, Our Movement – Building a Poor People's Credit Union. London, ITP

- Bouman, F.J.A., & O. Hospes, Hg., 1994:
Financial Landscapes Reconstructed. Boulder CO, Westview Press
- Conroy, J.D., K. W. Taylor & G.B. Thapa, 1995:
Best Practice of Banking with the Poor. Brisbane, The Foundation for Development Cooperation
- Count, Alexander M., 1996:
Give Us Credit. Research Press, New Delhi
- Deschamps, Jean-Jacques, & Olivier Lambert, 1997:
Financial Sector Note for Cote d'Ivoire. Weltbank, Washington DC, April 1997
- Garson, José, 1996:
Microfinance and Anti-Poverty Strategies. New York, UNCDF
- Getubig, I., J. Remenyi & B. Quinones, eds., 1997:
Creating the Vision: Microfinancing the Poor in Asia-Pacific. Kuala Lumpur, Asian and Pacific Development Centre
- Ghate, Prabhu, 1992:
Informal Finance: Some Findings from Asia. Manila, OUP (for ADB)
- Gibbons, David, 1994:
The Grameen Bank Reader. Dhaka, Grameen Bank
- Gupta, S.K., 1/1994:
From Co-existence to Colaboration: in Search of a Mutually Reinforcing Role for ADBN and NGOs in Nepal. Manila, ADB
- Hulme, David, & Paul Mosely, 1996:
Finance against Poverty. London, Routledge
- Krahn, J.-P., & R.H. Schmidt, 1994:
Development Finance as Institution Building. Boulder CO, Westview
- Llanto, Gilberto M., & Ronald T. Chua, 1996:
Transaction Costs of Lending to the Poor. Brisbane, The Foundation for Development Cooperation
- McKinnon, Ronald I., 1993:
Money and Capital in Economic Development. Washington DC, The Brookings Institution
- Meyer, Richard L., & Carlos E. Cuevas, 1990:
Reducing the Transaction Costs of Financial Intermediation: Theory and Innovations. Economics and Sociology Occasional Paper No. 1710. Agricultural Finance Program, Dept. of Agricultural Economics and Rural Sociology, The Ohio State University, Columbus, Ohio
- North, Douglass C., 1990:
Institutions, Institutional Change and Economic Performance. Cambridge, Cambridge University Press
- Otero, Maria, & Elisabeth Rhyne, 1994:
The New World of Microenterprise Finance. Hartford CT, Kumarian Press

Rutherford, Stuart, 1996:
A Typology of Financial Services for the Poor. London, Action Aid

SEEP1995:
Financial Ratio Analysis of Micro-Finance Institutions. The SEEP Network/Calmeadow. New York, Pact Publications

Seibel, Hans Dieter, 1989:
Finance with the Poor, by the Poor, for the Poor. Financial Technologies for the Informal Sector. With Case Studies from Indonesia. Social Strategies Vol. 3 No. 2: 3-48

---, 1996:
Financial Systems Development and Microfinance: Viable Institutions, Appropriate Strategies and Sustainable Financial Services for the Microeconomy. Roßdorf, TZ-Verlag

H. D. Seibel: Microfinance Capacity Assessment in Nepal. S. 79-88 in: I. Getubig, J. Remenyi & B. Quinones, Hg., Creating the Vision. Microfinancing the Poor in Asia-Pacific: Issues, Constraints and Capacity-building (ISBN 967-9928-56-X). Asian and Pacific Development Centre, Kuala Lumpur 1997

---, & Uttam Dhakhwa, 1997:
From Informal to Formal Microfinance – The Transformation of the Dhikuti in Nepal. Asia Pacific Rural Finance (Special Issue on Grassroots Finance)12/1997:98-101

---, Harihar Dev Pant & Dipak Dhungel: Microfinance in Nepal: an Assessment of Microfinance Institutions Banking with the Poor. Economics and Sociology Occasional Paper No. 2368. Rural Finance Program, Dept. of Agricultural Economics, The Ohio State University, Columbus, Ohio, revised January 1998

---, & Shrestha, Bishnu P., 1988:
Dhikuti: The Small Businessman's Informal Self-Help Bank in Nepal.. Savings and Development (Mailand) Bd. 12 Nr. 2, 1988: 183-200

Todd Helen, 1996a:
Cloning Grameen Bank: Replicating a Poverty Reduction Model in India, Nepal and Vietnam. London, ITP

-, 1996b: Women at the Centre: Grameen Bank Borrowers After one Decade. Boulder CO, Westview

Upadhyay, Shreekrishna, 3/1995:
Experience in Grassroot Organization Development for Poverty Alleviation in Nepal. SAPROS, Kathmandu