



2010

A Case Study of Successful MFI Branch Operation in the Hills of Ilam District



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Abstract:

*This study documents the 21 months progress of two MFI branches operating in different modalities in the hills of Ilam district under the **Expanding Access to Finance in the hills of Eastern Nepal** project implemented jointly by Mercy Corps Nepal and Nirdhan Utthan Bank Limited. The study captures a brief introduction of the two modalities, their differences, strengths and weaknesses and uses the different MFI progress indicators to compare the progress of the two branches over the same time period so that it will be easier to further analyze potential microfinance modalities suitable for the hills. The documentation of the successful operations in the hills can be a learning document for institutions willing to implement or support microfinance programs under similar conditions in the hills of Nepal. The study also provides a few recommendations to the implementing institutions for further improvement of microfinance services in the hills of Nepal which can be sustainable, affordable and easily accessible to a large number of clients.*

Acknowledgements:

The documentation of this study become possible with the due support and kind cooperation of Nirdhan Utthan Bank, Ltd. (NUBL) management, Regional office staff in Birtamod, and Branch office staff in Fikkal and Ilam, who provided a great deal of information and facilitated the interactions with the clients and communities. Many thank to the NUBL team. Special thank goes to the clients, community representatives and local leaders who provided their valuable time and expressed their views on the availability, options and comparison of the microfinance services in their communities.

Sincere gratitude to Mercy Corps Nepal Country Director Mr. Josh DeWald and Deputy Director Mr. Sanjay Karki who always encouraged and extended full support and guidance to document the practices and achievements and make it available for learning/ sharing.

1. Background:

Microfinance is defined as the access to financial services for the poor and low income groups. It is universally accepted as an effective tool for addressing poverty. Demand for microfinance is largely unmet in Nepal as it is in the world as a whole. About 31% of the population in Nepal lives below the national poverty line. As per multidimensional poverty index, the percentage of income poor (US\$ 1.25 per day) population in Nepal is estimated to be 55%¹. Microfinance Institution outreach, through government, private sector and international donor efforts, is inadequate and heavily concentrated in easily accessible areas, reaching only 6.3% of the total population and 20% of below the poverty line population². In the five development regions of Nepal, the Eastern development Region, which is the targeted area of the *Expanding Access to Finance in the Eastern Hills of Nepal* project- a partnership project of Whole Planet Foundation, Mercy Corps and the MFI Nirdhan Utthan Bank, Ltd. (NUBL)- outreach covers only 20% as of July 2009, up from only 11% in 2007³.

Over the past two decades, Nepal's financial sector has expanded and the number and type of financial intermediaries have grown rapidly. Still, access to sustainable financial services remains limited for many people in Nepal, especially in the rural plains, hills and mountains. Access to diverse financial products and services is an indispensable component for successful participation in a market economy. In order to expand access to sustainable financial services in the rural areas in Nepal, MFIs need outreach support and technical assistance to develop wider branch and client networks, appropriate products, and procedures for profitable lending.

Various microfinance modalities are practiced by different institutions in Nepal. The most common of them are Grameen banking modality, Saving & Credit Cooperative Modality, Self-Help Group (SHG) Modality or Village Savings & Lending Association (VSLA) modality, and the Village Banking Modality. Yet, no modality has proven successful in reaching a large number of poor people in the sparsely populated hills and mountains of Nepal in a sustainable and consistently well-governed way. In the recent years, NUBL has been testing the Self-Reliant Group (SRG) Modality both in the hills and plain. The modality is a blend of Grameen, Village Banking and SHG modalities.

The hilly and mountainous districts of the Eastern Development Region are rich in natural resources, especially non-timber forest products (NTFPs) and high value crops. Mercy Corps Nepal has been working in the Eastern Economic Corridor of Nepal to strengthen the value chain of high impact commodities (cardamom and ginger) since early 2007. In the course of implementing these projects, Mercy Corps found that the delivery of financial services to the poor remained a challenge despite the region's rich natural resources. As a result, Mercy Corps

¹ Oxford Poverty and Human Development Initiative (OPHI), Country Briefing 2010

² Presentation MF Summit Nepal 2010, G.B. Thapa

³ Presentation MF Summit Nepal 2008, GB Thapa

carried out a financial services assessment in May 2008 in the hilly, mountainous districts of the Mechi Zone, which confirmed that access to financial services was inadequate.

Expanding Access to Finance in the Eastern Hills of Nepal Project

Mercy Corps formed a strategic alliance with NUBL, the largest MFI in Nepal, to develop effective modalities for expanding access to finance into the hills and mountains of the Eastern Region of Nepal. This alliance, and concurrent discussions with the Whole Planet Foundation, led to the development of the *Expanding Access to Finance in the Eastern Hills of Nepal* project, which aims to provide microfinance services to under-served areas and communities through Grameen-model and Self Reliant Group (SRG)-model. The Goal of the project is to sustainably develop and expand appropriate financial services to poor households in remote hilly and mountainous regions of Eastern Nepal while simultaneously generating best practices that offer the potential for replication across Nepal.

Project Partners:

Whole Planet Foundation

The Whole Planet Foundation was born out of Whole Foods Market's desire to give something back to those who have helped Whole Foods Market succeed while focusing on the persistent problem of world poverty and hunger. The Foundation was established in October, 2005. The Whole Planet Foundation represents a significant expansion of Whole Foods Market's mission to actively participate in their communities. The creation of this foundation directly connects Whole Foods Market customers and Team Members to the villages in developing countries that supply them with products. Establishing these community partnerships will contribute to the economic well being of the communities where they source products. Whole Foods Market sources tea from Nepal.

Mercy Corps:

Mercy Corps is an international, non-governmental humanitarian relief and development agency that works amid disasters, conflicts, chronic poverty and instability to unleash the potential of people who can support positive change for their communities in transitional periods. The organization was founded in 1979. Since 1979, Mercy Corps has provided \$US 1.5 billion in assistance to people in 106 countries. Supported by headquarters offices in North America and Europe, the agency's unified global programs currently employ over 3,700 staff and reach over 16 million people in more than 40 countries.

Mercy Corps' Mission is to alleviate suffering, poverty, and oppression by helping people build secure, productive and just communities. Key program areas include emergency relief; sustainable economic development; and, initiatives that strengthen local civil society. The agency prioritizes public, private and civic sector partnerships as vital to positive change in transitional periods.

Mercy Corps has been active in Nepal since late 2005. Mercy Corps works in Nepal to strengthen, protect and expand access to productive livelihoods for the poor.

Nirdhan Utthan Bank Limited (NUBL)

Nirdhan was founded and registered, with the sole objective of poverty reduction, with the Government of Nepal in April 1991 as an NGO. It took approximately seven years to institutionalize the NGO to the first microfinance bank in Nepal, receiving its banking license in 1999. The vision of NUBL is to be a bank with a social conscience that enables poor to contribute equally to a prosperous, self-reliant rural society through self-employment and social awareness, and help to reduce poverty in Nepal. NUBL currently operates in 27 districts of 75 districts of Nepal.

As of today, NUBL is the largest MFI in Nepal serving to 126,787 poor households through 81 office networks (75 branch offices, 5 regional offices, and 1 central office) across 27 districts. NUBL has the mission of reducing poverty through microfinance and its support services.

2. Scope & limitations of the Study:

The study aims to document the practices, procedures and progress achieved by two branches operating in two different modalities under similar socio-economic, geographic, market access and infra-structure environments and makes comparisons to discuss the potential for replication in other parts of the hills and mountains of Nepal. Even though 21 months of operation is not sufficient for a 3-years project to draw conclusions and make comparisons, the trend analysis and documentation of the achievement thus far can be useful for other microfinance actors, researchers, students and the implementing partners themselves to further improve the service delivery modality to expand microfinance services into the hills and mountains. Furthermore, the socio-economic, market access and infrastructure conditions of Ilam district, where the MFI branches under this study are located, may not be representative of the broader Nepalese hills, but still there is a ground for the learning and sharing of the best practices among the different stakeholders.

Objectives of the study:

- To document the practices and progress achieved.
- To compare the progress trends of the two branches operating in two different modalities.
- To analyze the strengths and weaknesses of the two modalities.
- To make available the learning of the project for further improvement and use.

Methodology:

Desk top study & interactions with stakeholders, NUBL staffs and clients were carried out for this case study. Study of the monthly reports submitted by NUBL head office, reporting of the Regional Office in Birtamod, Reporting of the concerned branch office to Mercy Corps, discussions with NUBL branch, Regional and Head Office staff, interactions with selected communities and clients are the main sources of information for this study. Key indicators and ratios of MFI branch progress have been compared to provide a glimpse of the progress in two different modalities.

3. Branch information

As of Mid-July 2010

	Ilam Branch	Fikkal Branch
Date of Establishment	09/11/2008	09/11/2008
Working Modality	Grameen (modified)	Self Reliant Group (SRG)
VDC/Municipality Reached	8	6
Name of VDC/Municipality	Ilam, Barbote, Sangrumba, Soyang, Sumbek, Godak, Sakhejung, Maipokhari	Fikkal, Kanyam, Kolbung, Pashupatinagar, Gorkhe, Panchkannya
No. of Households in the above-mentioned VDCs⁴	12250	10671
Households Covered	1332	1323
No. of groups	63	65
Loan clients	1001	1059
Loan disbursement	37052500	29941400
Loan outstanding	17637150	18287587
Savings mobilized	2862046	3037733
Number of staff	4	4

4. Characteristics of modified Grameen and SRG Modalities operated by NUBL in Ilam District

	Modified Grameen Modality	SRG Modality
Group Composition	<ul style="list-style-type: none"> • A group consists of 10-40 women having permanent residency in the area • The group members elect Chairperson and Secretary 	<ul style="list-style-type: none"> • A group consists of 10-40 women having permanent residency in the area • The group members elect Chairperson, Secretary, Treasurer and Joint-Treasurer
Compulsory Group Training (CGT) & its content	<ul style="list-style-type: none"> • One week CGT (1-2 hours a day) • Training content includes prayer, group & group 	<ul style="list-style-type: none"> • One week CGT (1-2 hours a day) • Training content includes prayer, group & group meeting

⁴ Population projection, CBS

	meeting management, products, services, terms and conditions, procedures, interest calculation, repayment system, roles and responsibility of Chairperson, Secretary & members and signing by the members.	management, products, services, terms and conditions, procedures, wholesale group lending, individual lending, interest calculation, records keeping, minute taking, repayment system, roles and responsibility of office bearers & members, and signing by the members.
Pre-test	<ul style="list-style-type: none"> The branch staff other than the staff training the group conducts oral pre-test to ensure the members understanding and willingness to join microfinance group 	<ul style="list-style-type: none"> The branch staff other than the staff training the group conducts oral pre-test to ensure the members understanding and willingness to join microfinance group
Group Recognition Test (GRT)	<ul style="list-style-type: none"> The Branch Manager or a person from the Regional Office conducts GRT to make sure the members are from their target groups; they understood the service provisions and terms & conditions and accept each other as group members. Once the Group members pass the GRT, they become eligible for enrollment into NUBL financial system. 	<ul style="list-style-type: none"> The Branch Manager or a person from the Regional Office conducts GRT to make sure the members are from their target groups; they understood the service provisions and terms & conditions and accept each other as group members. Once the Group members pass the GRT, they become eligible for enrollment into NUBL financial system.
Group Meeting	<ul style="list-style-type: none"> Group meeting is held every 28 days at the time and venue agreed by the group. The first meeting day is decided by the group in consultation with the NUBL staff 	<ul style="list-style-type: none"> Group meeting is held every 28 days at the time and venue agreed by the group. The first meeting day is decided by the group in consultation with the NUBL staff
Record Keeping	<ul style="list-style-type: none"> NUBL staff keeps all the records related to the financial transaction. 	<ul style="list-style-type: none"> The SRG office bearers keep all the records related to financial transactions & group minutes and NUBL staff facilitates and mentors till the SRG is able to do the transaction independently. Transaction sheet is prepared in duplicate and a copy is kept by the SRG and the other submitted to NUBL.
Eligibility for getting loans	<ul style="list-style-type: none"> 50% of the group members 	<ul style="list-style-type: none"> The SRG is eligible for getting

(collateral free)	decided by the groups are eligible for getting loan in the first meeting. The rest of the members can get loan in the following meeting provided the members receiving loans in the first meeting have satisfactory utilization & installment repayment.	wholesale loan from NUBL only after 3 meetings (3 months) and opening of group saving account with NUBL. The maximum wholesale loan size is 20 times the SRG compulsory group savings or NPR 1000000 whichever is less.
Compulsory Savings	<ul style="list-style-type: none"> • 4% of the loan amount at the time of taking loans 	<ul style="list-style-type: none"> • The monthly compulsory saving amount is decided by the SRG; SRG may or may not deposit the compulsory saving amount exceeding 5% of their wholesale loan Bank account. The SRG mobilizes the savings as emergency loans among the members if required.
Interest on General Loans	<ul style="list-style-type: none"> • NUBL charges 20% on diminishing balance to the individual clients 	<ul style="list-style-type: none"> • NUBL charges 18% on diminishing balance to SRG and the SRG charges more than 18% (generally 24%) to its members.
Voluntary Saving	<ul style="list-style-type: none"> • Group members can save any amount in their individual account with NUBL 	<ul style="list-style-type: none"> • Group members can save any amount in their individual account with NUBL
Interest on Savings	<ul style="list-style-type: none"> • NUBL provides 7% interest on savings account. 	<ul style="list-style-type: none"> • NUBL provides 7% interest on savings account.
Memorandum of Understanding (MoU) Agreement	<ul style="list-style-type: none"> • No provision of MoU. • Loan agreement with individual members 	<ul style="list-style-type: none"> • All the SRG members have to sign MoU with NUBL • SRG has to sign agreement with NUBL
Group Responsibility	<ul style="list-style-type: none"> • Group responsibility exists as social pressure but individuals are liable to pay the loans 	<ul style="list-style-type: none"> • Strong group responsibility exists as the wholesale loans are issued to SRGs, group pressure ensures the repayment from the individual members
Group expenditures	<ul style="list-style-type: none"> • Minor group expenditures managed with center fund collected 	<ul style="list-style-type: none"> • SRG earns profit on the retail lending and meet the group expenditure with the revenue generated
Repayment Schedules	<ul style="list-style-type: none"> • Repayment schedules are agreed on the basis of cash flow situation of the project proposed by client, however, the interest has to be paid on 	<ul style="list-style-type: none"> • Quarterly installment payment by SRG, individual repayment schedules are agreed on the basis of the cash flow situation of the project purpose ensuring

	a monthly basis	that the SRG will have enough fund to pay the installment of wholesale loans, however, the interest has to be paid on a monthly basis by individuals and SRG
Service Charges	<ul style="list-style-type: none"> • 1% of the loan 	<ul style="list-style-type: none"> • No service charge for wholesale loan
Cost of fund to branch office	<ul style="list-style-type: none"> • 10% on diminishing balance 	<ul style="list-style-type: none"> • 10% diminishing balance
Loan purpose	<ul style="list-style-type: none"> • Loan purpose can be any productive income generating activity chosen by the members 	<ul style="list-style-type: none"> • Loan purpose can be any productive income generating activities chosen by the members for the wholesale loans but the SRG can disburse emergency loans to its members for any purpose out of their group fund
Capacity Building and Empowerment	<ul style="list-style-type: none"> • Access to financial services, participation in group meetings, decision making process and discussion on social and development issues leads in capacity building and empowerment of the group members. 	<ul style="list-style-type: none"> • The modality provides opportunities to SRG members to directly involve in their own capacity building, learning by doing, fund management, profit sharing and decision making leading to able, empowered and productive society.
Profit sharing	<ul style="list-style-type: none"> • No such provision as the MFI provides loans to individual members and takes the interest and service charges earned. 	<ul style="list-style-type: none"> • The SRGs generate revenue through retail lending, re-investing the repayment received, profit earned and members compulsory saving in short term emergency loans and earns more interest. Thus generating enough fund to meet its own expenses, loan loss provision and at the end of the year distributing bonus to its members. (In the FY ending in Mid-July 2010, 34 SRGs that have completed one year of operation, earned interest margin of NPR 897,078 in total. Out of the total profit of the SRGs, 20% is set aside as SRG reserve fund, 1% of the loan outstanding as loan loss reserve and the rest of the amount is distributed among the SRG members.)

Dependency	<ul style="list-style-type: none"> • The groups and members are dependent on the MFI and its staff for doing transactions and taking loans. 	<ul style="list-style-type: none"> • The SRG becomes more capable and independent with the time and experience and can manage the transactions taking place and provide loans to some extent at their own.
Ownership	<ul style="list-style-type: none"> • The group members feel less ownership of the group 	<ul style="list-style-type: none"> • Strong sense of ownership among the SRG members
Relationship with MFI	<ul style="list-style-type: none"> • Clients- service provider 	<ul style="list-style-type: none"> • The relationship of the MFI with SRG is like that of promoter, facilitator, mentor or partner.

5. Strengths and weakness of Modified Grameen and SRG Modalities

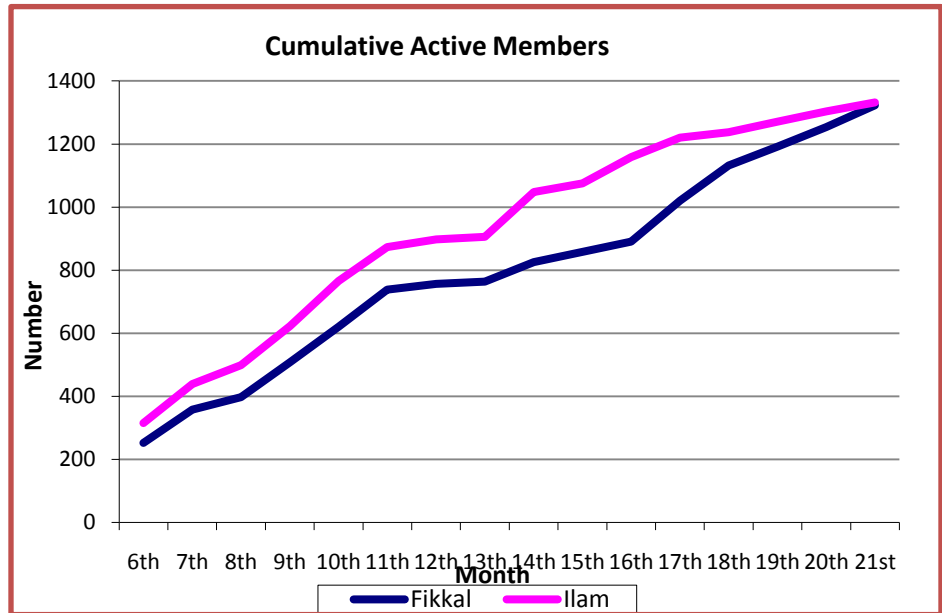
Modified Grameen Modality	
Strengths: <ul style="list-style-type: none"> • Easy and familiar modality of operation • All the members can have access to loans within 2 meetings • No need of records keeping by group, the MFI staff conducts meeting and keeps all the records, thus the meetings are not time consuming • Suitable modality even for the illiterate members • More suitable in easily accessible and densely populated area • Less paper work • The microfinance meeting can be used as the forum for discussion on different social and development issues and dissemination of awareness messages 	Weaknesses: <ul style="list-style-type: none"> • High cost of operations in hills and sparsely populated areas • Presence of MFI staff is compulsory in each group meeting • Difficulty in maintaining group discipline, as loans are provided to individual members, over the time the members are reluctant to take responsibility of other members • Less ownership feeling • Higher drop outs, exclusion of very poor and vulnerable members due to individualistic behaviors of the other members • More formal process even to get a small amount of emergency loan
SRG Modality	
Strengths: <ul style="list-style-type: none"> • Promising modality for the hills and sparsely populated area • Community ownership and acceptance • Self-Reliant and empowering process • Capacity building • Profit sharing • Direct participation of members in decision making 	Weaknesses: <ul style="list-style-type: none"> • Comparatively new modality, even the initiator is yet to build confidence on the success of the modality, still under testing • Difficulty in building trust with the groups and members in the beginning due to its savings led nature • More operational and capacity building cost in the beginning

<ul style="list-style-type: none"> • Reduced staff cost in the long run for the MFI • Membership growth • Comparatively lower dropout rate • Strong group discipline and group responsibility • Social capital formation • Easy and flexible process to get emergency loan at the door steps • Once SRG is able is capable of correct record keeping and minute taking, there is no need for the MFI staff to attend regular meetings, however, monitoring supervision is required at least in alternate meetings 	<ul style="list-style-type: none"> • Time consuming group meetings • Not that suitable for the groups where there are no literate members that can do simple mathematics and minute taking • More paper work • Transaction cost in submitting transaction records sheet & other documents to MFI after each meeting • More stationery expenses • Low yield on portfolio for MFI • Expensive SRG capacity building process
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6. Comparative Study of Progress Trend of Ilam and Fikkal Branches over the 21 months of Operation

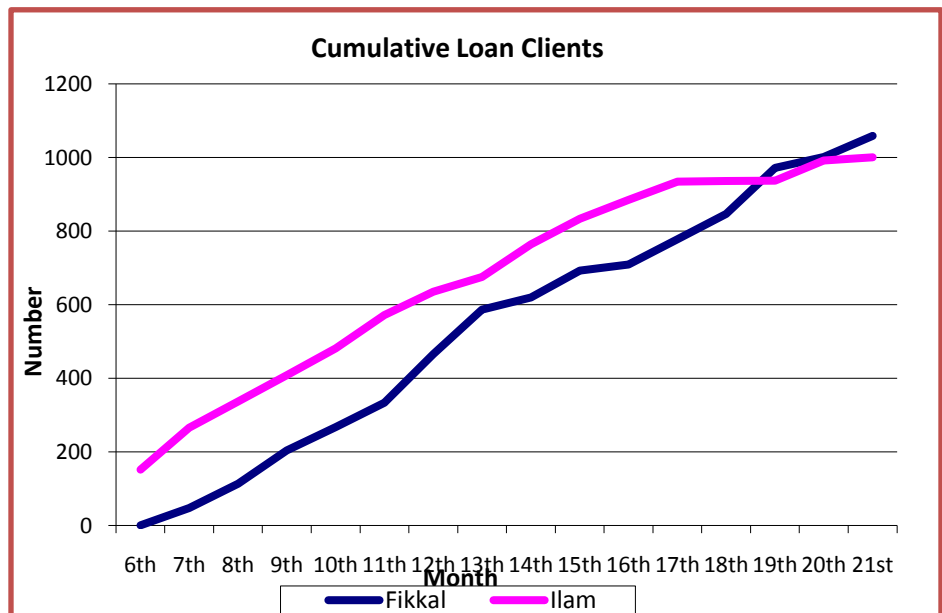
a. Active Members

The Ilam branch started group formation earlier, and enrolled more members, than the Fikkal branch. This is due to the familiarity of the Grameen modality among the staff members as well as the clients and immediate eligibility of loan disbursement under the modality. It took time for the members to understand the SRG modality and its benefits in case of the Fikkal branch. At the end of the 21st month, both branches have an almost equal number of active members.



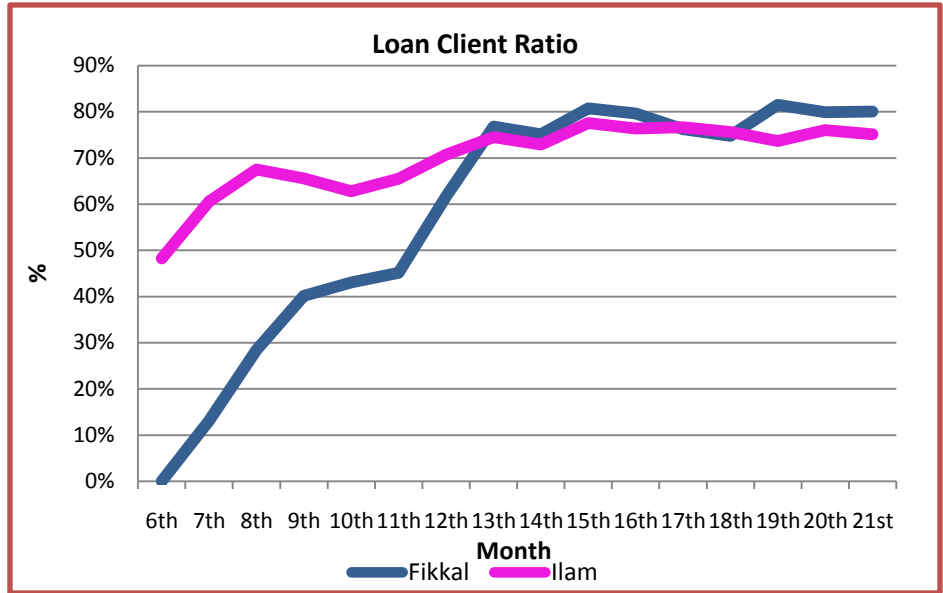
b. Loan Clients

In the beginning, Ilam branch had higher number of loan clients, whereas, in the later months, Fikkal branch supports a higher number of loan clients. This is due to the terms of SRG modality, where groups are eligible to wholesale loans only after 3 months of operations. As the SRG's continued transactions with NUBL, they realized the benefit of the modality and increased loan volume.



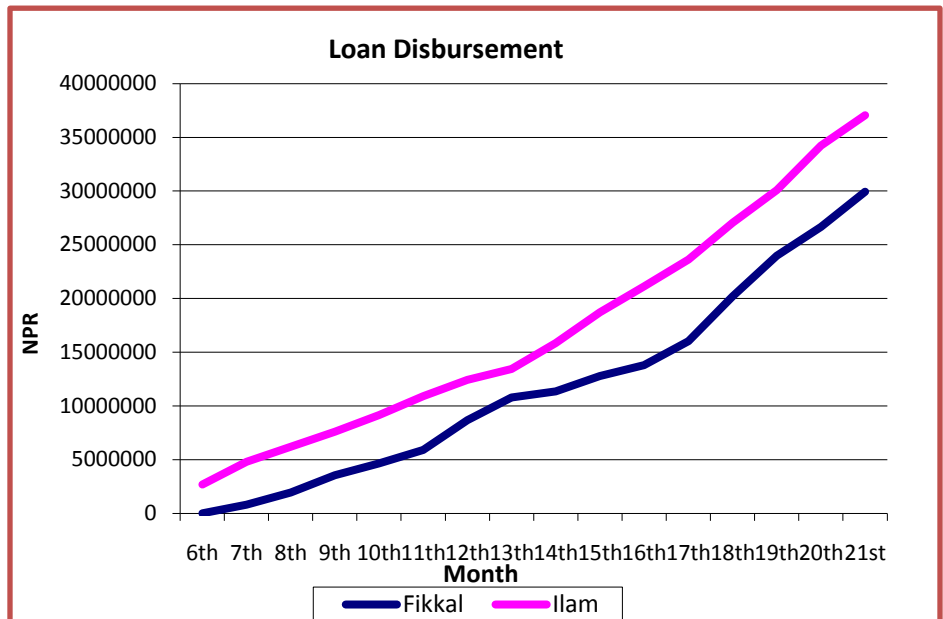
c. Loan Client Ratio

The SRG modality is a savings led modality where groups are eligible for loans only after 3 months of operation; the loan client ratio in case of the Fikkal branch is low in the first year of operations as compared to that of the Ilam branch. The loan client ratio of the Fikkal branch after the 13th month is more or less similar to the Ilam branch, in an increasing trend. This increase in the loan client ratio with the increase in active members is very much a positive sign for the success of the branch and indicates that the SRG modality is also sustainable and profitable over the period.



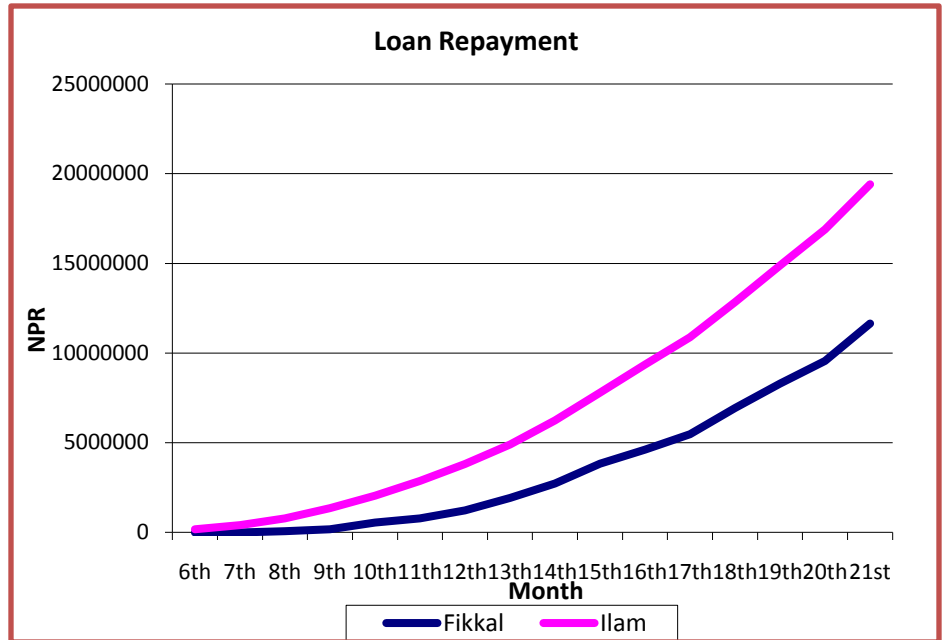
d. Loan Disbursement

The cumulative loan disbursement trends for both the branches show a steady increase throughout the period. However, the three months waiting period for SRGs to receive loans in the one hand and mobilization of member savings amongst the members themselves in the other resulted in less disbursement in the Fikkal branch. In the case of Ilam branch, the members apply to the bank even for the small amount of emergency or seasonal loans, whereas in Fikkal branch, the SRGs meet the demand of the small emergency loans of their members with their group fund and profit. Furthermore, the loan disbursement in SRG modality depends on the amount of the compulsory saving deposited by the SRGs; it is obvious that the savings amount is less in the early stage of operation.



e. Loan Repayment

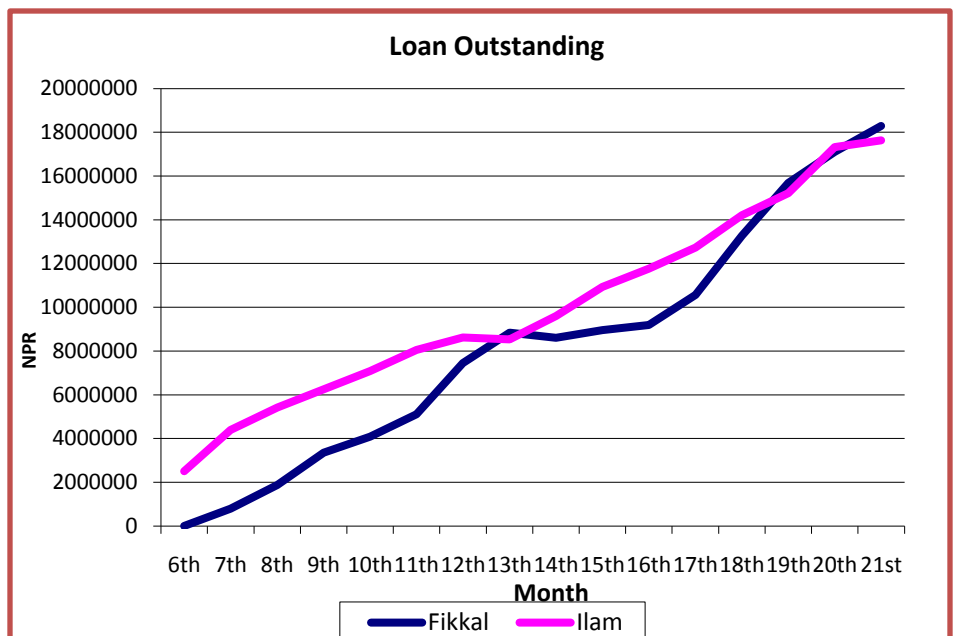
The loan disbursement in Grameen modality starts earlier, leading to the earlier repayment of loans and the loan disbursement in SRG modality takes some time, thus it is obvious that the loan repayment in Fikkal branch is less than that of the Ilam branch. In Grameen modality the loan repayment may start within one month of the first loan disbursement, if the loan repayment schedule of any of the loan client is on a monthly installment; whereas, in the



SRG modality, even if any of the individual members has monthly repayment schedule, the SRG is not obliged to pay the installment to the bank on a monthly basis. The SRGs repay the loans on a quarterly basis to the banks and mobilize the repayment received from the individual members among the SRG members.

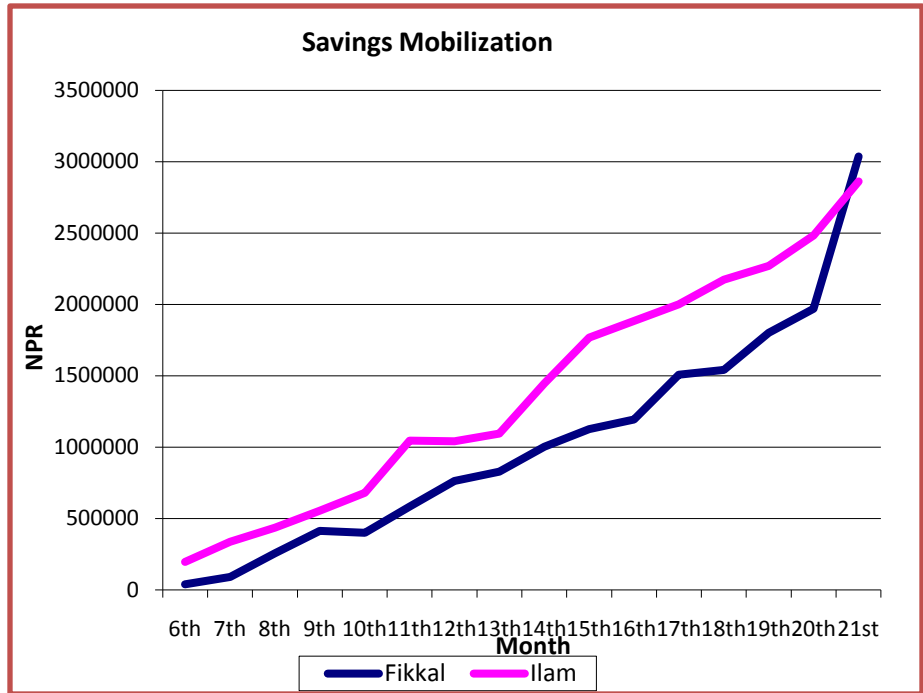
f. Loan Outstanding

A positive loan outstanding trend and a high repayment rate are key indicators of successful MFI operations. Since both the Ilam and Fikkal branches have 100% repayment rates thus far, the trend of loan outstanding shows that under similar conditions, SRG modality can be successfully implemented to benefit a large number of clients in sparsely populated area also.



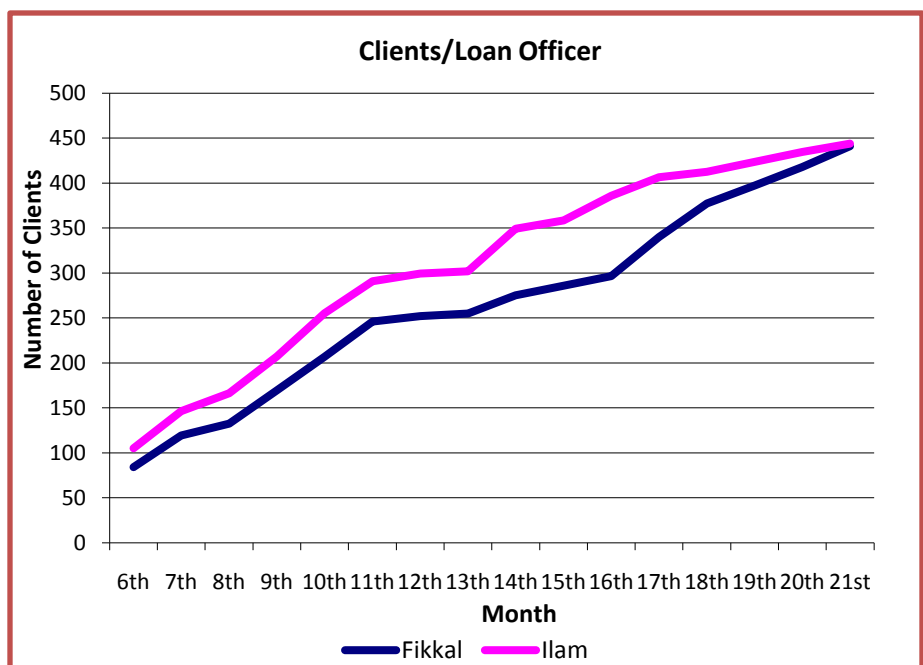
g. Savings Mobilization

The savings in both the branches includes compulsory savings and voluntary savings of the members. The savings mobilized in the Fikkal branch is lower than the Ilam branch in the beginning; however it has gone up in the last few months. The savings amounts in Fikkal and Ilam cover 17% and 16% of their outstanding loans, which is very low but the progress within two years of operation could be considered satisfactory. However, both the branches need to focus in increasing the savings.



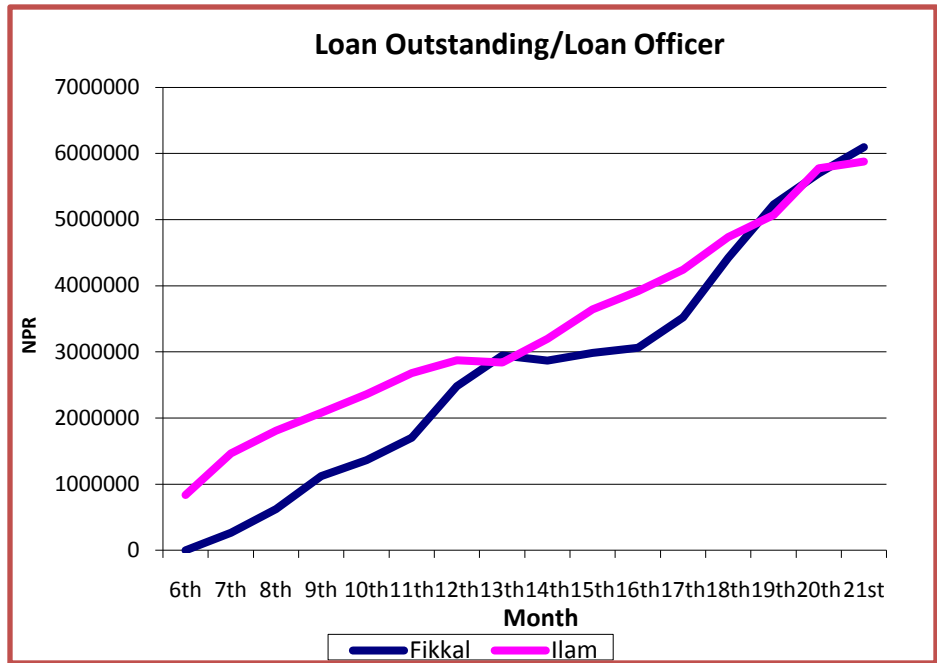
h. Clients/Loan Officer

The clients to loan officer ratio in both branches is increasing, but it has steadily increased in the Fikkal branch in the last few months, and at the end of the 21st month both branches have the same ratio. The trend shows that the ratio will be higher for the Fikkal branch in the coming months as the mature SRGs will conduct their operations themselves and the loan officers will need to visit alternate SRG meetings as opposed to each meeting.



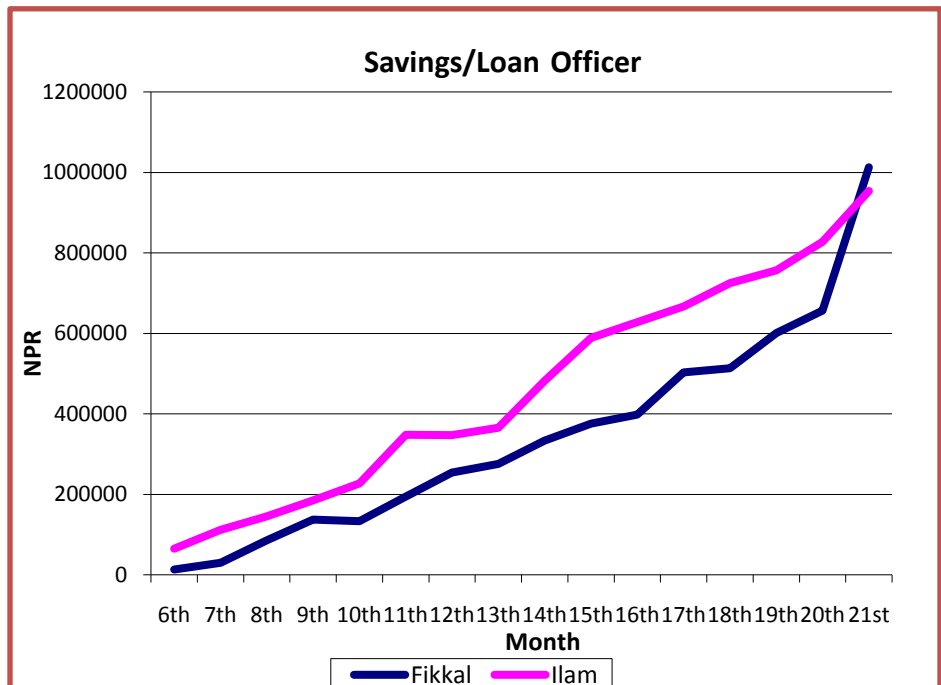
i. Loan Outstanding/Loan Officer

The loan outstanding per loan officer in the Fikkal branch has exceeded that of the Ilam branch in 21 months. The trend shows that it will increase faster in the Fikkal branch as the operation goes on and SRGs become capable of managing their transactions. The increasing trend of the ratio in both the branches is encouraging as both branches have 100% repayment rate so far. The higher the ratio, the lower will be the operating cost involved.



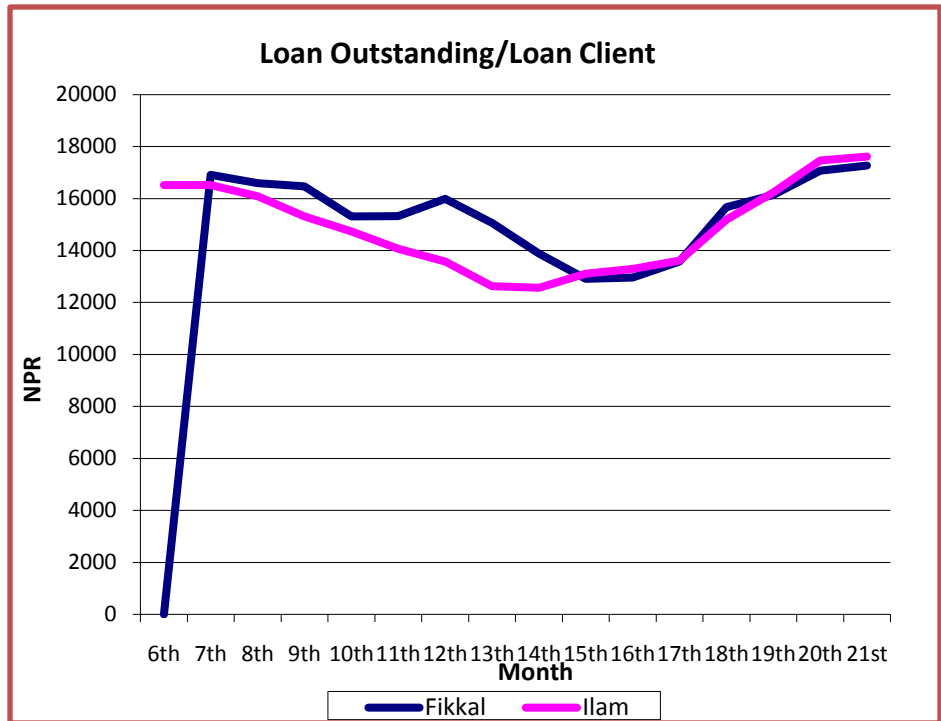
j. Savings/Loan Officer

The ratio of savings/ loan officer is slightly better in Fikkal branch in the last few months. This will keep on increasing faster in the Fikkal branch as at least 5% compulsory savings is required for wholesale loans whereas the minimum compulsory saving in Ilam branch is 4% of the loan amount. Besides the compulsory savings, mobilization of voluntary savings will play an important role as it will provide the MFI with loan funds at disposal; it is also an indication of the success of client enterprises and the creation of savings habits.



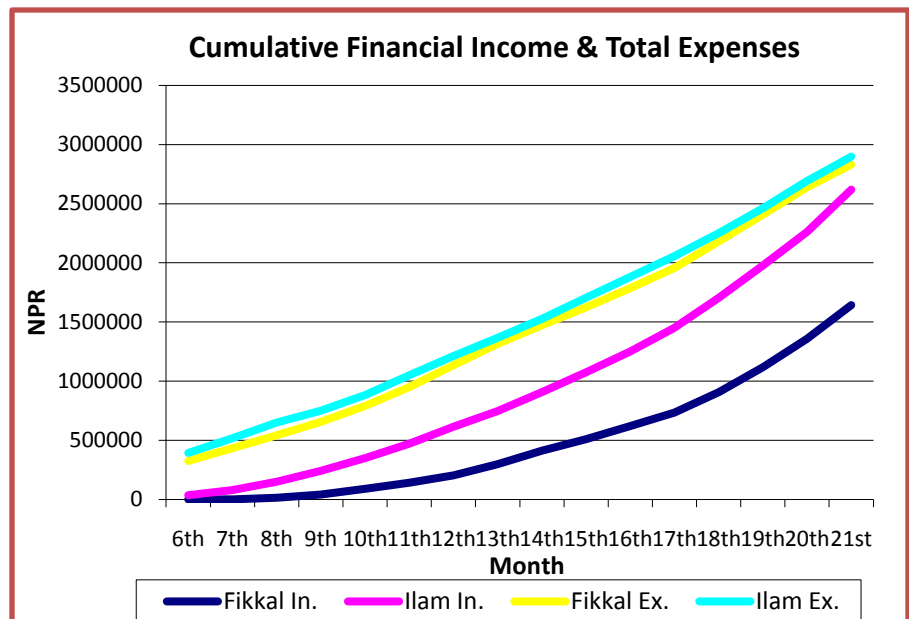
k. Loan Outstanding/Loan Client

The loan outstanding/loan client shows the loan consumption capacity of clients and performing assets of the MFI. The trend of loan outstanding/loan client in both the cases of Ilam and Fikkal branches is more or less similar. The ratio being a little lower in the Fikkal branch is contributed by the operational modality, in which the loan disbursement starts at least three months after member enrollment, and consequently, members are eligible to receive larger size loans in the second year only after completing at least one year of the first year loan disbursed.



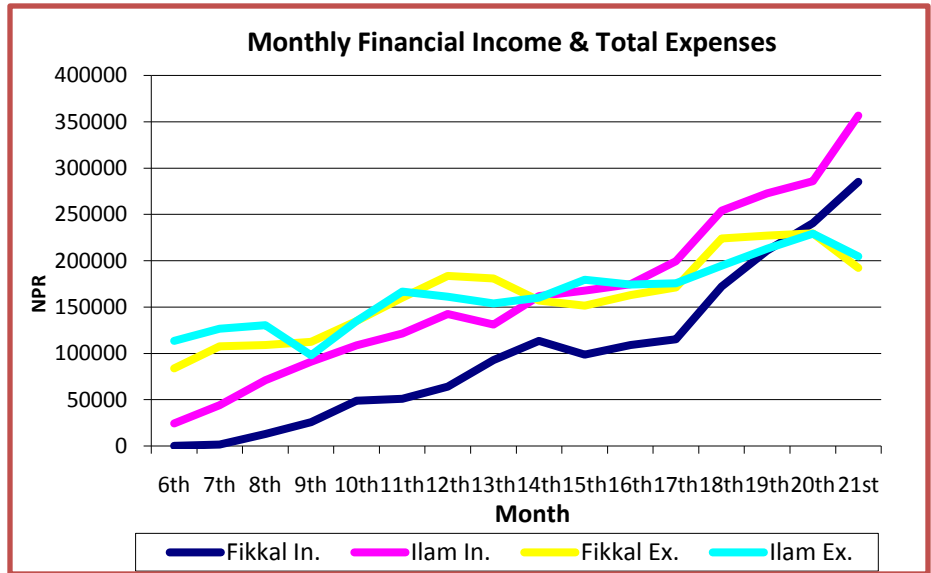
l. Cumulative Financial Income & Total Expenses

The trends of cumulative financial income and total expenses in both the branches show that the branches are yet to cover the total expenses incurred and it will take a few more months in case of Ilam and a several months in the case of Fikkal to cover the total cost incurred. However, the important indication of success is that the gap between the total financial income and total expenses is narrowing even without considering the grant received by the MFI for the interim loss incurred.



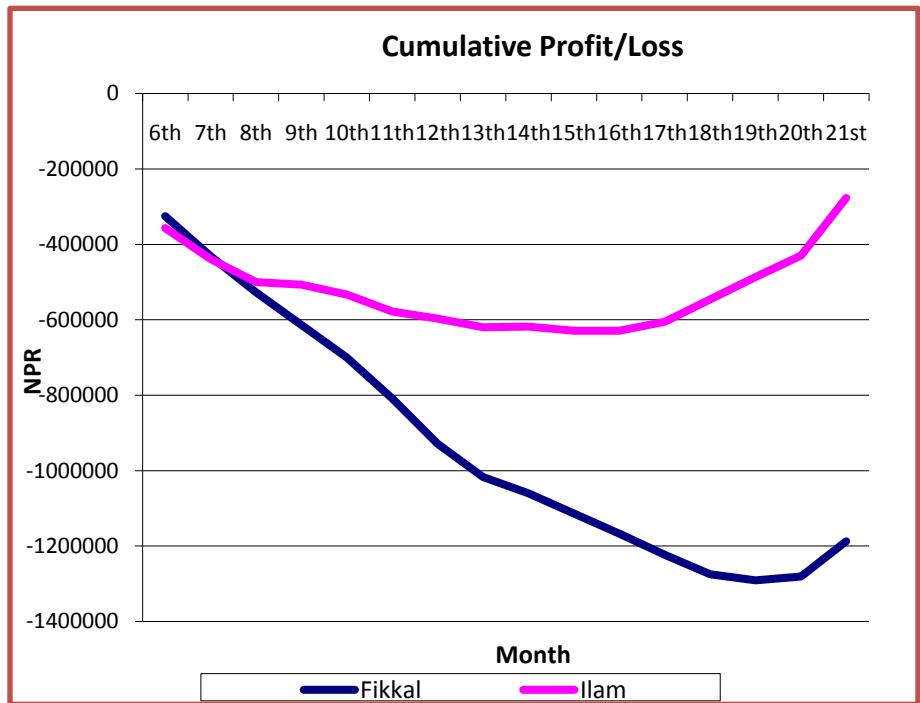
m. Monthly Financial Income & Total Expenses

The trends of monthly income and expense show that the Ilam branch is fully able to cover its total expenses as of the 17th month, whereas the Fikkal branch could cover its cost in the 20th month. If there is no huge disbursement in a single month contributing a large amount (1% compulsory) in loan loss provision, both the branches will be able to cover all of their expenses with their financial income on a monthly basis.



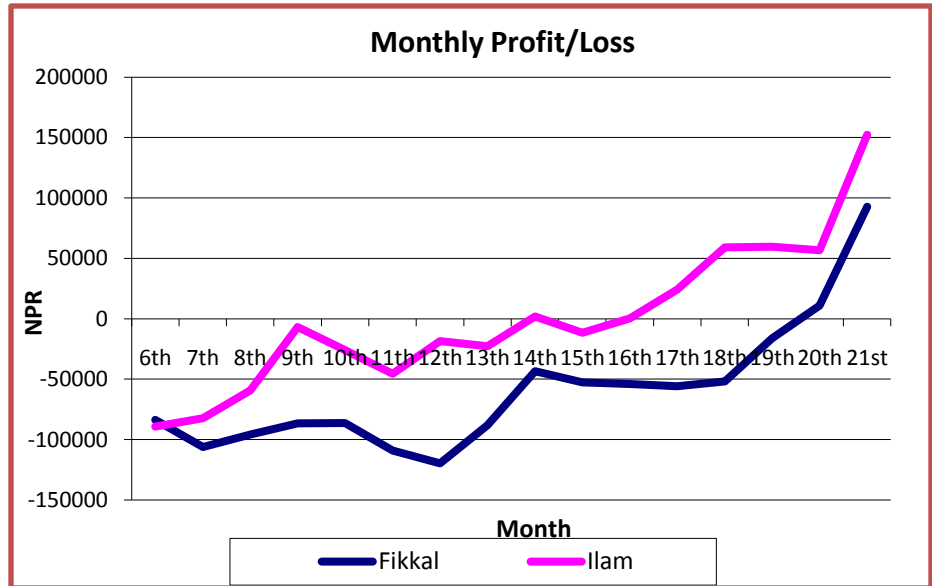
n. Cumulative Profit/Loss

Both the branches are yet to reach a cumulative profit figure; however, both of them are reducing their losses. By the end of 21 months of operation, the Ilam branch is in loss of NPR 277,353 and the Fikkal branch in loss of NPR. 1,187,630. Since both branches received grant support for the loss incurred until they are able to cover monthly expenses, the MFI did not have to bear extra financial burden or investment and the grant support has greatly contributed in expanding financial services in the hill with minimal risk to the MFI.



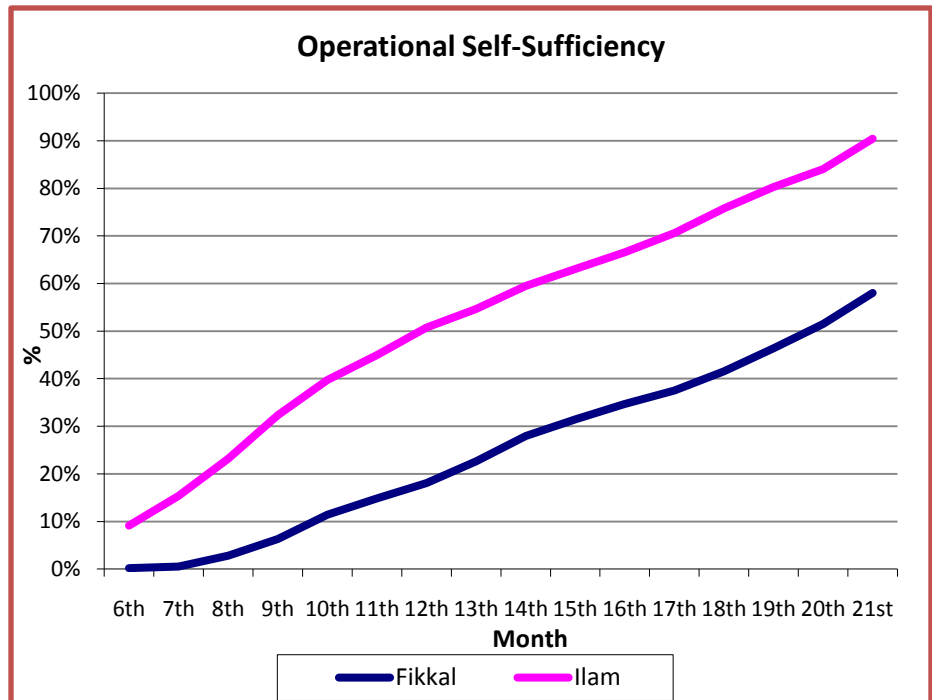
o. Monthly Profit/Loss

The monthly profit/loss trends for both the branches show fluctuations over the period. The factors contributing to the fluctuations are early period operations, loan loss provision and revision of staff cost and benefits. Once the branch expansion reaches a saturation point, the profit is supposed to be stable or in increasing trend.



p. Operational Self-Sufficiency

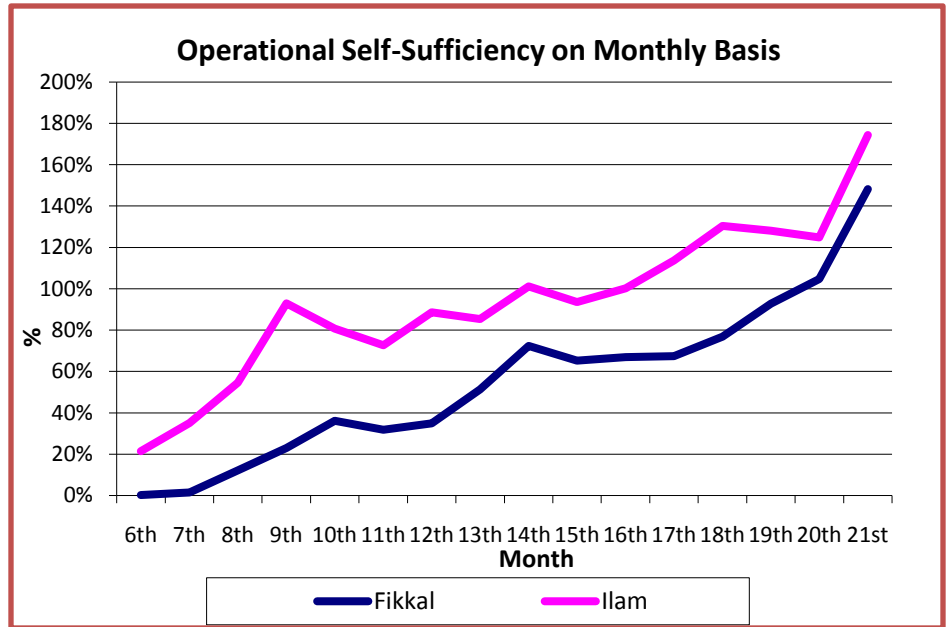
Operational self-sufficiency measures how well an MFI covers its costs (including loan loss provision and cost of fund) through its operational revenues. The trend of operational self-sufficiency for both the branches is gradually increasing. Since both the branches received grants for their incurred operational losses, both the branches can be considered to be 100% operationally self-sufficient, however, the MFI should look at the operational self-sufficiency without considering the grants received. The trends indicate



that Ilam branch will reach full operational self-sufficiency within 24 months, however, Fikkal branch will need around 10 months to reach full operational self-sufficiency.

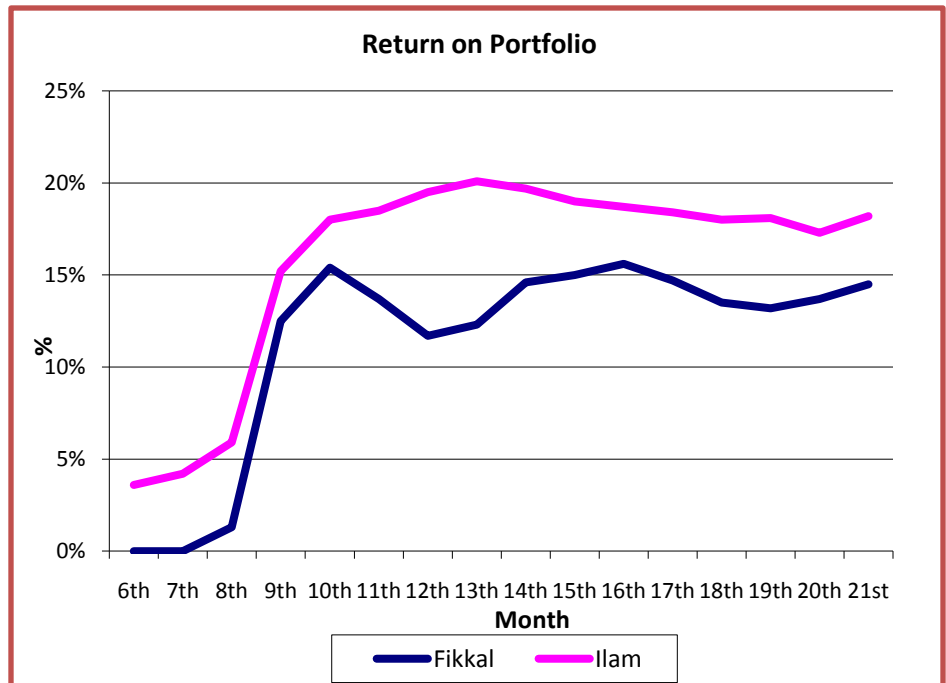
q. Monthly Operational Self-Sufficiency

Operational self-sufficiency on a monthly basis indicates the positive growth and successful operation of both the branches.



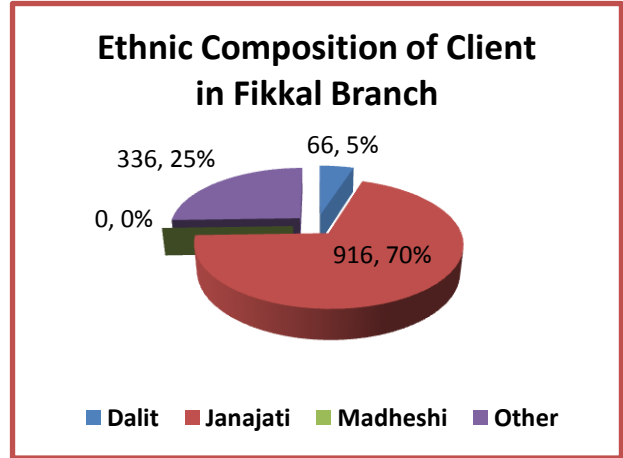
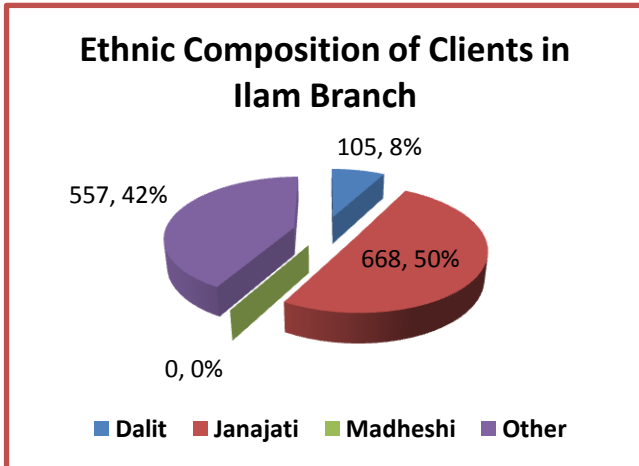
r. Return on Portfolio

Since both the branches are in the early growth stage, the return on portfolio does not indicate the exact yield. The outstanding loan steadily increases in the growth stage. However, the trend clearly indicates the difference in the yield in two different modalities. Provided there is no amount in arrears, the Ilam branch will have more than 20% yield (the branch charges 20% interest rate and 1% service charge) and the Fikkal branch which operates in SRG modality will yield around 18% (the branch charges 18% and no service charges). Portfolio yield is one of the contributing factors for the profitability; however, the profitability does not depend solely on portfolio yield. Therefore, the Fikkal branch will have to increase its profitability through serving more clients and reducing the staff cost, which seems to be possible in the long run.



s. Social Inclusion:

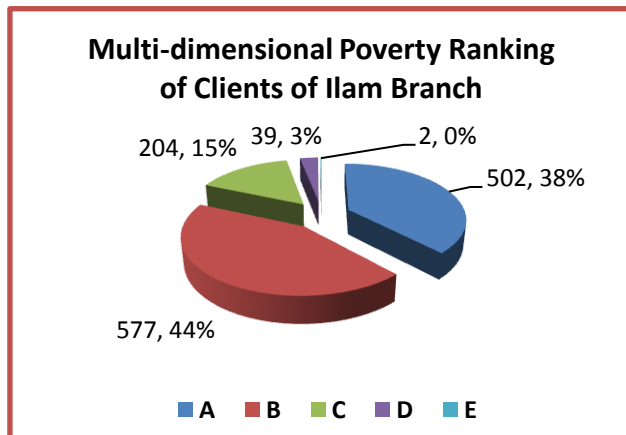
Even though microfinance programs targeted to populations below the poverty line are themselves an inclusive programs, MFIs should analyze their client composition from the social inclusion perspective and be able to provide the information to other stakeholders. The following is the client composition of NUBL Ilam and Fikkal branches from caste/ethnicity perspective:



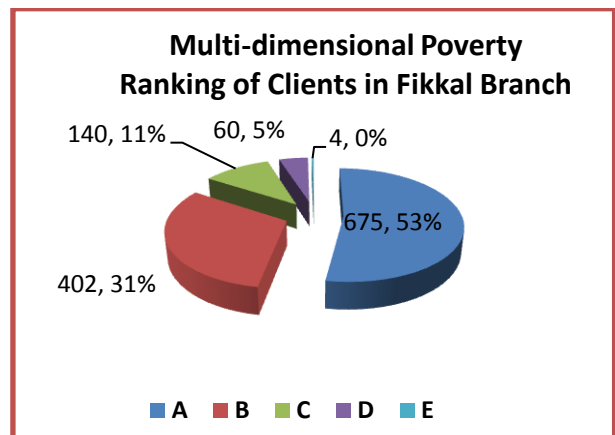
The figures depicted a good representation of proportionate ethnic and caste composition in the target areas, indicating inclusive enrollment.

t. Client Poverty Ranking;

NUBL has developed an advanced software package for client tracking, called a Client Data Monitoring System (CDMS). One of the components of CDMS is the Client Poverty Ranking. NUBL has identified five indicators - education of clients’ children, land ownership, housing index, living standards, and food sufficiency for measuring multi-dimensional poverty ranking. It uses five poverty ranks as A, B, C, D, and E: A being the upper poor and E the most destitute. The following is the graphic presentation of poverty ranking of the clients at the time of enrollment in both the branches as of Mid-July 2010:



Total client data (Ilam) =1324



Total client data (Fikkal) =1281

Overall, all the indicators mentioned-above show a positive trend and growth perspectives for both the branches operating in two different modalities. There are some clear indications - such as member growth, loan client ratio, loan outstanding and savings mobilization - in favor of Fikkal branch to support the argument that the SRG modality better fits in the hilly operating environments in the long run to expand microfinance services. However, Fikkal & Ilam are not indicative of the Nepalese hills at large, and the success of microfinance programs will depend on many other factors such as the utilization of loans, availability of non-services required for the success of enterprises of clients, acceptance of the modality by the clients and communities, and patience of the MFI. The return on portfolio clearly indicates that in SRG modality the MFI branch needs to invest more, reach more clients and wait longer to earn the profit equivalent to that of a branch (e.g. Ilam) operating under Grameen modality. A similar study of the two branches after 30 to 26 months will be very much realistic to draw conclusions about the modality more reliable for replication.

While analyzing the expenses of the MFI branches, some extra costs like monitoring and supervision by the Regional and Head Offices, and capacity building costs related to the branches that are incurred through the Regional and head offices, should also be considered, which are not taken into account in the above analysis.

The past experiences of NUBL on both the modalities is that the average branch office takes 2-3 years in Grameen modality and 3-4 years in SRG modality to reach the monthly break-even point. However, along with many other factors, the synergy created due to the partnership with Mercy Corps, modifications made in the methodologies building on the past experience, and use of Mercy Corps microfinance experiences in agricultural lending to facilitate the partnership in expanding access to finance contributed to earlier-than-expected monthly break-even of the branches in Grameen and SRG modalities in Ilam.

7. Factors contributing in the successful operation

- **Comparatively better productivity, market access and infrastructures:** Ilam district is comparative better than other hilly district of Nepal in terms of market access, infrastructure, education awareness, commercial orientation, agricultural productivity and engagement of economically active population in commercially productive activities. Whether the farmers are getting premium price of their products or not is another question, but whatever is produced on Ilam farms is saleable. Ilam is suitable and famous for cardamom, ginger, potato, chaute, broom grass, milk and tea, and the population is relatively entrepreneurial.
- **Financial and technical services:** Financial services are important for supporting economic engagement of poor people, but financial services alone are not the complete solutions. Technical services are equally important for increasing productivity, leading to increased household income. Mercy Corps has been working in the district facilitating cardamom and ginger value chain development and has played an important role in establishing relationships between the different actors and providing technical services like disease management, business planning, pre and post harvesting, low-cost storage, grading and collective marketing. The farmers are benefited through the parallel provision of financial services from NUBL and

technical services from Mercy Corps, and the financial and technical services together contributed in increasing productivity and profitability of the farmers.

- **Synergy of working together:** Since Mercy Corps was already working in the district, when it established a partnership with NUBL for providing financial services, it became easier for NUBL to work in the new area. Mercy Corps and NUBL field staff worked together, linking the financial and technical services which created synergy and benefited both the farmers and the MFI.
- **Community consultations and modification in loan terms and conditions:** Mercy Corps carried out community consultations especially with the ginger and cardamom farmers on the credit needs, loan terms and conditions and shared and discussed the findings with NUBL management. The NUBL management accepted the proposal and made adjustment in the loan terms and conditions suitable to the farmer groups. Even though NUBL has a policy to adjust the repayment schedule of clients on the basis of their cash flow situation and nature of the project carried out, it has been applied in the case of microenterprise loans with collateral but not with the group loans without collateral. NUBL agreed to make the repayment schedule flexible (monthly, quarterly, half-yearly and yearly) for all clients, depending on the cash flow and the loan purposes. The ginger farmers liked this flexibility as they can pay the loan in two installments, first by selling the *bruni* (the mother seeds) and the second by selling the new harvest. So far, more than 50% of loans in Fikkal branch have been invested in ginger farming. The other MFIs working in the area do not provide such flexibility in loan repayment.
- **Building on the past experiences:** NUBL modified its working approach, learning from past experiences, and this worked well in the Eastern region. NUBL has changed the weekly group meeting to fortnightly meeting, and now they have changed it to monthly meeting. This has allowed NUBL staff to look after larger case-loads and reduce the staff cost. The 5 members group and 8-10 groups or center system have been modified to 10-40 members group or center. The loan eligibility for group members (2+2+1 system, poorest two members get loan first, then the next two and finally the remaining one), which required a comparatively longer waiting period, has been changed to 50% members in the beginning and the remaining members in the subsequent meeting. The loan eligibility period for SRGs has been changed from 6 months to 3 months. These adaptations have helped NUBL to best fit in the current environment and interest of the clients.
- **Flexibility:** NUBL also provides flexibility to repay the loan earlier than the repayment schedule, which the clients may not find in some other MFIs; in cases where other MFIs offer early repayment options, there may be financial implications (fees) required to repay loans early.

- **Committed leadership and hardworking staff:** NUBL’s leadership is committed to expand financial services throughout the country and contribute in the poverty reduction in Nepal. The experienced and hard working staffs of NUBL have further contributed in the success of the branch operation in the hills.
- **Appreciation for the good work:** It is difficult to work in the hills compared to the plain areas. Only the committed and hardworking staff can best fit to serve the clients in the geographically difficult and sparsely populated area. NUBL Management and Mercy Corps team appreciated the work done by the staff in the hills, encouraging and motivating them to serve the poor families.
- **New Modality:** The SRG modality operational from the Fikkal branch is a new modality in the area. The clients’ acceptance for the modality is increasing with the understanding of salient features of the modality like ownership, profit sharing, flexibility, capacity building and independency. The modality is receiving fewer critiques from local political actors.

8. Recommendations:

- NUBL has made very good progress over a short period of time in expanding financial services in the Ilam district. However, NUBL or any other MFI providing services should consider the breadth and depth of outreach. There are a number of poor families in the remote hills without access to financial services, and special provisions may be required to reach these families.
- Joint efforts from MFIs and development agencies as well as the non-financial service providers, can bring synergy in the expansion of sustainable microfinance services.
- The smallholder farmers require both financial services and technical services. Institutions involved in providing financial services should link the microfinance groups with technical service providers, and the technical service providers should link the farmers groups with MFIs, if both the services are not available through one umbrella.
- Development agencies supporting non-financial technical services for farmers groups should promote local service providers and help establish linkage with them, so that the farmer groups will have permanent access to non-financial services.
- MFIs willing to replicate the SRG modality in the hills need to consider the literacy level of the clients, link them with business literacy service providers, or make provisions for capacity building costs for clients.
- There should be some incentive provisions for the office bearers of the SRGs so that they will continue to support the operations of the SRGs. This could be possible through the SRG earnings. Volunteerism in the long run may not work well.

- A thorough analysis of branch operations in SRG modality after at least 3 years of operation will give a clear picture of the potentiality for replicating the modality in other parts of Nepal.

9. Conclusions:

Expanding access to financial services in the hills and mountains of Nepal is expensive and risky. Different modalities of microfinance service delivery are in practice, but no modality is proven yet to be replicable in the hills and mountains of Nepal. The efforts of MFIs and development agencies to explore possibilities for sustainable financial service delivery models are to be appreciated, but the MFIs themselves should have confidence in some modality that will fulfill the double-bottom lined mission of poverty reduction and self-sustainability. NUBL's innovation of SRG modality, and its commitment to expand microfinance services in the hills and mountains, is a positive move in this direction. The results of the branch operation in Fikkal of Ilam in SRG modality are very much promising for the replication of the modality in other hills of Nepal considering different factors and possibilities for partnerships to support the establishment period. A thorough study of the branch operations after at least 3 years of operations in the different parts of the hills will provide a clear picture regarding whether SRG modality could be replicated successfully; although the findings of this study suggest that indeed it can.