分　类　号:　　F830.2　　　　　　　　　单位代码:　10183
研究生学号:　　9200921102　　　　　　　密　　　级: 公 开

吉林大学

博士学位论文

关于尼泊尔小额信贷机构可持续性发展的研究

Sustainable Development of Nepalese Microfinance Institutions

作者姓名：**Bal Ram Duwal (博乐)**

专　　业：金融学

研究方向：金融理论与政策

指导教师：孙少岩　教授

培养单位：经济学院

2013 年 6 月

“Sustainable Development of Nepalese Microfinance Institutions”

A Thesis submitted in partial fulfilment of the requirements
for the degree of Doctor of Philosophy

In
Finance

Bal Ram Duwal

School of Economics, Jilin University
P. R. China

关于尼泊尔小额信贷机构可持续性发展的研究

Sustainable Development of Nepalese Microfinance Institutions

作者姓名：Bal Ram Duwal (博乐)

专业名称：金融学

研究方向：金融理论与政策

指导教师：孙少岩 教 授

学位类别：金融学博士

培养单位：经济学院

论文答辩日期： 2013 年 06 月 01 日

授予学位日期： 年 月 日

答辩委员会主席：

论 文 评 阅 人：

吉林大学博士(或硕士)学位论文原创性声明

本人郑重声明：所呈交学位论文，是本人在指导教师的指导下，独立进行研究工作所取得的成果。除文中已经注明引用的内容外，本论文不包含任何其他个人或集体已经发表或撰写过的作品成果。对本文的研究做出重要贡献的个人和集体，均已在文中以明确方式标明。本人完全意识到本声明的法律结果由本人承担。

学位论文作者签名：

日期：2013 年 06 月 日

《中国优秀博硕士学位论文全文数据库》投稿声明

研究生院：

本人同意《中国优秀博硕士学位论文全文数据库》出版章程的内容，愿意将本人的学位论文委托研究生院向中国学术期刊（光盘版）电子杂志社的《中国优秀博硕士学位论文全文数据库》投稿，希望《中国优秀博硕士学位论文全文数据库》给予出版，并同意在《中国博硕士学位论文评价数据库》和 CNKI 系列数据库中使用，同意按章程规定享受相关权益。

论文级别：□硕士 ■博士

学科专业：金融学

论文题目：**关于尼泊尔小额信贷机构可持续发展研究**

作者签名：

指导教师签名：

2013 年 06 月　日

作者联系地址（邮编）：

作者联系电话：

摘要

关于尼泊尔小额信贷机构可持续发展研究

大多数发展中国家都面临这样的问题：庞大的低收入人群、落后的金融业、单一的资金来源，以及少量的金融机构，小额信贷创新是解决上述问题的最好办法之一。随着小额信贷机构数量的持续增加，包括小额信贷从业者、政府部门、研究机构和慈善机构在内的社会各界也把目光更多地投向小额信贷的可持续发展这一领域。同时，小额信贷危机、高利贷现象、强制贷款回收、目标偏差、商业化等问题也引起了人们对小额信贷机构的不少质疑。因此，对那些旨在扶贫的小额信贷机构的可持续发展进行深入研究是十分必要的。

尼泊尔是一个发展中国家，有 82%的人口生活在农村地区，25%的人生活在贫困线以下，只有 20%的人向正规银行和金融机构贷款。在此背景下，小额信贷成为向农村地区贫困家庭提供金融服务，以改善其经济状况的一种重要方式。蓬勃发展的小额信贷机构和数量众多的贫困人口，使得尼泊尔成为一个理想的研究对象。

尼泊尔的传统小额信贷的历史极为悠久，而现代小额信贷起步较晚，1975 年，尼泊尔农业发展银行推行了小农户发展计划，该计划在一定程度上具有现代小额信贷的特征。尼泊尔的第一家现代小额信贷机构成立于 1992 年，由政府创办，下设五个区域开发银行，采用孟加拉国的“乡村银行小额信贷模式”。20 世纪 90 年代中期，非政府组织和私人也开始成立小额信贷机构。

二十多年来，尼泊尔的小额信贷行业发展迅速，并在农村金融领域发挥了显著作用。本文从金融可持续发展的角度对尼泊尔的小额信贷机构加以研究，分析了不同类型的小额信贷机构的经营状况，包括政府创办的小额信贷发展银行，私人创办的小额信贷发展银行，非政府组织的金融中介，储蓄和信贷合作社。本文根据

所有制结构，经营期限和规模等指标，从这四种类型中选取了 20 家小额信贷机构，采纳 2005 年至 2011 年的数据进行了分析。

分析结果表明，由于具备充足的资产和大量的会员，私人创办的小额信贷发展银行和非政府组织的金融中介的整体财务表现较为理想；有着较少资产和成员的储蓄和信贷合作社的表现差强人意；而同样有着充足资产和大量会员的政府创办的小额信贷发展银行却表现得不尽理想。尽管对储蓄和信贷合作社来说，向公众吸收存款并无多大用处，但是尼泊尔的小额信贷机构却都可以开展此项业务，事实上，很多小额信贷机构对公众存款有着高度的依赖性。

值得注意的是，小额信贷机构的存款人数及借款人数相差甚远，只有有限的人积极参与借贷活动。除了储蓄和信贷合作社以外，其他小额信贷机构都以女性为目标人群。无论是政府创办的还是私人创办的信贷机构，都在经营区域和业务范围上扩大着自己的影响力。

私人创办的小额信贷发展银行和非政府组织的金融中介有着较高的资本收益率和每股收益，它们的收入水平也高于其他两者。 政府创办的小额信贷发展银行的资本收益率和净资产收益率均为负数，因此，亟需相应的体制改革，政府作为政府创办的小额信贷发展银行的创办者，应当实行私有化改革，向私人投资者出售股份。希望私有化与结构整合可以为其注入新的活力，帮助其夺回市场份额。最近，尼泊尔国家银行（尼泊尔央行）开始鼓励银行和金融机构进行机构整合，毫无疑问，这一举措将给小额信贷行业带来深远影响。

解决农村融资缺口和消除贫困是所有发展中国家所面临的挑战。中国政府把农村发展的重点放在了“三农问题”上，为了减少农村地区融资缺口、增加金融普惠性，政府把建立新型金融机构和小额贷款公司作为一项重要工作常抓不懈。中国的基本国情与其他发展中国家有着很大不同，在社会主义市场经济中发展小额信贷是一件前无古人的尝试。在中国，提供小额信贷服务的除扶贫项目和商业银行外，还有五类大型金融机构，即：民间小额信贷机构、小额贷款公司、村镇银行、农村资金互助社和农村信用合作社。由于民间小额信贷机构缺乏相应的法律地位，

而私人投资和外资不允许进入小额信贷行业。从理论上讲，发展中国家的利率管制阻碍并限制了金融业的发展。中国限定小额信贷的利率上限为基准利率的四倍。平心而论，小额信贷的初衷是提升低收入和中等收入人群的社会经济地位，故其利率不应比商业性信贷机构的利率高出太多。因此，中国对小额信贷机构设定贷款利率上限是合理的，但不应该对存款利率加以管制。

“三农问题”的提出和解决，为像尼泊尔一样的发展中国家处理农村发展问题提供了宝贵经验。中国建立了新型农村金融机构并为农民提供更多的金融服务，推动农村信用社和小额信贷健康发展，加强小额信贷机构与企业间的联系，实行利率上限制度以防止高利贷的产生等，这些都值得学习和借鉴。另外，联保贷款，按揭贷款创新（林地使用权和牲畜也可做抵押品）以及第三方参与（公司和企业）贷款等方式，也可供其他国家参考。

尼泊尔的小额信贷机构应该更加注重产品设计和创新，加强与农村金融机构的合作，引进新技术（电汇，手机银行），减少对政府的依赖，建立对员工的奖励制度以实现可持续发展。更为重要的是，小额信贷机构应该及时改正其目标偏差，实现统筹兼顾，既要保证其盈利，又要实现其建立的初衷（向低收入家庭提供金融服务）。

理论研究从实践中来，还要回到实践中去。对于极度贫困的家庭而言，“贫困家庭+扶贫计划/发展项目+团体贷款”的方式较为适用。因为这些家庭需要政府或慈善机构的特殊补贴，以满足其消费和投资需要，集团贷款的方式可能会最大限度地降低信贷风险。

对于中低收入水平的家庭来说，可以采用“中低收入家庭+第三方参与+团体/个人贷款”的方式，小额信贷即储蓄和信贷合作社、非政府组织的金融中介和小额信贷发展银行是较为理想的选择。其中，储蓄和信贷合作社尤其适用于偏远且人口分散的地区，因为这种地区难以召开经常性的会议（即采用“乡村银行团体贷款模式”）。

对于中等收入水平的家庭和微型企业而言，“家庭/企业家+公司+银行+个人贷款”的方式比较可行。小额信贷发展银行和商业银行更适合于参与此类业务。

本文由七章组成，第一章阐述了所研究的问题，课题意义和目标，论文研究办法和创新之处。第二章是理论综述，主要介绍发展中国家的金融发展理论，尤其是金融深化论和金融抑制论。同时详细描述世界农村金融和小额信贷部门的新问题，主要借鉴了不同的学者的多种观点。第三章描述了尼泊尔经济发展中的主要问题。同时追溯金融体系的历史，回顾尼泊尔扶贫政策和当前情况。第四章主要讲述尼泊尔的小额信贷的发展历史，以及小额信贷机构的现状。第五章分析了尼泊尔四个不同种类小额信贷机构的经营状况，从小额信贷机构选取 20 多个小额信贷的数据样本，分析金融结构，营业实绩，收益,费用支出,业绩效率与收益率和风险管理等七个方面。第六章分析中国小额信贷的发展和实践和小额信贷发展过程，小额信贷体系的主要特征。第七章阐述了尼泊尔小额信贷体系的法律和政治结构。作者精密地分析了尼泊尔目前的小额信贷法律和政治结构，并提出了一些政策建议，希望能解决尼泊尔小额信贷存在的一些根本问题，实现尼泊尔小额信贷的可持续发展。最后一章总结全文。通过分析尼泊尔的小额信贷体系和借鉴中国小额信贷体系的发展与实践，作者为尼泊尔小额信贷未来发展提出了建议。

关键词：小额信贷机构，可持续发展，农村金融，借贷方式

Abstract

Sustainable Development of Nepalese Microfinance Institutions

Many developing economies are facing the problems of widespread poverty, lack of financial inclusion, lack of financial resources and lack of proper financial institutions to provide financial services to the poor household. The innovation of microfinance became one of the best alternatives to cope with these problems. Growing trend of MFIs raises the issue of its sustainability and issue of institutions' sustainability has attracted the attentions of many microfinance practitioners, government authorities, researchers and donor agencies. In the meantime; microfinance crisis, usurious interest rates, forced loan recovery, mission drift issues raise scepticism over MFIs. These factors, including commercialization of MFIs, justify the importance of a thorough study on the sustainability of MFIs that are destined to reduce poverty.

Nepal is a developing country, where 82 per cent of its population lives in rural areas. 25 per cent of its population lives below poverty line and only 20 per cent of its people borrow credit from formal banking and financial institutions. Considering this background, microfinance became an important mechanism to provide financial services in Nepal's rural areas to improve economic status of poor household. The rapidly growing number of MFIs and wide spread poverty condition makes Nepal an ideal character for research.

In Nepal, the concept of modern microfinance is new. But a part of modern microfinance has been practiced since 1975 with commencement of Small Farmers Development Programme under Agricultural Development Bank of Nepal. Microcredit practice as integrated with co-operative is not new for Nepal. Traditional types of co-operative practices used to exist since immemorial time. On the other hand, modern types of MFIs are established following Bangladesh's Grammen Bank microfinance model. The first Grammen Bank replicator microfinance banks are established under government initiation in 1992 by forming five Regional Development Banks. In mid 90s, NGOs and private microfinance banks also started microfinance programs in the country.

Within two decades, Nepal's microfinance industry has significantly developed and brought positive impact to rural financial sector.

This dissertation studies Nepalese Microfinance Institutions (MFIs) from financial sustainability view point. Furthermore, it analyzes whether different MFIs' modalities make differences in their financial performance. In Nepal, there are mainly four modalities of MFIs in operation viz. the Government initiated microfinance development bank - GIMFB, Privately initiated microfinance development bank - PIMFB, Financial intermediary Non-Government Organizations - FINGOs and Saving and Credit Cooperative Societies - SACCOS. This research takes 20 sample MFIs from four types of MFIs (GIMFB, PIMFB, FINGOs and SACCOS). The basis of selection is ownership structure, operating period and size. The study utilizes seven consecutive years' data from 2005 to 2011.

To test the significance of the differences among four sample means F-distribution technique called the "Analysis of Variance-ANOVA" is used. ANOVA-F test is a statistical method, to detect if there is a statistical difference between the means of the populations. Set the null hypothesis "The financial performance of four different modalities of MFIs is same. There is no any significant difference in their financial performance."

Results proved that the overall financial performance of PIMFB and FINGOs are sound as they have more assets and large number of members. SACCOSs' performance is only satisfactory since it has comparatively low assets and members. Finally, despite having more assets and large number of members GIMFB's performance is weak. Nepalese MFIs are allowed to collect deposit from the members though it is not effective except for SACCOs. In effect, dependency in external funding sources is high.

Remarkably, there is a huge gap between number of depositors and borrower s in Nepalese MFIs. Only limited members are active in credit transaction. Other than SACCOS, all MFIs are gender based and targeting to women member. Both governments initiated and privately initiated MFDBs are operating in large scale with covering large geographical area and outreach in large.

PIMFB and FINGOs have higher Return on Assets and Return on Equity ratio and their earning level is also higher than other two. GIMFB has negative ROA and ROE ratio. So, institutional improvement is required in GIMFB. The government, as the main stakeholder of GIMFB, has adopted privatization policy and sells its share to private investor. Hopefully, privatization and merging of these weak performers will result in a new spirit and strategy to regain their market share. Recently, Nepal Rastra Bank, the central bank is encouraging banking and financial institutions to go for merger procedure towards developing strong financial institutions that would easily affect the whole microfinance industry.

Nepalese MFIs except for GIMFBs are running in operational self-sufficient level. Based on the empirical data, it is proved that the financial performance of Nepalese MFIs varies in accordance with the applied modalities of the MFIs.

Rural financing gap and poverty alleviation are existing challenges for emerging China. Chinese government and authorities are giving focus on "Sannong" problems concerning rural development. Establishment of new-type financial institutions and microcredit companies is important policy level decision taken by Chinese authorities, which support to minimize financing gap in rural areas and increase financial inclusion. China’s political and economic condition is totally different from the other developing countries. Microfinance practice in market socialist system is a unique example for the rest of the world. Except for poverty alleviation programs and commercial banks, five major financial institutions are providing microfinance services in China viz. NGO-MFIs, Microcredit companies, Village and Township Banks, Rural Mutual Credit Co-operatives and Rural Credit Cooperatives.

Theoretically, financial repression in the form of controlling interest rate leads to stagnant financial development and further seriously restricts the financial development in developing economy. In China, interest ceiling is fixed for MFIs up to four times of basic interest rate. From the philosophical approach, microfinance is a service business targeting to uplift socio-economic status of poor, low and middle income people. Microfinance borrower should prevent from excessive usury imposed by commercial MFIs. In this base, the interest cap on lending for MFIs in China is reasonable but for deposit taking institutions interest cap should not be imposed.

In order to promote and encourage more MFIs in rural area, Chinese government should adopt a relaxed tax policy, remove discriminating tax and interest cap policy, permission should be given to collect deposit from members, and government intervention must be avoided for the smooth operation of MFIs.

The innovative approach of 'Sannong' to deal with rural development issue, establishment of new-types rural financial institutions to provide more financial services in rural area, promotion policy for RCCs and MCCs, microfinance link with banks and companies and interest cap to prevent from usury are the major lessons of rural and microfinance in China. These are useful for other developing economies. Likewise, use of co-guarantee loan, innovative mortgage loans (Forest tenure and livestock) and third party involvement (business enterprise and companies) ideas can be applied in other countries.

Based on the research, Nepalese MFIs should pay attention on product innovation and design, build cooperation with rural financial institutions, introduce new technology (wire transfer, mobile banking), reduce dependency on deprived sector loan and grants from donor agencies, and build incentive system for both members and staff for sustainable development. More importantly, Nepalese MFIs should immediately correct the fraudulent practice, mission drift and maintain double bottom line viz. social bottom line (providing financial services to poor, low income households) and financial bottom line (operational self-sufficiency or reasonable profit).

One of the objectives of this research is to prescribe suitable model and institutions for different income level people. This author recommends; 'Poor Household+Poverty Alleviation Programme/Development project+Group Lending' modality can be applied for extremely poor community. Extremely poor household need special subsidized program from government or donor agencies to meet the demand of consumption and income generating loan. To minimize the credit risk, group lending method may be useful.

MFIs viz. SACCOS, FINGO and MFDB can be suggested for moderate and low income household. Particularly SACCOS is recommended for hill and remote area where population is scattered and regular centre meeting (Gramen Bank method) is not convenient. For this group; "Poor/low income household+Third party involvement +Group/individual lending" modality is prescribed.

MFDB and commercial banks are more suitable for middle income level and micro-entrepreneurs. "Household/entrepreneur+Company+Bank+Individual lending" modality can be used for this group.

The study mainly consists of seven chapters. The first chapter presents the introductory part with statement of problems, significance of the study, objectives of the study, research methodology, innovation and limitation of the study.

The second chapter is theoretical review. This chapter presents the financial development theory for developing countries, particularly financial deepening theory and financial repression theory. Likewise, it elaborates the emerging issues in rural finance and microfinance sector in the world. This chapter also presents the review of literature regarding various studies conducted and articles written by different scholars, organizations in microfinance.

The chapter three refers to overview of Nepalese economic condition. This chapter describes current economic status of country and major problems in economic development of Nepal. Likewise, chapter deals with the historical development of modern financial system, review poverty alleviation program and current credit condition of Nepal.

The chapter four elaborated historical development of Nepalese microfinance and current status of Nepalese MFIs.

The chapter five analyses the financial performance of Nepalese microfinance institutions. For data analysis, author takes financial performance data of sample 20 MFIs from four different types of MFIs microfinance service providers. Here, financial sustainability of the MFIs is analyzed through seven parameters, financing Structure, operating performance, revenue, expenses, efficiency and productivity and risk management.

The chapter six refers to microfinance development and practice in China and major characteristics of Chinese MFIs.

The chapter seven presents the legal, policy framework of Nepalese microfinance institutions. Author critically analyses, the current legal and policy framework of Nepalese microfinance and puts forward some important policy recommendation to solve the existing problems in Nepalese microfinance and for the sustainable development of Nepalese MFIs.

The last chapter concludes and summarizes the whole dissertation. Through the analysis of Nepalese MFIs and study of Chinese microfinance development and practice, author draw policy recommendation for the sustainable development of Nepalese Microfinance institutions and prescribe suitable model and institutions for different income level people.

Keywords: Microfinance Institutions (MFIs), Sustainability Development, Rural Finance, Lending modality

Abbreviations and Acronyms

AACCU	: Association of Asian Confederation of Credit Union
ABC	: Agriculture Bank of China
ADBC	: Agriculture Development Bank of China
ADB/N	: Agriculture Development Bank Nepal
ANOVA	: Analysis of Variance
BAFIA	: Bank and Financial Institutions Act
BFIs	: Banks and Financial Institutions
BIPPA	: Bilateral Investment Promotion and Protection Agreement
CAR	: Capital Adequacy Ratio
CB	: Commercial Bank
CBO	: Community Based Organisation
CBRC	: China Banking Regulatory Commission
CCB	: Chhimek Bikas Bank
CDB	: China Development Bank
CGISP	: Community Ground Water Irrigation Sector Project
CICETE	: China International Center for Economic and Technical Exchange
CO	: Community Organizations
DTAA	: Double Taxation Avoidance Agreement
FINGOs	: Financial Intermediary Non- Government Organizations
FY	: Fiscal Year
GDP	: Gross Domestic Product
GBBL	: Grameen Bikas Bank Limited
GIMFB	: Government Initiated Microfinance Development Banks
GNI	: Gross National Income
GON	: Government of Nepal
HSBC	: The Hongkong and Shanghai Banking Corporation
INGO	: International Non- Government Organization
MCW	: Micro Credit for Women
MFIs	: Micro Finance Institutions
MIFAN	: Microfinance Association of Nepal
MCC	: Microcredit Companies
NBL	: Nepal Bank Limited
NEFSCUN	: Nepal Federation of Savings and Credit Cooperative Unions Ltd.

NGO	: Non- Government Organization
NLSS	: Nepal Living Standard Survey
NPC	: National Planning Commission
NPR	: Nepalese Rupees
NRB	: Nepal Rastra Bank
OSS	: Operating Self Sufficiency
PAF	: Poverty Alleviation Fund
PAPWT	: Poverty Alleviation Project in Western Terai
PBOC	: People's Bank of China
PCRW	: Production Credit for Rural Women
PIMFB	: Privately Initiated Microfinance Development Banks
RBB	: Rastrya Banijya Bank
RCC	: Rural Credit Cooperatives
RDB	: Regional Development Bank
RMB	: Renminbi (Chinese Yuan)
RMCC	: Rural Mutual Credit Cooperatives
RMDC	: Rural Microfinance Development Center
ROA	: Return on Assets
ROE	: Return on Equity
ROSCA	: Rotating Saving and Credit Association
RRDBs	: Regional Rural Development Banks
SACCOS	: Saving and credit cooperative society
SFDP:	Small Farmer Development Programme
SKBBL	: Sana Kisan Bikas Bank Limited
SPSS	: Statistical Package for the Social Sciences
TLDP	: Third Livestock Development Project
UN	: United Nations
UNDP	: United Nations Development Program
USAID	: United States Agency for International Development
USD	: United Sates Dollar
VDC	: Village Development Committee
VTB	: Village and Township Bank
WEP	: Women Empowerment Project

Contents

List of Tables

List of Figures

Figure No. **Title** **Page No.**

CHAPTER ONE：INTRODUCTION

This chapter deals with the general study of microfinance and sustainability issue of Microfinance Institutions (MFIs) with its significance which has aimed to spotlight in the research with its objectives, thesis framework, research methodology with innovation and limitations of research.

Section 1: Background of the Study

It is estimated that over a billion people in the world -roughly one in six people- are living in extreme poverty[①] . According to The World Bank, nearly half of the world's population lives in moderate poverty[②]. Almost half the world, over three billion people, lives on less than USD 2.50 a day[1]. This terrible poverty figure is raising so many questions and challenges in front of the entire world. Poverty, inequality and the growing income gap between rich and poor are the major fundamental issues of the social instability. The United Nation announced the Millennium Development Goals in September 2000, with 8 goals and 21 targets. Eradication of extreme poverty and hunger by the year 2015 is one of the important goal of the Millennium Development Goal. The huge numbers of poor people are living in Sub-Saharan Africa (more than 40% of its population) and South Asia (more than 30 % of its population). Many political and development theories have been developed and many plans, programs and policies have been formulated with the aim to eradicate the poverty. Microfinance is innovated as a one of the ideas or tools to alleviate poverty.

Poverty is a multidimensional phenomenon. Most of countries are facing difficulties in solving poverty problem. Poverty causes various social issues which lead to the country on unrest. Through microfinance, economic condition of low income people has been improving, increasing effective demand in society as a whole and promoting social investment and national economic development. It is one of the big challenges of

---

① The World Bank has defines extreme poverty as living on less than USD 1.25 (PPP) a day.
②The World Bank has defines moderate poverty as basic subsistence living below USD 2 a day.

every government to involve large numbers of poor people living in rural areas into the mainstream economic development. Microfinance emerged as a one of the best financial tools to attain the goal of poverty reduction.

Microfinance is focusing on low-income groups and small & medium enterprises and providing small size of on-going credit services to these target groups with other financial services. Basic characteristics of microfinance are small amount of credit, unsecured loan, loan without physical mortgage and serving the poor with various financial services such as saving, insurance, credit and remittance.

Many governmental and non-governmental organizations, national and international organization are using different kinds of microfinance models. Microfinance programs which are operating in present world could be summarized in to three basic categories on the basis of program initiator viz. government initiated program, privately initiated program and community group initiated program. The initiation of Pawn shop in Europe in 1462, Irish Loan Fund System in 1700s, Financial Cooperatives in the beginning of 19th century are the major historical innovation of privately initiated and community initiated microfinance institutions. The state owned development finance institutions such as development banks came on operation only after the year 1950[①].

Sustainability is one of the most discussed issues on the Microfinance industry. Simply, sustainability refers to the long-term continuation of the Microfinance program after the project activities have been discontinued. It entails that appropriate systems and processes have been put in place that will enable the Microfinance services to be available on a continuous basis and the clients continue to benefit from these services in a routine manner. Sustainable MFIs are desirable in that durability creates confidence among clients and financial viability allows institutions to reach wider markets without relying on subsidies to target one small sector of the population[②]. Sustainable MFIs can cover and serve large number of poor households in the long run. The word sustainability itself

① Helms, B. (2006). *Access for All: Building Inclusive Financial Systems* [M]. CGAP Pp.3

② Paxton, J., Cuevas, C. E. (2002). Outreach and sustainability of member-based rural financial intermediaries. In Zeller, M., Meyer, R. L., (Eds.), *The triangle of microfinance: financial sustainability, outreach, and impact* [M] (pp. 135-151). The John Hopkins University Press, UK.

covers very wide dimension. It includes institutional sustainability, market sustainability, legal policy environment sustainability, impact sustainability etc. Among them, the most important one is the institutional sustainability which includes financial sustainability, mission sustainability, program sustainability, human resource sustainability etc.

Financial sustainability refers the smooth operation of the microfinance institutions with necessary profitability having adequate liquidity to overcome any challenges of bankruptcy[①]. The lack of financial sustainability makes the MFIs depend on donations, subsidized loan and government support which affects the overall sustainability of the institutions.

Every developing country is facing a common problem of poverty. Not just only the economic conditions are same but also socio-demographic condition of the developing countries are similar. Developing countries are the living place of the huge number of poor people. Poverty is a widespread problem in South Asia, with the bulk of the poor in most countries living in rural areas. South Asia still has nearly 400 million poor people (out of a population of 1.37 billion)[2]. This indicates around 30 percent of the total population is still below poverty line.

In Nepal, people have been practicing microcredit since the immemorial time informally. Formal microcredit was started after the year 1953 by establishing co-operative department under the ministry of agriculture. In 1956 the formation of co-operative society was legalized and the first Credit Co-operative Society was established. This cooperative movement has partly included the saving and credit components of microfinance. The first government initiated pro-poor microcredit program was started in 1975 with the advent of Small Farmers Development Programme under Agricultural Development Bank of Nepal. This sector gained further momentum after restoration of multi-party democracy in 1991 with the establishment of Rural Development Bank (Grammen Bikas Bank) in the five development regions and after that, there has been a significant growth in the MFIs such as Microfinance Development Banks (MFDB), Saving and Credit Cooperatives Society Ltd. (SACCOS), Financial Intermediary Non-Government Organizations (FINGOs) in the formal and semi-formal sector. Nepalese

[①] Schreiner, M. and Colombet G., (2001), Aspects of Outreach: A framework for Discussion of the Social Benefits of Microfinance [J]. *Journal of International Development*. Vol. 14. Available at http://www.pdfio.com/k-1124301.html microfinance sector currently comprises a wide variety of modalities and diversified method.

Section 2: Significance of the Research

Various research has proved that financial exclusion is the another cause of poverty. Growing trend of microfinance institutions reveals a significant meaning in financial market. For many policymakers and the governments, the issue of providing financial services for all has raised on both national and international agendas, highlighted by the emergence of microfinance as an effective tool for putting financial services in the hands of the poorest people. In this background the study of MFIs carries significant meaning.

The issue of financial sustainability of MFIs has attracted more attention in mainstream analysis. Research on financial sustainability of microfinance institutions will analyze whether the institutions are able to use and manage its resources or not. The study and analysis of financial performance of MFIs will help microfinance practitioners and service receiver.

Developing countries' socio-economic, demographic conditions are more or less similar. Growing income gap between urban population and rural population is another knocking problem in developing countries. Every developing country has been fighting against the poverty. They can get lessons from this research work. It will also help the government, donor agencies, NGO/INGOs, policy makers, development agencies etc. to formulate appropriate policies and programs to alleviate poverty.

China, the rapidly growing economies of the world have also same challenges of reducing poverty and growing income gap. China is also a large ground for microfinance program. There are many microfinance programs running in China but the social-political and cultural condition is totally different than other countries. Comparative research between China and Nepal on the microfinance sector is hardly found. This research will also give concern on microfinance in developing countries with special focus on China. The researcher tries to find out major lessons from microfinance practice in China and its implication in other developing countries. In case of Chinese scholars, most of them are relatively unfamiliar with Nepalese economic condition and economic problem, thus this study has an outstanding significance for Chinese scholars who want to explore on Nepalese economic condition.

From the perspective of MFIs ownership structure, basically it can be divided into four categories such as Government owned, privately owned and community/member owned MFIs and Financial Intermediary Non-Government organizations. Further, it can be described as government initiated, privately initiated and community initiated MFIs. Financial performance of these institutions may vary because of different objectives. It is believed that privately initiated institutions have more competitive strength, serving with qualitative products and getting more productivity as well as earning profit. The government initiated institutions are facing the challenges of low profile performance with low productivity whereas community based MFIs are suffering from lack of high technical and managerial human resources. This research focuses on comparative study of financial performance and sustainability of these four different types of MFIs which is a new research work in the microfinance sector. The findings and recommendation of this study may be applicable to any developing countries. Especially, it will be meaningful for those economies where both planned/state economy and private economy are in operation.

Microfinance crisis is newly emerged challenge for microfinance practitioners and government. Tragically borrowers of Microfinance institutions committed suicide because of their inability to repay the loans taken from micro finance institutions. The 'usurious interest rates' and 'forced loan recovery' practices are responsible for these tragic stories. After this case, great question mark is aroused seriously against microfinance institutions. It is assumed that the community based MFIs will be the best alternatives for microfinance practitioners and poor people, which can provide financial service with member-friendly nature.

The study of financial sustainability in public (government initiated), private and community based MFIs with special reference to Nepalese context is totally a new research. The findings and the policy recommendations of this study will be beneficial for other developing countries, microfinance providers, researchers and policy makers. So, this study has a great relevance and justification in the present context.

Section 3: Objectives of the Study

The general objective of this research is to analyze sustainable development of Nepalese Microfinance Institutions. The specific objectives of this research as stated below:

1. Review of overall status and the activities of Microfinance Institutions in Nepal.
2. Analyze the problems in Nepalese microfinance industry.
3. Analyze the financial sustainability of Nepalese Microfinance institutions.
4. Study the microfinance practices in China and learn lessons from microfinance practice in China.
5. Recommend the effective measures, strategies and policies for development of Microfinance Institutions in Nepal.
6. Prescribe suitable model and institutions for different income level people.

Section 4: Thesis Framework

The study mainly consists of seven chapters. The first chapter presents the introductory part with statement of problems, significance of the study, objectives of the study, research methodology, innovation and limitation of the study.

The second chapter is theoretical review. This chapter presents the financial development theory for developing countries, particularly financial deepening theory and financial repression theory. Likewise, it elaborates the emerging issues in rural finance and microfinance sector in the world. This chapter also presents the review of literature regarding various studies conducted and articles written by different scholars, organizations in microfinance.

The chapter three refers to overview of Nepalese economic condition. This chapter describes current economic status of country and major problems in economic development of Nepal. Likewise, chapter deals with the historical development of modern financial system, review of poverty alleviation programs and current credit conditions of Nepal.

The chapter four focuses on overall microfinance condition in Nepal. This chapter elaborated historical development of Nepalese microfinance, microfinance model practicing in Nepal and current status of Nepalese MFIs.

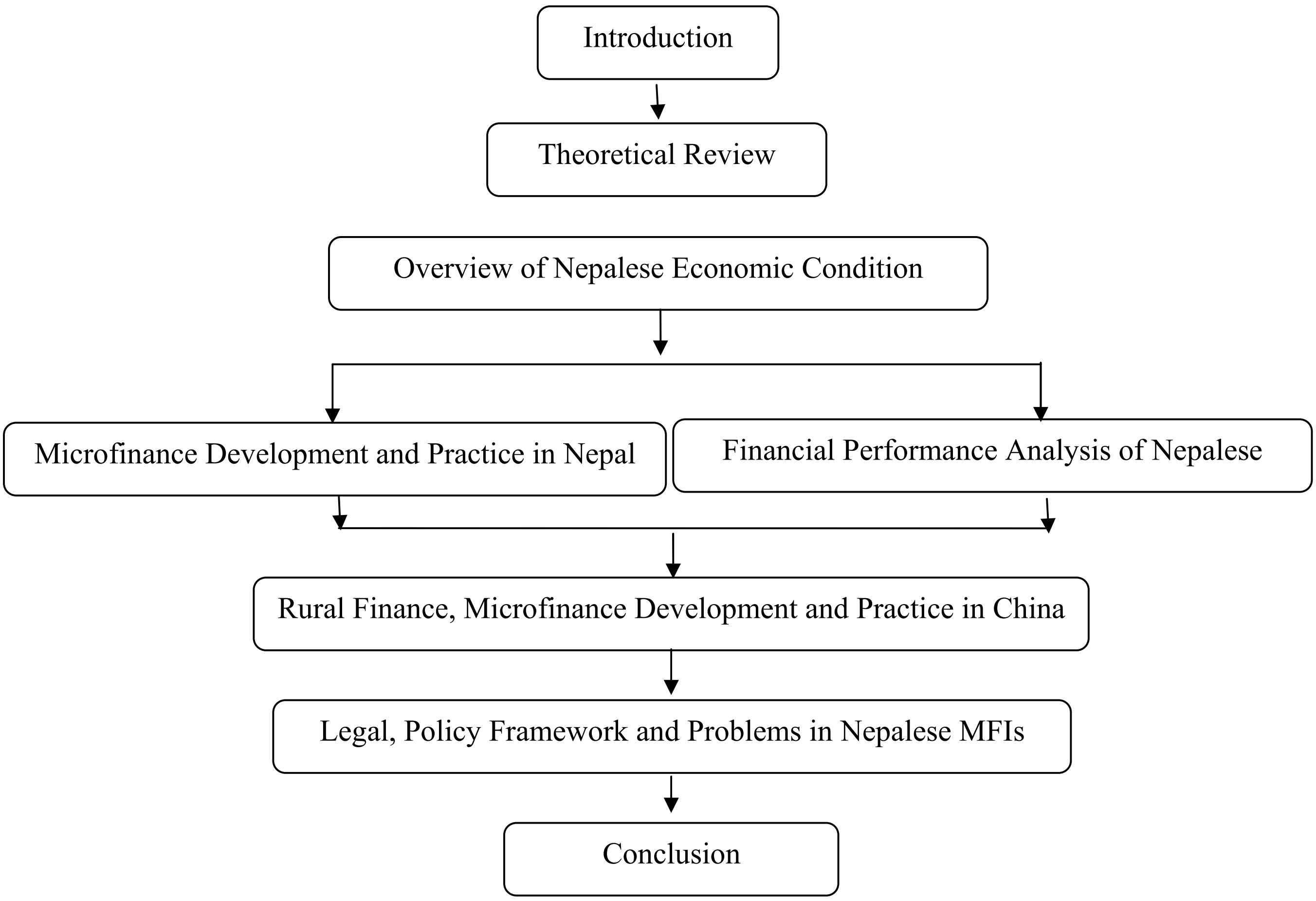
The chapter five analyses the financial performance of Nepalese microfinance institutions. For data analysis, author takes financial performance data of sample 20 MFIs from four different types of MFIs microfinance service providers such as Government initiated microfinance development banks (GIMFB), privately initiated microfinance development banks (PIMFB), Financial intermediary non-government organizations (FINGOs) and Saving & Credit cooperative societies (SACCOS) are taken in to study. Here, financial sustainability of the MFIs is analyzed through six parameters, financing Structure, operating performance, revenue, expenses, efficiency and productivity and risk management.

The chapter six refers to microfinance development and practice in China. It includes overview of China's rural financial system, historical development of microfinance in China, major characteristics of Chinese microfinance institutions and problems in development of microfinance in China. This chapter will be summed up with lessons from the Chinese MFIs practice.

The chapter seven presents the legal, policy framework of Nepalese microfinance institutions. Author critically analyses, the current legal and policy framework of Nepalese microfinance and puts forward some important policy recommendations to solve the existing problems in Nepalese microfinance for the sustainable development of Nepalese MFIs.

The last chapter concludes and summarizes the whole dissertation. Through the analysis of Nepalese MFIs and study of Chinese microfinance development and practice, author draws policy recommendation for the sustainable development of Nepalese MFIs and prescribes suitable model and institutions for different income level people.

Figure 1-1: Thesis Framework



Section 5: Research Methodology

To attain the predetermine objective of the research, descriptive and empirical analytical research design is adopted in the study. The comparative study is also applied during study to find-out the similarities and dissimilarities.

1. Source of Data:

The study is basically based on the secondary data and other related information. The secondary data and other related information have been collected from various sources such as articles, journals, books, annual and periodical reports, internet, publication etc. The researcher will collect primary data and visit field/study area if it is needed.

2. Population

The study basically gives focus on the financial sustainability of Nepalese MFIs. The banks and financial institutions are licensed under the NRB regulations. These institutions are classified as A, B, C, and D categories depending upon their authorized capital, paid up capital, scope of activities, credit flow and geographical coverage. The Grammen Bank Replicates fall under Class D including all the regional level Rural Banks.

Table 1-1: Number of Banking and Financial Institutions

Up to Mid-Jan 2012

S.N.	Institutions	Class	No.	Firs Operation Year
1	Commercial Banks including Agricultural Development Bank	A	32	1937
2	Development Banks	B	88	1968
3	Finance Companies	C	69	1990
4	Microfinance Development Banks	D	24	1991
5	Saving & Credit Co-operatives (Limited Banking Activities)	Non Classified	16	1956
6	FINGOs ((Microcredit Transaction)	Non Classified	36	1978
	Total		265	

Source: Nepal Rastra Bank, 2011. Banking and Financial Statistics Vol.57.

3. Sample size

In this study five MFIs from each three different categories of MFIs i.e. Government initiated (Rural Development Banks), Privately initiated (Microcredit Development Banks) and Community initiated (Saving & Credit Co-operatives) are selected on the basis of their operating period, transaction volume and geographical location. In Nepal there are numerous number of saving and credit cooperatives in operation. In this study Saving and Credit cooperatives which reported in mix market are randomly selected.

Table 1-2: Number of Sample Microfinance Institutions

S.N.	Micro Finance Institutions	Category	Total	Sample
1	Rural Development Banks	Government Initiated	5	5
2	Microfinance Development Banks	Privately Initiated	12	5
3	Financial Intermediary-NGOs (Limited banking transactions)		36	5
4	Saving and Credit Cooperatives (Limited banking transactions)	Community Initiated	16	5
	Total		76	20

4. Time period: The seven consecutive year's data from 2005 to 2011 is taken in the study.

5. Method of Data Presentation and Analysis

5.1. Data Presentation

The collected data and information are presented by using various statistical tools such as bar diagram, graphs, charts, and histograms, which help to understand the data and figure easily. Also, these tools help in making a quick comparison of data relating to different times and institutions.

5.2. Data Analysis:

To analyze the financial performance of sample MFIs data ratio analysis, arithmetic mean (Mean) and one way ANOVA test (the application of difference of means test) are used. Data collected from the sample MFIs are divided into four groups i.e. GIMFB, PIMFB, FINGOs and SACCOS. Each group contains 5 institutions and data from the seven consecutive years 2005 to 2011 are taken for the study.

To attain the research objectives the cross-sectional descriptive analytical research design is adopted. The required data are taken from the MIX Market. The Microfinance Information Exchange (MIX) is the premier source for microfinance data and analysis which provides objective data and analysis with the goal of strengthening the microfinance sector. MIX Market (www.mixmarket.com) is the premier source for objective and unbiased microfinance data and analysis.

Likewise, to test the significance of the differences among four sample means, F-distribution technique, called the "Analysis of Variance-ANOVA" is used. ANOVA-F test is a statistical method, to detect if there is a statistical difference between the means of the populations.

The null hypothesis in the simple ANOVA test is the following:

H_0:μ_1=μ_2= μ_3 = μ_4, The financial performance of four different modalities of MFIs is same. There is no any significant difference.

Against the alternative:

H1: $\mu_1 \neq \mu_2 \neq \mu_3 \neq \mu_4$, The modalities has effect on the financial performance of the MFIs.

The application of difference of means test has been done at a=0.05 (degree of freedom at 95%).

Decision Criteria: If the test statistic from the table is greater than the F critical value, reject the null hypothesis.

To get the result for analysis purpose, data are processed from the SPSS programme version 17. SPSS Statistics is a software package used for statistical analysis.

Section 6: Innovation and Limitation of Research

Innovation and Output

The comparative study in financial sustainability of four different kinds of MFIs is new research work in the field of microfinance. The research found that the ownership structure and modality of MFIs make differences in its overall financial performance.

Through the study, this author recommends microfinance model for different income groups. 'Poor Household+Poverty Alleviation Programme/Development project+Group Lending' modality can be applied for extremely poor community. Likewise, for moderate and low income household, "Poor/low income household+Third party involvement +Group/individual lending" modality is prescribed. MFDB and commercial banks are more suitable for middle income level and micro-entrepreneurs. "Household/entrepreneur+Company+Bank+Individual lending" modality can be used for this group.

In policy sector, the author suggests to the Government of Nepal, allocation of tax received through MFIs in to separate fund and utilized this fund as subsidized fund for MFIs which are working especially in rural and remote area. In financial innovation for MFIs, the author prescribed, 'Leasing of Agricultural equipment and machinery' for the poor and income household, especially rural household. These are the some major innovative idea and output of this research.

Limitation of Research

The limitations of research are pointed out as follows:

1. This study is limited into only four types of microfinance institutions in Nepal viz. GIMFB, PIMFB, FINGOs and SACCOS. Other than these MFIs (Small Farmers Cooperative Limited) which are also providing microfinance services to poor household are not deeply studied.
2. Microfinance institutions should include two aspects: the financial and social performance. This paper just studied financial performance, lack of evaluation and analysis of the social performance and its effects. Of course, financial and social performance study will be more comprehensive.

CHAPTER TWO: THEORETICAL REVIEW

This chapter aims to discuss on theoretical base of the whole research work. So, financial development theory in developing economies and emerging issues in microfinance sector are elaborated. Similarly, with the motive to find out what other scholars have previously done and what remains to be done, and to access resemblances and dissimilarity with the proposed study some study reports, journals and articles published by different institutions , scholars and researches were reviewed. Conclusion of the review has been drawn with difference and similarities in various aspects with that of the present study.

Section 1: Evolution of Financial Development Theory in Developing Economies

The foundation of financial development theory was begun during the 19th and 20th century. During this period economists Walter Bagehot (A Description of the Money Market), K. Wicksell (Interest and Prices), Schumpeter (The theory of Economic Development), Keynes (General Theory of Economic Development, Interest and Money), Harrod & Doma (Economic Dynamics), Robert M. Solow (Growth Theory: An Exposition), Joan Robinson (The Second Crisis of Economic Theory) and James Tobin (Inflation and Unemployment) contributed to develop many economic growth theory[①]. The systematic study of financial development theory has begun from the period of 1950's after the publication of John G. Gurley and Edward S. Shaw's two articles "Financial Aspects of Economic Development" and "Financial Intermediaries and the Saving-Investment Process" in 1955 and 1956 respectively. At the same time, economist started to study causal relationships between financial development and economic growth.

After the Second World War, economic independence of the developing countries started with the independence of the country from the colonization, which attracts many western economists in the research field of developing nation's economy

[①] Xia , J. and Han, T. (2004). The History and Future of Financial Development Theories: A Review. [J]. *China Public Administration Review*, Vol. 1, 177-197 and rise new discipline as a "Development Economics". In this historical background, in 1973 the 'Financial Repression' Theory and 'Financial Deepening' Theory were first time discussed in the book "Money and Capital in Economic Development" and "Financial Deepening in Economic Development" by the economist R.I. McKinnon and E.S. Shaw respectively.

Later on, on the foundation of McKinnon and Shaw's financial theory and regarding developing economy, the economist Basant K. Kapur ("Alternative Stabilization Policies for Less Developed Economies"-1976), Vicente Galbis ("Financial Intermediation and Economic Growth in Less-Developed Countries, A Theoretical Approach"- 1977), Donald J. Mathieson ("Financial Reform and Stabilization Policy in a Developing Economy"-1980) and Maxwell J. Fry ("Models of Financially Repressed Developing Economies"-1982) established and expanded the financial deepening model.

Marco Pagano (1993), Greenwood & Jovanovic (1999), King & Levine (1993) contributed in the "Finance and Growth" relationship. Likewise Thomas Hellmann, Kevin Murdock and Joseph Stiglitz (1996) put forward "Financial Restraint Theory" in developing and transitional economy. According to them, financial restraint is a set of policies designed to improve the efficiency of financial markets. Its two fundamental building blocks are deposit rate control and limitations on the amount of competition in the financial sector[①]. They mainly give concern on many developing and even developed economies, moral hazard in banking, deposit mobilization and asset substitution.

Section 2: Features of Rural Financial Markets

Developing countries rural financial markets has some common features. Here, common features of rural financial markets in developing countries are presented.

1. Fragmented Markets

The rural financial markets are fragmented, having small number of players' on the supply side and large number of player on the demand side. Due to high transportation and information costs, informal financing sources are dominating the rural

---

① Hellmann, T., Mudock, K. and Stiglitz, J. (1996). *Deposit Mobilization Through Financial Restraint.* [C] Pp 4.

financial markets. The local moneylenders and landlords are main sources of rural financing in developing economies. Extreme variability in interest rate and very large spreads between borrowing and deposit rates are commonly existed in rural financial markets.

2. Government Interventions

Different kind of government interventions can be seen in the rural financial market. Governments have enforced strict 'anti-usury' laws that capped market interest rates or acted to prohibit or constrain the participation of certain types of intermediaries. Through the directed credit programme or specific sector lending programme banking institutions open rural branches and allocate a specified fraction of total lending to agricultural and rural sector lending. Likewise, financial repression is commonly seen government interventions in rural financial market. Directed credit, interest rate caps (by limiting supply and increasing demand), credit rationing, credit ceilings are examples of government interventions in rural financial markets.

3. Credit constraints

In rural financial market, it can be seen demand-side constraint and supply-side constraint. The supply-side credit constraint refers to quantity rationing. Rural people have many opportunities to earn income or expand their business, but they cannot qualify for a loan. In many cases, they cannot meet the collateral requirement and if they get loan, that is also below than their demand. The transaction cost and risk rationing are created from the demand-side. Due to transaction cost and risk associated with the loan, rural people themselves are not interested to take loan.

4. Segmentation

The persistent co-existence of formal and informal lenders, the concentration of formal lenders on households with land titles, limited supply of credit, credit rationing, high interest rate at informal sector shows that the rural financial markets are segmented. That means some rural households have access to credit at formal sector with comparatively lower interest rate, and others may have access to credit with high interest or may not have access to credit at all.

Likewise lack of specialization with local financial supplier, a very small group (particularly the rich and the elites in the village) receiving a very large share of the total amount disbursed, interest rate variation are the features of rural financial market.

Section 3: Analysis of Financial Repression Theory and Financial Deepening Theory

Many developing economy are facing the problem of low scale financial development and lower economic growth. Undeveloped financial system and low economic growth is the common phenomenon seen in the developing economy. McKinnon and Shaw put forward their specific views on the relationship of financial development and economic growth in developing economy which is clearly described in "Financial Repression theory" and "Financial Deepening Theory".

3.1. Financial Repression Theory

McKinnon and Shaw thought that a country's financial system affect the national economy due to existence of mutual incentive and constraints in relationship between financial system and economic growth. Many developing countries have errors in its financial policies and financial systems, such as government intervention in financial market, fixing of artificial low interest rates and exchange rates, which they termed as the "Financial Repression". They advocate that, in sake of financial development and economic growth, the government should implement the "Financial Liberalization" or "Financial Deepening" instead of "Financial Repression".

Generally financial repression means the ideas that a set of government rules, regulation, policy and other non-market restrictions which prevent the financial intermediaries of an economy from full capacity functioning[①]. Under normal circumstances, a county's financial development and economic growth have mutual interaction and mutual promotion relationships. But in developing countries, financial system and economic development have the vicious circle of distorted relationship status, so developing countries sink into poverty, the reason is existence of country's policy of

[①] Princeton University Press (2009). The Princeton Encyclopedia of the Economy. [M] United Kingdom Pp 430.

"Financial Repression", which led to the financial development remain stagnant and seriously restrict the financial development phenomenon.

Firdu Gemech and John Struthers (2003) explained that the artificial ceilings on interest rates reduce savings, capital accumulation, and discourage the efficient allocation of resources. Moreover, Mckinon pointed out that the financial repression may lead to dualism.[①]

Dualism in economy is common characteristics of developing countries; it is the case where "Modern Financial Sector" and "Traditional Financial Sector" both are co-exist.

The interest rate ceilings, high bank reserve requirements, capital controls, liquidity ratio requirements, credit ceilings, restriction on market entry into the financial sector and government ownership or domination of banks are the major reasons which creates the financial repression.

3.2. Financial Deepening Theory

The special nature of developing countries attracted some economists and researcher and opens the new chapter in the financial system and had started various research works in this field. Especially financial repression theory and financial deepening theory were developed by the American economists R.I. McKinnon and E.S. Shaw in during 70's of 20th century.

The financial deepening denotes to the abandon of extreme interference in financial system and market, liberalization of interest rates and exchange control and allow private capital and foreign exchange supply and demand. In addition, it refers to give full role to market mechanisms to effectively manage of inflation by the government. From this kind of deed, balanced financial system and lively financial market can be built by providing suitable lending rate and allowing the capital demands and high competence of capital flows in the economy. Alternatively, it can acquire the booming economy and increase national income through a variety of economic units and an enlarged demand of

---

① Gemech, F. and Struthers, J.(2003). *The Mckinnon-Shaw Hypothesis: Thirty Years on: A Review of Recent Developments in Financial Liberalization Theory.* [C] University of Paisley Pp 2.

financial services and inspire the extension of the financial system, creating financial and economic development.

The degree of financial deepening can be measure as follows[1]: （1） inflation under control and real interest rate is positive, (2) higher interest rate flexibility and strong attractiveness of financial assets, (3) steady increase in the degree of monetization, (4) decrease in foreign debt and foreign aid dependency, (5) free floating exchange rate, no any black market and speculation, (6) multi-level and multi types co-existence of financial institutions.

McKinnon and Shaw argued that, many developed countries especially developing countries, have restricted competition in the financial sector with government interventions and regulations. Repressed financial sector discourages both savings and investment because the rates of return are lower than what could be obtained in a competitive market. In such a system, financial intermediaries do not function at their full capacity and fail to channel saving into investment efficiently, thereby creating obstruction the development of the overall economic system. Loan rate ceilings as well as deposit rate ceilings exist in most repressed economies and there are very few competitive banking systems in the world.

McKinnon and Shaw's have different argument on starting point of financial repression. McKinnon measured that, in backward economy, the market is split, especially in competent capital markets, enterprise and capital owner be short of financial and investment mechanism for enterprises and capital owners, jointed with the government interference and low interest rate policy, which added more complexity to attain well-organized financial system. He mainly set his theory from the financial repression opinion, whereas Shaw made his theory from the view of point of "Financial Deepening".

Shaw argued that, under developed financial market creates impenetrability to capital owner to effectively access to the capital market, which makes the scarcity of capital in the developing countries. If the well-developed financial system can be form, the country has its own capital fund which can be utilized effectively without any dependence on the foreign investment. Even though their preliminary point of raising

[1] Wen Y. C. and Yan G.J. (2006). *Western Financial Theory* [M]. Commercial Press, Beijing. Pp 252

problem are diverse, but their policies are comparable that is to vigorously promote "Financial Deepening" and abolish "Financial Repression". They both give stress on improving financial markets, shaping the ideal saving and investment instrument, so as to institute an efficient financial system with detailed method of growing saving and income ratios.

Economists have commonly argued that financial repression prevents the efficient allocation of capital and thereby impairs economic growth. These are the serious phenomenon of financial repression. The financial repression and development can be measured[①] through, reserve ratio, real rates, liquidity, private borrowing, bank lending and market value.

As a key financial player in developing countries MFIs can flourish in financial deepening policy. Microfinance is a financial mechanism which helps to deepen finance in developing economy.

Section 4. Emerging issues in Rural Financial Market and Micro Finance

The financial deepening and financial inclusion are two major issues in developing economy. In the lack of financial deepening, financial system development and economic growth could not take adequate speed. Likewise in the absence of financial inclusion, poverty couldn't alleviate. A major root cause of poverty is lack of access into formal financial sector.

Large portion of people of many developing countries are still living in rural areas where basic infrastructure such as electricity, school, health, transportation, financial services are rarely meet. Large majorities of the population live in rural areas and earn their livelihoods primarily from agriculture in most developing countries. In 2010, 3.1 billion people i.e. 55 per cent of total population still living in rural areas. Among them 1.4 billion extremely poor people of developing worlds are living in in rural areas[3]. Key areas of concern are Sub-Saharan Africa and South Asia. The rural poverty report 2011 concluded that new approaches to rural development would help the

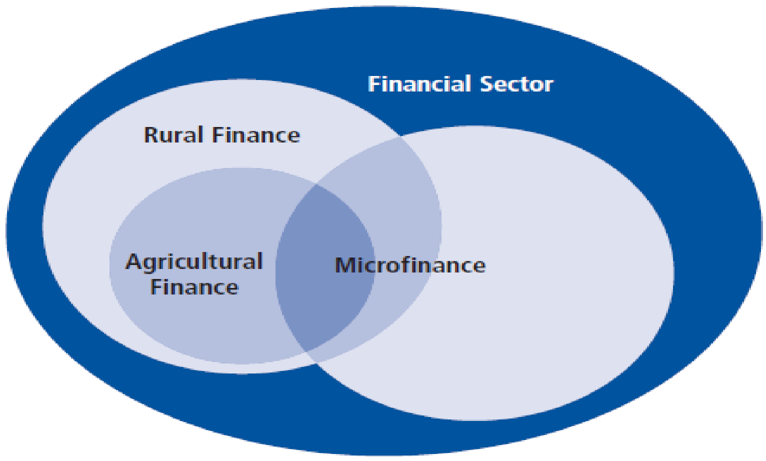
① http://uir.unisa.ac.za/xmlui/bitstream/handle/10500/2501/02chapter2.pdf Pp 66 agricultural sector become an effective driver in the rural poverty eradication[1]. It is accepted that rural poverty exists from lack of assets, limited economic opportunities and poor socio-economic infrastructure. Wide and deepen rural financial system as well as agricultural markets are essential for rural growth and poverty reduction.

In most developing countries, policymakers recognize a large gap in the supply of financial services in rural areas, even microcredit programs are struggling in these areas. Rural financing is a major issue in many developing economy. Rural finance, agriculture finance and microfinance are subset of overall financial sector. Brigit Helms[2] (2006) elaborated this scenario in this way: Rural finance refers to financial services offered and used in rural areas by people of all income levels. Agricultural finance is a subset of rural finance dedicated to financing agricultural activities, such as loans to buy fertilizer or for marketing crops, or insurance products designed to meet the specific needs of farmers and agricultural workers. Microfinance means financial services for poor and low-income people, and it encompasses the lower end of both rural and agricultural finance. It can be shown through the figure clearly:

Figure 2-1: The Set of Rural finance, Agricultural finance and Microfinance in Financial Sector

[1] IFAD (2011). *Rural Poverty Report 2011: Facts and Figure.*[R] Available at http://www.ifad.org/rpr2011/media/kit/factsheet_e.pdf Pp 5

[2] Helms, B. (2006). *Access for All: Building Inclusive Financial Systems* [M]. CGAP Pp 124



Source: Pearce, "Financial Services for the Rural Poor."

Saving facilities, payment services, access to credit, and reliable insurance mechanisms enable poor households to reduce vulnerability by smoothing consumption and mitigating risks[①]. The design of efficient and appropriate financial services and financial institutions are an essential component of rural financial market, which boost the rural economic growth and reduce the poverty.

4.1. Problems in Rural Financial Market

To develop and deepen effective way of finance in rural areas, it is necessary to identify the existing problems in the current rural financial market in developing countries. The existing problems in rural financial markets can be pointed out as follows:

1. Dispersed demand

In rural areas people are dispersed and population density is very low. As a result credit demand is also dispersed. This makes it tough to financial service providers to reach rural household's doorstep.

2. High information and transaction costs

[①] The International Bank for Reconstruction and Development Agriculture & Rural Development Department (2003*). Rural Financial Services: Implementing The Bank's Strategy to Reach the Rural Poor* [R]. Washigton DC. Pp 17

Remote geographical location, lack of adequate infrastructure, low credit size but dispersed demand, relatively very few clients per service center, low market penetration increases the high information and transaction cost in rural finance.

3. Domination of traditional finance

Formal financial service providers are mostly concentrated on urban areas and very few financial institutions are operating in rural areas. The financial sector in rural areas is dominated by the tradition finance such as money lenders, landlords and relatives. Dualism is common characteristics of rural finance in developing countries. Lack of appropriate collateral, lengthy loan process, and low level knowledge let rural household to use traditional finance.

4. Socio-economically backward rural households

Rural households are more socio-economically backward than the other region of the country. They are suffering from the low human development index (life expectancy, literacy, GDP per capita etc.). Low and unstable income is common phenomenon of rural households.

5. Weak institutional capacity of rural finance providers

Weak institutional capacity of rural finance providers due to poor governance and operating systems and low skills of manages and staff results the weak performance from the rural finance providers.

6. Lack of infrastructure and social services

The lack of infrastructures (communications, electricity, transportation, internet, etc.) and social services (education, health, etc.) are the common condition of rural area, which also increases the information cost and transaction costs and limit the risk diversification opportunities.

7. Seasonality

Due to seasonality of agricultural production and susceptibility to natural disasters increases the probability of covariant risks (in prices and yields) and add to more risks and costs of rural financial intermediaries.

8. Risks in farming

Farming is totally dependent upon the nature and weather too, which is out of control from the farmers' hand. Also the farm product market is very flexible. Small changes in market factor can easily bring the price fluctuation within a short time period.

9. Lack of usable collateral

In many developing countries, the farmers themselves do not have the own farm land. Formal financial institutions need the usable collateral to issue the credit. Without physical collateral these institutions are not willing to issue big loan and lack of big credit the farmers could not use the new farming technologies such as machinery and equipment.

10. Low business and financial skill of clients

Rural people who are involved in farming have low education and socially as well as economically back-ward in many developing countries. They have low business and financial skill, which decreases their confidence level in utilization of the credit. It is a reason of not taking credit from financial institutions although they have access to financial service providers.

Due to the above mentioned problems rural financing is facing many challenges and many financial institutions are not willing to enter in the rural financial market. In such a condition especial financial mechanism with financial innovation and financial product should be developed by the authorities. Especially, government initiation and supporting roles to develop rural financial institutions must be put forward to develop and deepen rural financial market.

4.2. Financial Innovation in Anti-poverty Strategy

Financial services play a key role in reducing poverty and long-term and easy access to financial services help to improve economic condition of the rural and poor household. But the major problem of many developing countries is the lack of access to formal financial services. Microcredit, microfinance is a major financial innovation to support the rural, poor and low income level household. So, it is also well known as a poverty alleviation tool.

1. Financial demand of rural and poor household

Rural and poor household need a whole range of financial services, many of which they get from the informal financial sources in the absent of formal financial sources. They need many different kinds of services to solve a wide range of financial problems at different points of time.

Large numbers of rural and poor households are vulnerable; some are extremely poor and destitute. There financial needs started after their birth to till death that means they need financial support in each and every moment of their life. Basically the financial needs of these people can be explained in four categories: livelihood, life-cycle events, emergencies and opportunities.

1. Livelihood: Many poor household facing the problem of absence of cash in their present life. Extreme poor and descent poor are struggling for their livelihood. They need cash or financial support for satisfying food, shelter and clothing needs which are minimum requirements to live.

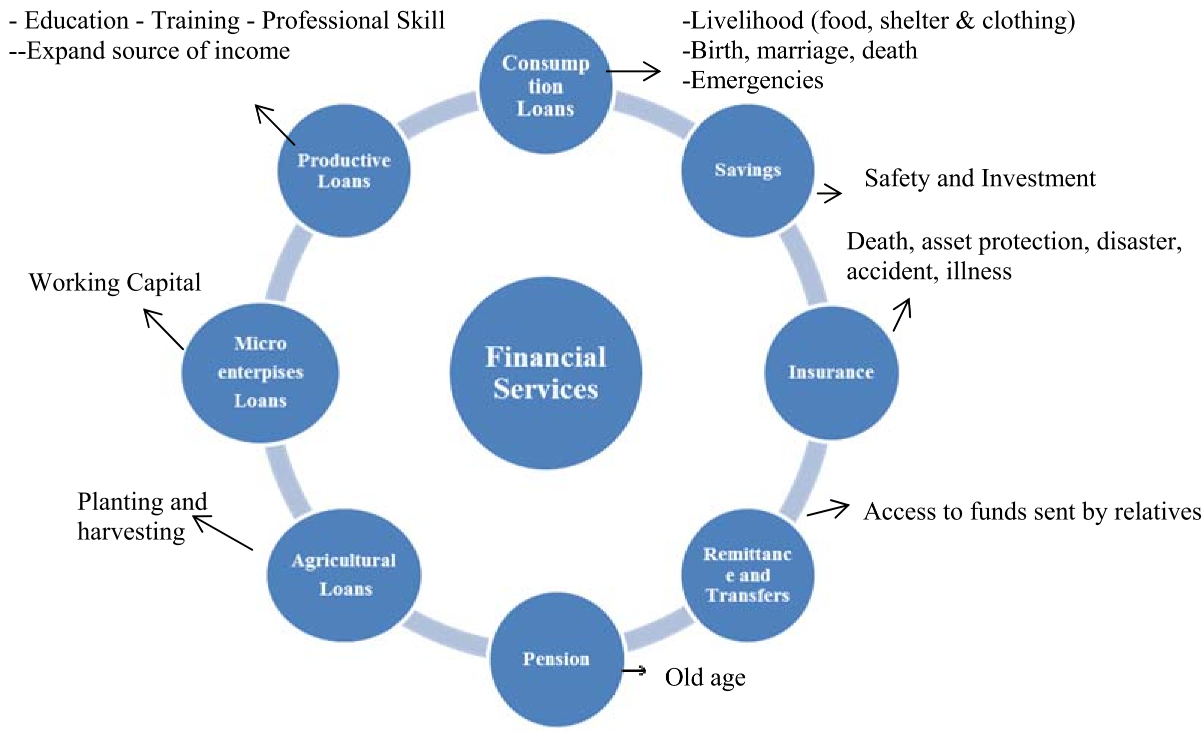
2. Life-cycle events: Life-cycle events include those once-in-a lifetime occurrences (birth, marriage, death, and some kind of ceremony) and recurrent incidents (education fees, festivals, harvest and planting time, holidays) that every household faces in their life. Likewise other life-cycle events include home building and reconstruction, old age, widowhood. During this life-cycle events people need lump-sum cash

3. Emergencies: It includes personal crises; sickness or injury, theft, the death of an economically active family member or loss of the employment, natural disaster (earthquake, floods, fires, cyclones etc.) which are out of control, these creates the sudden need for cash.

4. Opportunities: Poor people need credit to invest in business, land, or household assets. They also want to invest in costly item that make life more comfortable such as better roofing, better furniture, a television, etc. To fulfill these kinds of desire they seek credit too.

These are the some typical financial needs of poor household beside these needs they need more financial services. The link between typical financial needs and financial services for poor and low-income households is illustrated below.

Figure 2-2: Financial Demand and Services for Poor and Low- income Households



Source: Compiled by Author

2. Financial services for poor and low-income households

Different kinds of financial services need to solve financial demand of poor households such as credit, saving, insurance, remittance and transfers, pension fund, microenterprise loans and agricultural loans etc.

1. Consumption Loans: The various kind of financial demand of poor people can be met from the microcredit service. They need microcredit service to satisfy the financial demand in their daily livelihood (food, shelter & clothing), life-cycle events (birth, marriage, death and other custom) and emergencies. This kind of financial demand is commonly advocated from the consumption loans. Basically these kinds of loans are unproductive in nature.

2. Productive Loans: People need credit to expand the source of income, named as productive loans. Due to low income earning, rural people need education loan (enroll school, college, tuition fee and stationery). Likewise, in order to get technical skill and professional knowledge, they seek for loans too. Many rural households depend upon their family occupation but the income is not enough for them, so they need other jobs. To exploit job opportunity and expand the source of income, they seek productive loans.

3. Microenterprises loans: Poor and low-income households needs credit to start microenterprises in their local area. Some micro businesses are related with their family occupation and skills. If they have an easy access to microenterprises loans, they can easily promote their business and they can exploit the good business opportunity too. They need this kind of loan to establish the business (primary investment, capital) and operate (working capital).

4. Agricultural Loans: In many developing countries rural and poor households are involved in agriculture. Agriculture occupation is still in the condition of livelihood for them. They seek loans in planting and harvesting season. To transfer traditional agriculture to modern agriculture, they need agricultural loans.

5. Saving: Poor people want to save despite low-income and many of them do save for their future financial need and security purpose. Many financial service providers do not accept deposit from their clients. The convenient deposit service will help poor to tackle small size credit demand and also improve their saving habit.

6. Insurance: Very few poor people have an access to insurance against such risks as the death of a family breadwinner, illness, accident, natural disaster, loss of an asset including livestock and housing. Micro-insurance service will protect them from these kinds of risk in exchange for regular monetary payments (premiums). Micro insurance is a new product and still at the experimental stage. Most common types of micro-insurance products are credit life (debt dies with debtor), health insurance, agriculture, endowment life, property insurance (physical and animal), saving life, term life/personal accident and life insurance.

7. Remittance and transfers: Nowadays many rural and poor households' family members have become migrant workers. Some of them are working abroad and many of them are working in urban areas. The domestic and international remittance income has become a source of income for them. Thus they are facing problems of sending and receiving this money. Also money transfers services helps to bring more people into the formal financial system.

Likewise, education loans (for schooling and vocational training), pensions (after retirement or old age) are the financial services which poor and low-income households need. The financial service providers should design appropriate financial product to advocate these various kinds of financial needs of poor households which can improve their socio-economic condition as well as ensure quality of life too.

2. Microfinance

Microfinance refers to the provision of financial services for poor and low-income clients. It is one of the best financial services targeted to low income household to ultra-poor, which includes savings, microcredit, insurance, fund transfer and other financial products targeted at poor and low-income people. From wide perspective, microfinance means the permanent access to high quality financial services, financing income generating activities, creating assets, improving consumption, and protecting against financial and non-financial risks.

It is the developed form of microcredit. From historical perspective, microfinance has been in practice since the beginning of informal savings and credit groups. Early 1970s, formal microcredit came into rise after successful implementation of tiny loans to groups of poor women to invest in micro-business in Bangladesh. It is believed that the term "micro-credit" was be replaced by "microfinance" in early 1990s, which includes not only credit, but also savings and other financial services such as insurance and money transfers. Now a days many traditional microfinance, larger financial institutions, commercial banks are offering microfinance services. Now MFIs are making image of 'bank of the poor' too.

In developing countries, dual economy is existing and financial access is still challenging task. In this condition money lenders higher interest rate became bigger issue and it motivated government for market interventions. Beatriz and Joanathan (2005) suggested that the creation of microfinance institutions instead of interventions[①]. Therefore, expansion of microfinance services and growth of MFIs, support to deepen financial market.

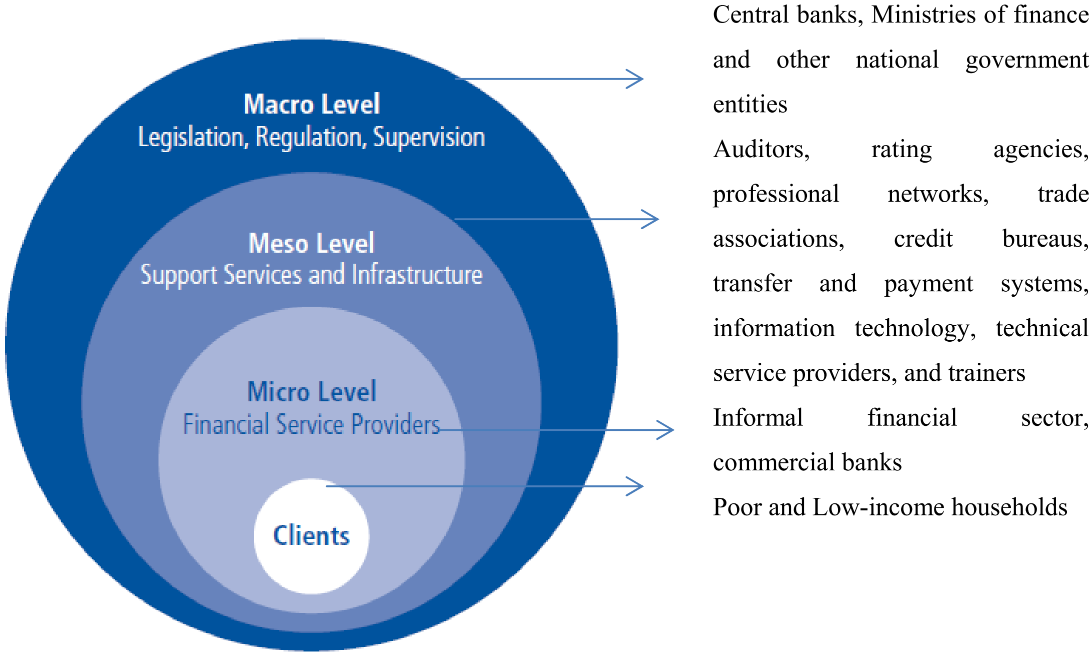
4. Inclusive Financial System

From the past more than 20 years, constantly widening the concept of micro-credit, from small amount credit to micro-finance, further introduced the "Inclusive Financial System" to provide services to the poor and low-income groups. The concept of financial inclusion is a way to look at the financial system that has become increasingly widespread after its articulation at the end of the International Year of Microcredit . The United Nation declared the International Year of Microcredit 2005 for building inclusive financial sectors to achieve the Millennium Development Goals.

[①] Armendariz de Aghion, B. and Morduch, J. (2005), *The Economics of Microfinance*.[M] The MIT Press Cambridge, England, Pp51.

An inclusive financial system is one that services all clients, not just the relatively well-off. This means reaching out to poor and low-income clients and providing them with affordable financial services tailored to their needs. This system provide basic financial services as well as let alone more advanced financial services that could provide security, predictability and the seeds of economic growth for their household. The inclusive financial systems framework recognizes that the massive number of excluded people will gain access only if financial services for the poor are integrated into all three level of the financial system: micro, meso, and macro [①](Figure 2-3).

Figure 2-3: Inclusive Financial System



Source: Brigti H. (2006)

In this system, clients (poor and low-income household) are put in the center and in micro level financial service providers offer services directly to the clients which are the backbone of financial system. The informal financial service providers to formal financial institutions and even commercial banks are the financial service providers. In

[①] Brigit H. (2006), *Access for All: Building Inclusive Financial Systems* [M]. The World Bank, Washington D.C., USA Pp 14 meso-level support services and infrastructure include auditors, rating agencies, professional networks, trade associations, credit bureaus, transfer and payment systems, information technology, technical service providers, and trainers. These various basic financial infrastructure and support services are required to reduce transaction costs, increase outreach, build skills, and foster transparency among financial service providers.

Finally, an appropriate legislative and policy framework is necessary to allow sustainable microfinance to flourish. In this macro-level include; central banks, ministries of finance, and other national government entities. In this overall system, especially in meso-level the support services and infrastructure, the relevant stakeholders can go beyond national boundaries and include regional or global organizations. It is the system which recognizes both the market potential and the development opportunities of learning to bank the poor.

5. Cooperative Finance

The cooperative finance is also a major rural financing model. At the beginning of the 19th century Robert Owen's ideas and principles of common ownership production for and abolition of private made a profound impression among certain people conceptualizing his principle's Rocadale pioneers developed the cooperative concept. In many countries farmers and rural communities are forming the cooperative organization to meet their financial needs and to coordinate their supply, farming and marketing activities. The major features of cooperative organization are voluntary and open membership, democratic member control, member economic participation, autonomy and independence, mutual cooperation and concern for community. The contemporary cooperative principles[①] are based on the User-Owner, User-Control and the User-Benefits Principle.

In many developing countries, the Rural Co-operative Financial Institutions are playing major role in rural financial market. Nowadays, it has become core of rural financial system because these institutions are promoting self-finance and supporting to reduce the fund shortage in rural financial market. The mobilization of private capital,

[①] James R. B. (2006). Current Issues in Cooperative Finance and Governance. [J]. Available at http://uwcc.wisc.edu/info/governance/baard.pdf self-financing, low financial and transaction cost, comparatively low moral hazard risks, more flexibility nature, adequate information of member, sharing investment and return among all the members are the main characteristics of cooperative finance.

It is believed that the modern type of cooperative finance is developed from Germany in the mid of 19th century, then it expanded to the Europe and America and gradually take shape in rest of the world. These days cooperative finance is an essential part of policy, commerce and cooperation. Whether the countries are developed or developing including like USA, Germany, France, Netherlands, South Korea, Japan, Taiwan have certain common characteristics.[①] In many developing countries there are also practicing cooperative finance. From the historic perspective, the cooperative finance was developed from the small scale credit society to the large scale cooperative bank.

Many researchers described that the cooperative finance is an appropriate tool for rural development. Dharia (2000) emphasized on the importance of co-operative ideas for the growth of an agro-based rural economy in whole of south Asia. Credit co-operative and cooperative banks have been instrumental in breaking the shackles of the feudal moneylenders in the country. The movement has considerably succeeded in rendering social justice along with the growth in equality that has disclosed a new direction in the farmers' economy. [②] The practice of cooperative finance in developing countries such as India, China, Sri-Lanka, Bangladesh shows the significance result in development of agricultural economy with rural economy. Dairy and agricultural production cooperatives, saving and credit societies, rural credit cooperatives, small farmers cooperative societies are well known examples of cooperative finance. Due to the positive result (socio-economic) of credit cooperatives, nowadays the cooperative finance became the major financial instrument in rural finance.

[①] Du X.S.(2012). Microfinance Institutions Should not be Purely Commercialized [N]. 2012-4-26 Available at http://bank.hexun.com/2012-04-26/140831777.html

[②] Neupane S.R.(2006). Co-operative Movement: A People Based Development approach, Its Role in the Economy of Nepal (D).Pp 34

Section 5. Review of Recent Research Works in Microfinance

In this section, the past research work related with microfinance and sustainability issue of MFIs are reviewed.

5.1. Microfinance, Financial Development and Economic Growth

After the successful implementation of Grammen model in microfinance industry, microfinance revolution up rises and microfinance sector became an emerging issue in research field. The research work on financial development and economic growth is inspiring the study in microfinance and financial development. Later on researcher give concern on study of relationship between microfinance, financial development and economic growth.

Michael S. Barr[①] (2005) elaborated the role of microfinance and financial development in his work. According to him, Microfinance institutions can play an important role in development in circumstances where other sectors of the economy are repressed. MFIs can help to improve the ability of the poor to build assets, increase price competition and drive down interest rates, and lay the groundwork for banking sector development should legal institutions take root.

Pankaj K. Agrawal and S.K.Sinha (2010) did a cross sectional study on Indian MFIs. They used 22 different ratios on six parameters (financial structure, revenue, expenses, efficiency, productivity and Risk) of financial performance during the study. They concluded that most of the best performing firms are following different business models in India. However in other areas especially in risk coverage, debt equity ratio, productivity, cost per borrower, operational self- sufficiency etc there exist a similarity between the firms performance. They further concluded that the similitude in performance is not due to a chance factor but a deliberate business model that emanates from group lending and rural focus of MFIs operating in the Asian sub-continent. This study sample is limited only on five star rated MFIs of India reported on Mix- market database. It cannot be generalize for all the MFIs operating in the country. They just

---

[①] Barr, M.S. (2005*), 'Microfinance and Financial Development' University of Michigan Law School,* The John M. Olin Center for Law & Economics Working Paper Series, 2005 Pp 285 analyzed data taken from 2008 single year so it would be better to comparative analysis of multiple year data[①].

Emma Svensson[②] (2007) explored the linkages of microfinance to economic growth and developed a model. The study concluded that the financial system development affects economic growth once it passes the threshold and with appropriate technologies, microfinance leads to the expansion of financial services but the type of development of the financial system is likely to be contextual. Moreover she argued that the financial intermediation may further affect growth through the saving rates.

Vicki Bogan[③](2012) examined the existing sources of funding for MFIs by geographic region, and explored how changes in capital structure could improve the efficiency and financial sustainability of MFIs using the regression model to find-out the relationship between the level of operational self-sufficiency and various MFI characteristics. The researchers find-out the strong empirical support for the notion that asset size was significantly and positively related to sustainability. The capital structure variables were strongly associated with sustainability. Grants as a percent of assets and share capitals as a percent of assets were negatively and significantly related to sustainability. Further noted that that grants relative to assets was negatively related to sustainability was a particularly meaningful result given that it was consistent with a growing view that MFIs should rely less on grants, soft loans, and other types of donor.

Maksudova N.[④] (2010) research work is based on a broader finance-growth nexus where microfinance is seen as new pillar capturing informal intermediation and directly contributing to financial sector development. For empirical study she had test on panel of 103 countries for 1995-2008 period using VAR specification. She concludes there is evidence of microfinance to Granger-cause economic growth and it is positive only in less developed countries where formal financial intermediation is immature

---

[①] Agrawal, P. K. and Sinha, S.K. (2010). Financial Performance of Microfinance Institutions of India- A Cross Sectional Study. [J] *Delhi Business Review* Vol.11 (2), 37-46

[②] Svensson, E. (2007). *Microfinance, Financial Systems and Economic Growth-A Theoretical Framework and Findings from Bolivia*. [D] Lund University.

[③] Bogan, V. (2012). Capital Structure and Sustainability: An Empirical Study of Microfinance Institutions. [J]. *The Review of Economics and Statistics*. Vol.94,(4) 1045-1058

[④] Nargiza M. (2010). Contribution of Microfinance to Financial Sector Development and Growth. [J].Available at http://www.microfinancegateway.org/gm/document-1.1.8998/Contribution%20of%20microfinance.pdf leaving significant space for alternative means such as microfinance and this positive impact, however, has risk to become a negative as middle income countries already face nowadays.

These research works show that the microfinance and economic growth has causality relationship. However, microfinance sharing in overall national GDP is comparatively very low. Likewise some researcher tries to find-out the effects of microfinance in poverty reduction whereas microfinance is taking as means of poverty alleviation in developing economies.

The ADB (2009) published a research paper on 'Financial Sector Development, Economic growth, and Poverty Reduction: A Literature Review'. The report concludes that financial sector development contributes to poverty reduction, and a major channel is through economic growth. They argued that microfinance and SME credit programs are considered as effective instruments to improve poor household's economic and social welfare and reduce poverty and for microfinance to benefit the ultra-poor, programs should be well targeted and designed, and should be supplemented with training, social empowerment programs, and other safety net measures[①].

According to The SEEP Network, Poverty Outreach Working Group, Most MFIs aim to reach poor people; it has become increasingly apparent that they rarely serve very poor people. Most MFIs reach the "upper poor" in much greater numbers than the "very poor." The research on Microfinance and Non-Financial Services For Very Poor People (2006)" by the SEEP Network concluded that the most microfinance practitioners seem to agree that financial services are not sufficient in fact, alone they are often counterproductive to lift very poor people out of poverty. However, there is less agreement on what kinds of complementary services should be offered to this target group in addition to financial services. Further pointed out that, in order to successfully serve very poor people, they need to be explicitly targeted in most cases and assisted with products and services specifically tailored to their needs[②]. They seek market research and evidence to understand the needs of microfinance clients and relate their needs to their at

---

[①] Asian Development Bank (2009). *'Financial Sector Development, Economic growth, and Poverty Reduction: A Literature Review'.* Working paper

[②] The SEEP Network (2006), *Microfinance and Non-Financial services for very poor people: Digging Deeper to find keys to success.* [Working Paper] Poverty Outreach Working Group very poor people different poverty levels and to know the effectiveness of pro-poor financial services reaching at very poor people, but also at responding to their needs.

Michael S. Barr[①] (2009) viewed the financial development through the lens of microfinance. He pointed out four reasons which might help to financial development through microfinance. First, financially self-sustainable microfinance programs can contribute directly to poverty alleviation, and promote market deepening that in turn advances financial development. Second, microfinance may be a useful strategy to consider in countries with bad governance where other development strategies face significant barriers. Third, microfinance can help financial markets in developing countries to mature, while playing more limited, but useful, roles in poverty alleviation in both financially undeveloped and financially developed countries. Fourth, microfinance can help to break down opposition to, and build support for, domestic financial reforms.

Many empirical researchers found that the microfinance is helping to alleviate the poverty in developing countries. Through the means of microfinance, financial accessibility became widen and deepen, creating more job opportunities, increasing income of the people. Financially excluded people are integrated into financial market through the mechanism of microfinance. Microfinance is supporting to financial development and economic growth. This is the commonly accepted arguments towards the positive impact of microfinance. But the question is to what extent microfinance can make it more likely that financial development leads to economic growth.

5.2. Microfinance Institutions: "Institutionalist" and "Welfarist" approach

Growing number of MFIs, necessity of expanding financial access，providing better financial services to poor household are creating more challenges for current MFIs. To tackle these challenges MFIs have to maintain its sustainability.

The breakthrough in microfinance lending methods, savings mobilization and commercialization approach was first time occurred in Indonesia, Bangladesh and Latin America in the 1980s. The Lain American region shows the greatest profitability and

[①] Barr, M.S. (2005*), 'Microfinance and Financial Development' University of Michigan Law School,* The John M. Olin Center for Law & Economics Working Paper Series, 2005 pp 285 sustainability in microfinance industry than any other region in the world. In Latin America, 'Upgrading[①]', 'Downscaling[②]' and 'Greenfields[③]' these three strategic business model are used for the commercialization transformation of MFIs[④]. Indonesian MFIs such as the Bank Rakyat Indonesia (BRI), The People's Credit Bank (Bank Perkereditan Rakayat-BPR) are the successful commercial MFIs. Cost-recovery interest rates and high repayment allow commercial MFIs to achieve long-term sustainability and reach large number of customers[⑤]. NGOs and large retail banks (including state-owned institutions) are the major driving force for commercialization of Microfinance[⑥].

The paradigm shift in microfinance through commercialization approach creates a hot issue in microfinance industry and raised the debate between financial sustainability and primary objective of MFIs. Consequently, 'financial sustainability', 'reaching of the poor' and 'welfare impact' these three issues are came into discussion during 1990s[⑦]. Which was well summarizes by Zeller Meyer in ""The Triangle of Microfinance".

Since the success of financially sustainable MFIs, the division between two approaches viz. "Institutionalist" (Financial Systems/Self-Sufficiency/Cost Recovery) approach and "Welfarist" (Subsidized) approach became clearer and widen. "Institutionalist" is also known as 'Financial Systems', 'Self-sufficiency', and 'Cost Recovery', whereas "Welfarist" is known as 'Subsidized'. These two approaches are also named as "Sustainability Camp" and "Poverty Camp"[⑧]. The followers of Institutionalist approach focuses on financial sustainability of the institutions by attaining the cost

---

[①] Turning NGOs in to full-fledged microfinance bank or a non- bank financial institution

[②] it refers to service target to the microfinance customers

[③] It represents to creating a completely new institution with the help of international networks.

[④] Dacheva , P.(2009). Commercialization in Microfinance -A Study of Profitability, Outreach and Success Factors within the Latin American Context. [J]. Available at http://sbc.edu/sites/default/files/Honors/PDacheva.pdf

[⑤] Helms, B. (2006). *Access for All: Building Inclusive Financial Systems* [M]. CGAP P,Pp 3

[⑥] Christen,R. and Drake,D. (2001). Commercialization of Microfinance [R]. Available at http://mfbbva.org/uploads/tx_bbvagbmicrof/Commercialization_of_Microfinance.pdf

[⑦] Manfred , Z. and Meyer R.L. (2002). *The Triangle of Microfinance : Financial Sustainability, Outreach, and Impact* [M].The Johns Hopkins University Press, London .

[⑧] Rhyne, E. (2011). The Yin and Yang of Microfinance: Reaching the Poor and Sustainability. [J] Available at http://www.jointokyo.org/mfdl/readings/Rhyne-yingyang.pdf recovery. Supporter of this approach seem committed in commercialized microfinance and determining profitability than its impact on poverty[①].

Contrary, traditional MFIs are following Welfarist approach with the philosophy and ethics of serving poor people with different financial services. Welfarist tries to provide financial services to the poor and low income people at low cost and for this purpose they seek subsidized fund from the government, private sector and donor agencies. Welfarists aims at the very poor who are riskier and less accessible and NGOs or Co-operatives which regarding as microfinance as a major tool for poverty reduction[②]. Profitability, competition and regulation of MFIs are the key principles which constitute a commercial approach and the commercialization of microfinance was reflected in strong financial performance.[③]

In contrast, it has been experiencing that the primary goal of the Welfarist programmers is to reach the poor; especially the poorest of the poor with financial services. Many institutions using this approach provide microcredit to poor borrowers at low cost. The Welfairst approach vision that microfinance is but one tool to achieve broad-scale social or human development.

The organizations/agencies such as Ohio State University Rural Finance Program, the World Bank, USAID, ADB, CGAP, ACCION International are supporting and advocating the Institutionalist approach. The researcher Welfaires Chisten (1997), Rodey (1997), Grammen Bank foundation, are in favour of Welfarist approach. The 'father' of modern microfinance, Mohammad Yunus has recently proposed new type of business model which he termed as 'Social Business'. According to Yunus, this new type of Social business can be link with microfinance to serve the poor with various financial services. Grameen family of companies is the spirit of and experimentation that animates

---

[①] Bruce, E. M. (2010): *The Great Divide in Microfinance: Political Economy in Microcosm, in Todd A. Watkins, Karen Hicks (ed.)* [M]Moving Beyond Storytelling: Emerging Research in Microfinance (Contemporary Studies in Economic and Financial Analysis, Volume 92), Emerald Group Publishing Limited, Pp.109-144

[②] Berguiga, I. (2008). Social Performance Vs. Financial Performance of Microfinance Institutions. [J] Available at http://www.gredeg.cnrs.fr/Colloques/NFI/Papers/PapierOnLine/Berguiga.pdf

[③] Shil, N.C. (2009), Micro Finance for Poverty Alleviation: A Commercialized View. [J] *International Journal of Economics and Finance* Vol.1, No.2, Pp. 191-205 social business and Grameen Bank itself is probably the best example of this spirit[①]. Islamic microfinance institutions where interest in credit assumed as against the Islam religion and interest free Microfinance Institutions[②] are some examples of Welfarist MFIs.

The follower of Institutionalist approach main focusing point is financial sustainability of MFIs, they believed without financial sustainability MFIs could not provide qualitative services to the targeted clients for long run. Further they explained that social investors who donate fund for MFIs as a form of equity do not expect to earn monetary returns but private investors who purchase equity in a publicly traded firm, do expect monetary return[③]. Beside these Institutionalist approach and Welfarist approach the third approach of "Double bottom line" is also widely accepted by many MFIs in the world. The state-owned banks like agricultural banks, development banks, postal saving banks, member-owned saving and credit associations, community banks, rural banks and specialized MFIs are following the "Double bottom line" approach. In one hand, they aim to serve poor community and other hand they also aim to cover their costs and even turn a profit[④]. In all over the world, it can be found the MFIs are following above mentioned three different approaches.

Researchers had tried to analyse the both Institutionalist and Welfarist MFIs. Researcher could not avoid any approach and they came to conclusion with need of both Institunalist and Welfarist MFIs. Welfarist NGOs, agencies and academics must work together to ensure that what began as grassroots projects to reduce poverty is not abandoned in favour of the pursuit of profit[⑤]. Likewise Imene Berguiga (2008) concluded that social performance - targeting the poorest among the poor and financial performance-enhancing the profitability of the institution are compatible and may even be complementary. Jessica Schicks (2007) did case study on Bacosol from Bolivia

---

[①] Muhammad Yunus (2007). Creating a World Without Poverty. [M].Public Affairs New York, United States of America Pp.101

[②] Janat, P. A. (2009). Microfinance Institutions in Rural Development and Poverty Alleviation: The Bangladesh Perspective. [J]. *Theoretical and Empirical Reseraches in Urban Management.* Vol.2 (11), 112-133.

[③] James, C. B. and Bary, M. W. (2004): Microfinance: A Comprehensive Review of the Existing Literature. [J] *Journal of Entrepreneurial Finance and Business Ventures.* Vol. 9 (1), 1-26

[④] Helms, B. (2006). Access for All: Building Inclusive Financial Systems [M]. CGAP Pp 4

[⑤] Bisen, A., Dalton, B. and Wilson, R. (2012). The social Construction of the Microfinance Industry: a comparison of donor and recipient perspectives. [J].*Cosmopolitan Civil Societies*. Vol.4(2), 62-83

(Institunalist) and Grammen Bank for Bangladesh (Welfarist) and argued that the both kinds of MFIs are justified and should continue to coexist[①]. In contrast, Miki Hamada (2010) is one who expressed that the commercialization of MFIs is one solution for financial sustainability and commercialization of MFIs is the best way of maintain financial sustainability[②].

McFurie & Ors (1998)[③] define the two layers self-sufficiency of the MFIs viz. operational self-sufficiency and financial self-sufficiency. To be operational self-sufficiency, MFIs requires to cover all administrative costs and loan losses from operating income and for the financial self-sufficiency, MFIs requires MFIs to cover all administrative costs and loan losses from operating income; after adjusting inflation and subsidies and treating all funding as it had a commercial cost.

Pissarides (2004) defined self-sustainable MFI. In his view, those MFI which can operate without using of subsidies, grants or other concession resources to poor on an acceptable scale is knows as self-sustainable[④].

Whether the MFIs should follow institutional approach or Welfarist approach or double bottom line approach depends on the three factors: first one is MFIs' internal objective, aim and capacity, the second one is local people's economic status and last one is particular nation's state of financial system. Considering these three factors, MFIs should choose their own path for institutional development.

5.3. Microfinance in Nepal

Nepal is one of the practical field of microfinance programmes. Nepal has itself very specific geographic, cultural, demographic, social condition in small territory, which

---

[①] Schicks J. (2007). Development Impact and Coexistence of Suitable and Charitable Microfinance Institutions:Analysing Bancosol and Grameen Bank. [J].*The European Journal of Development Research.* Vol. 19(4) 551-568

[②] Hamada, M. (2010). Financial Services to the Poor: An Introduction to the Special Issue on Microfinance [J]. *The Developing Economies*, Vol.48(1), 1–14

[③] Al-Haidi, Abdulaziz M. (2009). Evaluating the Self-Sustainability of (MFIs) Using the Balanced Scorecard Approach [J]. Available at http://www.microfinancegateway.org/gm/document-1.9.41541/printing%20edition%201.pdf

[④]Pissarides, F. N. (2004). Sustainability of Microfinance Banks: the Ultimate Goal [J]. from *European Bank for Restruction and Development*. Available at www.ebrd.com/pubs/legal/lit032c.pdf we can rarely found in other area. The study on Nepalese microfinance will support to other developing countries to adopt the best practice model of microfinance.

Dhakal Nara Hari[①] （2007） concluded that historically Nepal witness Microfinance as an anti-poverty tools and demonstrated a significant paradigm shift on the sector beginning late 1990's and it forward departure as an industry, which benefit thousands of the poor people, poor women, micro-entrepreneurs and farmers and anticipate that the industry should transform further as a profitable business providing financial services for the poor. He further explored emerging issues such as policy on macro-economy and financial system stability, regulation and supervision of MF sector, institutional capacity building, expanding the frontier of MF services in remote areas, introduction of information and communication technology, encroachment or unfair competition and financial viability.

Sapkota Shanti (2008) has conducted a study on " Micro Finance Institution and Its Role in alleviating Rural Poverty in Nepal: A socio-economic Analysis" with the aim to find out the overall situation of Small Farmer Cooperative Limited in the Hill and Terai Districts of Nepal. The study concluded that the Small Farmer Cooperative Limited program has had a positive impact on social as well as economic well-being of the group members. Thus grass-roots level self-help organizations like SFCL has been proved to be an effective means in the process of poverty alleviation[②].

In Nepal, microfinance was formally initiated with the advent of Small Farmers Development Programs (SFDP) in 1975 as a targeted on rural poor focusing on farmers. Social mobilization is a major part for MFIs as well as providing financial services to the low-income household.

Shrestha Purushottam (2007) analyzes the financial performance and social mobilization of MFIs on the "financial performance of MFIs with special references to

---

[①] Dhakal, N. H. (2007), Emerging Issues in Nepalese Micro Finance Sector. [J] *Socio-Economic Development Panorama*. Vol. 1 (2), 35-46

[②] Sapkota, S. (2008), *Micro Finance and Its Role in Alleviating Rural Poverty in Nepal: A Socio-economic Analysis (Case study of Hill and Terai Region)[R]*. Pakistan Institute of Development Economics, Islamabad, Pakistan. Pp 43 small farmers cooperative limited in Nepal". He remarks that the status and activities of MFIs in Nepal considerable efforts have been made to help microfinance and social mobilization from government, donor community, INGOs banks, cooperatives to assist the poor and disadvantaged section of the society with different policies, programmes, projects, modalities and approaches. However the sustainability or these programmes and projects has been given less attention and in this regard SFDP has presented a model of SFCL a sustainable model, developing an organization of small farmers, which is operated and managed by the small farmers themselves. To analyze the financial performance of SFCL he used hypothesis test and multivariate regression model taking loan investment, repayment rate, profit and overhead cost as dependent variable. The study found that there is no significant difference in average investment, average repayment rate and profit in the Hills and the Terai. Rate of interest on loan is ignored while in evaluating financial performance[①].

Acharya Yogendra Prasad and Acharya Uma[②] (2009) argued that without a strong understanding of the divergence between the perspectives and interests of rural small farmers and those of bankers and policymakers, microfinance programs are likely to continue to struggle and fulfill their mission of poverty alleviation and sustainability of microfinance. The study revealed that the small farmers' definition and frame of reference to sustainability was entirely different to those of bankers and microfinance professionals. The lack of sense of ownership towards organization and apathy towards institutional sustainability were some of the reasons for high credit defaults amongst small farmers.

Shankar Man Shrestha (2009) prepared a report for Institute of Microfinance on "State of Microfinance in Nepal". The key objective of this study was to document the status of progress achieved in poverty alleviation through microfinance programs of the MFIs or Self-Help Groups (SHGs) in Nepal. The study give focuses on the Microfinance models, Outreach, Impact of microfinance programs at household level, Regulatory

---

① Shrestha, P. (2007). *Financial Performance of Microfinance Institutions with Special References to Small Farmers Cooperatives Limited (SFCL) in Nepal*.[D] Tribhuvan University, Kathmandu.

② Acharya, Y.P. and Acharya U.(2006), Sustainability of Microfinance Institution from Small Farmers' Perspective: A Case of Rural Nepal.[J] *International Review of Business Research Papers* Vol.2(2) 117-126 frameworks, Sustainability of MFIs, and Challenges for MFIs. The study concentrated on four different categories of MFIs, Grameen Bikas Banks, Private Microfinance Banks, Financial and Non-Governmental Organizations and Cooperatives. He used various ratios to analyze the overall condition of MFIs and key indicators of sustainability such as Operational Self-Sufficiency (OSS) and Financial Self-Sufficiency (FSS) are also elaborated in the report. The studied found that the, Cooperatives are more self-sufficient followed by PMFBs and FI-NGOs. The GBBs have their total expenses almost at par with their total income levels indicating a greater challenge for sustainability. The study remarked that the performance of PMFBs with regard to profit, was the highest among all four types of MFIs and these PMFBs have maintained the best management information system in their institutions allowing their management to track down any shortfalls rectified in time. He suggested that the MFIs in question could be easily made sustainable if they rationalize their staff numbers, increase staff productivity and reduce unwanted expenses. These MFIs should also pay attention to non-politicization of their staffs and making them professionally sound. They should also charge appropriate rates of interest to their clients such that they earn adequate profit to sustain their operations[①].

Conclusion

Review of different research papers, books and dissertation works help to generate the idea on related research area. Different kind of researches used different methodologies and tools, similarities and dissimilarities, findings and recommendation on such research work is beneficial to do new research work on this field. Some studies are related with the affect and impact of microfinance, some founds concentrating on historical development, whether some studies are based on empirical study. While some studies have analyzed current problems, threatens facing by MFIs. Its rarely found the comparative study of MFIs on the basis of its ownership and management. The objectives and methodologies of the present study are different from that the above reviewed research and studies. This study is focusing on financial sustainability of MFIs in

[①] Shrestha, S. M.(2009). *State of Microfinance in Nepal* [R]. Rural Microfinance Development Centre Ltd. Kathmandu.

developing countries and it will analyze various indicator related with financial sustainability.

This research aims to analyzed the Nepalese MFIs with comparative study of three different kind of MFIs (Government initiated, Privately initiated and Community initiated). The research area is new itself and it is expected that the findings of the research would support to develop, strengthen the current MFIs and to provide better and qualitative financial services to its target group such as poor and marginal poor with maintaining the financial sustainability of MFIs.

CHAPTER THREE: ECONOMIC CONDITION OF NEPAL

This chapter aims to present the brief introduction of Nepal, economic development and current economic condition of Nepal. Likewise, discuss on Nepalese financial system and its components and functions. In this chapter, the author analyses the poverty alleviation programme run by the Government of Nepal. Meantime, elaborate the present credit condition. This chapter helps to understand the current economic and financial status of Nepal and existing credit in credit supply.

Section 1: Nepal Introduction

Nepal is one of the smallest, least developed and landlocked country in the world. It lies between two giant and rapidly developing countries China and India. It occupies 147,181 square kilometres which is 0.03% of the world and 0.3% of the Asia region. The country stretches from east to west with mean length of 885 km and widens from north to south with mean breath of 193 km. The altitude ranges from 70 meter to world highest peak 8,848 meters. The country is topographically very varied which is reflected in the diversity of weather and climate. The climate varies from tundra to polar. Nepal is a much diversified and rich country in terms of environment, climate, culture, language, natural resources etc. Administratively Nepal is divided in to 5 regional development zones, 75 administrative districts, 58 Municipalities and 3,915 Village Development Committees. Nepal is a multi-cultural and multi-ethnic country. There are 125 caste/ethnic groups, 123 spoken languages, 10 different religions. Nepali is the major language of Nepal and also the official language of Nepal[4].

Geographically, the country is divided into three east-west ecological zones, the Northern Range-Mountain, the mid-range -Hill and the southern range- Terai (plain) land. According to census in 2011, the country has a population of about 26.62 million with the average population growth of 1.4 percent per annum, and the population density is 181 per sq.km[5]. Every year addition of more than 400,000 labor force is projected in the labor market[6]. Nepalese workers are going to the foreign countries in search of employment due to the existing poverty and unemployment situation in the country.

According to Nepal Living Standard Survey (NLSS) 2010/11, 25.16 percentage of the population is still estimated living below the poverty line. Such percentage was 41.76 per cent in FY 1995/96[①]. Based on the same survey, in terms of Purchasing Power Parity (PPP) calculated on the basis of an income of One USD a day, which is the internationally adopted measurement standard adopted by the World Bank, around 24.1 percent population is still living below the poverty line. The World Bank, in 2005 has redefined USD 1.25 a day as the poverty line. Nearly 83 percent of its people live in rural area. The gap between urban and rural as well as various geographical regions and groups is still stunningly wide in Nepal. According to Gini-coefficient, the indicator for income inequality, which was is 0.328[②] in the year 2010/11 suggesting that the growth rate of income level of the rich has been higher than that of the poor. It has necessitated to take the poor oriented policy-wide, structural and program-level measures accompanied by the creation of short as well as long-term income oriented employment opportunities and effective implementation of economic transfer programs.

Section 2: Current Economic Condition of Nepal

GDP is the popular means of measurement economic status of the any country. GDP growth rate indicates the country's economic development trend. It is main indicator of economy growth of the country. GDP structure shows the contribution of agriculture, industrial and service sector in the overall GDP. This section further discusses the current existing problem in economic development of Nepal.

2.1. GDP Growth

Since last three decades the GDP growth rate of Nepal is around 4 to 5 percentage. Average GDP growth rate was 4.8 % during the year 1981-1990 and 4.9 % during the year 1991-2000[7]. During the latest 10 year period the average GDP growth rate stands to 4.03 %, which indicate average GDP growth rate is decreasing compare to previous decades. Nepal's annual GDP growth rate seems fluctuating, only in the fiscal

① The Nepalese fiscal year generally begins on July 16 and ends on July 15.

② Central Bureau of Statistics, Nepal (2011). Nepal in Figures 2011 year 2007/08, the GDP growth rate reached at the highest point of 5.8 % (Table 3-1). The government estimated to attain 4.6% annual growth rate in current fiscal year 2011/12. From this GDP growth rate, it can conclude that the national economic growth is not enough to promote economic activities.

Table 3-1: GDP Growth Rate in Nepal

Fiscal Year	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12*	Average
Real GDP (in Basic Price)	3.8	4.4	3.2	3.7	2.8	5.8	3.9	4.3	3.8	4.6	4.03
Agriculture	3.3	4.7	3.5	1.9	1	5.8	3	2	4.5	4.9	3.46
Industry	3.1	1.5	2.9	4.4	4	1.6	-0.6	4.1	2.9	1.6	2.55
Service	3.7	6.8	3.3	5.6	4.5	7.3	6	5.8	3.6	5.1	5.17
Per Capita GDP (USD)	261	293	328	350	410	491	497	610	712	735	

*Estimated

Source: Ministry of Finance (2005, 2008 and 2012). Economic Survey.

Both agriculture and non-agriculture sector annual growth is also volatile that mean each economic sector are suffering from the problem. In recent decade the industrial sector average growth rate is 2.55% while the service sector average growth rate is 5.17 %. Despite the slow economic growth the per capita GDP is still USD 735 in the year 2011/12 which was USD 261 in the year 2002/03.

2.2. Structure of GDP

Total GDP of Nepal in the FY 2010/11 stood at NPR 1246 billion (nearly USD 17.23 billion), on which sharing of primary sector (Agriculture) is NPR 4823 billion, secondary sector (Industrial) is NPR 1841 billion and territory sector (Service) is NPR 6220 billion (Table 3-2). The sectoral composition of GDP has been gradually changing over the few decades. In real GDP, contribution of agriculture, industry and services sector were 37 %, 17.2 % and 45.9 % respectively in 2002/03. Such contribution stood at 37.4 %, 14.3 % and 48.3 % in 2010/11 respectively. Agriculture remains Nepal's principal economic activity, employing 80% of the population and providing 37 % of GDP. During recent ten years period, the contribution of agriculture sector is constant while the industrial sector has been decreasing and service sector has been increasing.

Agriculture sector is still livelihood for rural households. In order to develop agricultural sector, agricultural modernization, irrigation, scientific seeds and fertilizer, more investment and credit is require. Agricultural sector includes food crops, fishery and forestry. Rice, Maize, Wheat, Millet, Barley and Buckwheat are major food crops of Nepal. Among them rice plays important role in overall agricultural output.

Table 3-2 : Sector-wide GDP of Nepal

Unit: NPR in billion

Fiscal Year	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12*
GDP at basic prices (current)	4603	5006	5484	6111	6758	7552	9095	10834	12464	14182
Primary Sector	1751	1886	2021	2148	2302	2515	3146	4016	4823	5239
Secondary Sector	812	869	943	1019	1121	1265	1438	1634	1841	2058
Composition of GDP (in percentage)										
Primary Sector	37	36.4	35.7	34.1	33	32.3	33.5	35.9	37.4	35.7
Secondary Sector	17.2	16.8	16.6	16.2	16.1	16.2	15.3	14.6	14.3	14
Territory Sector	45.9	46.8	47.7	49.7	50.9	51.5	51.2	49.5	48.3	50.3

* Estimated

Source: Government of Nepal , Ministry of Finance (2012). Economic Survey Fiscal Year 2011/12

2.3. Major Problems in Economic Development

The existing major problems in economic development process are noted down:

1. Lack of agricultural modernization:

Nepal's economy is agricultural based economy but this sector is still in primitive phase of development. Traditional and livelihood farming is the major characteristics of agriculture. Lack of irrigation facilities, improved seeds, fertilizer, chemical, agricultural inputs and machinery, agricultural credit are the major reason behind the constant contribution by agricultural sector in overall GDP. Scientific and modernize agricultural practice is must for the agricultural sector development in Nepal.

2. Not having land rights:

Those farmers who are working from generation to generation in the farm, they still do not have land rights. Few landlords have occupying very large scale of farmland. *Aadhiya* system[①] is widely practicing in overall country. In one side, farmers who want to improve the agricultural productivity do not have land rights and could not invest due to lack of credit access but if farmers could improve the productivity by themselves, they must share it with landlords and another side the landlords who don't contribute anything to improve the agricultural productivity, continue reaping benefit from the farmers. It can be said one party couldn't improve and deploy investment in farming, another party do not show any interest to improve productivity. So this is the major cause behind the practicing of traditional farming in Nepal.

3. Unfavourable business environment for industrial sector:

Lack of adequate capital, low business competitiveness, lack of institutional and infrastructural improvements are old problems in industrial sector. Political transition, political intervention, labor dispute, power (energy) shortage added more problems for industrial sector, as the result many industries are shut down in recent decades.

[①] farmers should pay half of the agricultural production to the landlords as a rent

4. Energy crisis:

It has been the largest obstacle for country's economic development. Each and every nuke of society has been badly affected from the energy crisis. Recently, in dry season (winter period) daily 12 hours power cut off creating difficult condition to factory production. Alternative source of energy is very expensive and if factory, manufacture use alternative source of energy in production. It add high manufacturing cost and weaken the competitiveness in the market. So, the manufacturing sectors are compelled to reduce their production in winter season.

5. Lack of employment opportunities:

Due to low economic growth, long political transitional period and low investment, there are less new employment opportunities. As the result many labor force are diverted from domestic labor market to foreign market. In one hand, remittance income is supporting the countrys' economy but in another hand, labor shortage problem is facing especially in agricultural and industrial sector. Remittance income from International migration workers is now playing major source of income in Nepal remittance.

6. Lack of representative in local government body:

Since last 10 years the local political bodies are fully paralyzed. In the absence of elected peoples' representatives in local government body, the development fund couldn't properly utilized and development budget is freezing. Development spirit could not take its speed; as a result it has greater indirect influences in local level economic activities.

7. Lack of adequate liquidity in financial institutions:

Recently, Nepalese banking sector are facing the liquidity problem, which created the situation of unnatural competition between financial institutions to attract more deposit from the clients. The competition leads to higher deposit interest rate to attract more deposit and meantime heavy investment nearly 60 percentage of total banking investment went to land and housing sector. The speculation market of land and housing sector boomed, meantime the share of unproductive investment is also increasing.

8. Lack of investment:

The government is unable to generate adequate amount of capital to invest in social and physical infrastructure. The state of private capital and investment is also weak. The authorities are trying to attract more foreign direct investment in the country. To attract more foreign direct investment, the country has entered into Bilateral Investment Promotion and Protection Agreement (BIPPA) and Double Taxation Avoidance Agreement (DTAA) with some countries for the promotion of investment, though investment has not been made as projected. Even the private sector has not come forward openly for such investment.

Likewise, the problems such as: growing foreign trade deficit, poor performance of public enterprises, poverty, weak capital market, lack of social and physical infrastructures, double digit inflation rate are adversely affecting the overall economic growth of the country.

Section 3: The Historical Development of Modern Financial System in Nepal

History of formal financial system in Nepal is not much long; it has only 76 years old history. In this section we see the historical development of formal financial institutions and current regional distribution of banking and financial institutions.

1. Historical Development of Modern Financial System

The historical development of financial system is closely related with the political system of the country. Here the only brief history of formal financial system in modern Nepal is described.

1.1. Primary Phase of Formal Financial System (1937-1955):

During the Rana's regime (1846-1951/104 years) economic activities were totally dominated by feudal production system. After the fall of Rana's regime and establishment of democracy in the year 1951 had brought many positive changes in politics and economy. Progressive reforms in the land relations, abolition of land tenure system like *Birta*[①], currency reforms, initiation of development planning were the major economic reform steps taken by the government during this period. The formal financial system has started with the establishment of a commercial bank, Nepal Bank Limited (NBL) in 1937 with the joint contribution of 51 % government share and 49% private share. This bank has played a role as a central bank until establishment of Nepal Rastra Bank (NRB) in 1956. It was the big challenge for the newly established NBL to bring the people in to the formal financial channel and maintain the stable exchange rate between Indian and Nepalese currency[②].

1.2. Regulatory Phase (1956-1983):

The government instituted the NRB on April 26, 1956 as the central bank of the nation under the Nepal Rastra Bank Act, 1955. It was an important step towards financial regulation and development in the country. The time period from the establishment of NRB to before the operation of joint venture bank in 1984 is named as the regulatory phase. In this period the central bank started to impose regulatory and controlled policies. Meantime, it started to maintain the stable exchange rate between Indian and Nepalese currency.

The second state owned commercial bank, Rastriya Banjiya Bank (National Commercial Bank) was established in 1966. During this period, there was established Industrial Development Corporation (a state-owned development finance organization) in 1959 and Cooperative Bank in 1963. Cooperative Bank was converted in to Agricultural Development Bank of Nepal (ADB/N) in 1968. The NRB issued currency in 1959 and to control free flow of Indian currency it regulated the Foreign Exchange Act (1962) and also implemented the Credit Control Regulation Act (1966).[③] At that period, ADB was the major source of financing small farmers, agriculture, business and cooperatives.

[①] An assignment of income from the land by the state in favour of individuals in order to provide them with a livelihood.

[②] Bhusal, B. P. (2011). Developments and the Current State of Financial System in Nepal. [J] *The Keizai Ronkyu*. Vol. 139, 121-143

[③] Bhusal, B. P. (2011). Developments and the Current State of Financial System in Nepal. [J] *The Keizai Ronkyu*. Vol. 139, 121-143

In this phase, formal financial system was dominated by limited banks and state owned financial institutions. However, Employees Provident Fund, and Security Exchange Centre had taken place along with commercial and development banks in this time.

1.3. Liberalization Phase (1984-2005):

Nepal has gradually adopted liberalization and economic reforms since mid-1980s. As a result private and foreign sector had participated in the financial system. At the beginning of liberalization a joint venture bank; Nepal Arab (Nabil) Bank was established in 1984. Likewise, Nepal Indo-Suez Bank and Nepal Grindlays Bank were jointly established with foreign commercial banks. The entry barriers of private sector investment in the commercial banking industry were removed after amended of the Commercial Bank Act in 1984. In 1985, the Finance Companies Act was enacted in order to allow finance companies to be active in financial system with the objective of serving small borrowers and meeting the consumer credit demand. ADB had also started commercial activities since 1984.

After the restoration of democracy in 1991, the new economic development phase was started with the implementation of economic liberalization and privatization policy. The state role in market was reduced and encouraged many private firms to invest in socio-economic infrastructure. Banking and financial industries, telecommunication and media industry, information and technology, tourism, educational and health sectors are boomed in this period with large amount of private investment.

In Janauary 1, 1992 Purbanchal Grammen Bikas Bank Ltd. was established as a rural development bank by NRB. This is the beginning of microfinance development bank in Nepal. Later on, five regional rural development banks were established in a separate development region with the aim of providing formal credit to rural and poor households. These five regional development banks are replicator of Bangladesh's Grameen Bank.

Cooperative societies are active in Nepalese financial market since the very beginning of time. The enactment of Co-operative Act in 1992 started to bring informal cooperative societies in the regulatory framework.

This phase was fertile phase for financial institutions to establish and development. At the end of 2005 there were established 181 financial institutions (Commercial Banks-17, Development Banks-26, Finance companies-60, Microfinance Development Banks- 11, SACCOS-20 and FINGOs-478), the number of financial institutions was only 5 (Commercial Banks- 5 and Development Banks-2) at the end of 1985.

Table 3-3 : Growth of Financial Institutions in Nepal

Types of Financial Institutions		Regulatory Phase	Liberalized Phase						Growing and Sustainable Phase					
	Class	1980	1985	1990	1995	2000	2005	2006	2007	2008	2009	2010	2011	2012
Commercial Banks (1937♦)	A	2	3	5	10	13	17	18	20	25	26	26	31	32
Development Banks (1968♦)	B	2	2	2	3	7	26	28	38	58	63	79	87	88
Finance Companies (1990♦)	C				21	45	60	70	74	78	77	79	79	69
Micro-credit Dev Banks (1991♦)	D				4	7	11	11	12	12	15	18	21	24
SACCOS (limited banking activities)(1956♦)					6	19	20	19	17	16	16	15	16	16
FI-NGOs (1978♦)						7	47	47	47	46	45	45	38	36
Total		4	5	7	44	98	181	193	208	235	242	263	272	265
Insurance Companies									21	25	25	25	25	25
Employees Provident Fund									1	1	1	1	1	1
Citizen Investment Trust									1	1	1	1	1	1
Postal Savings Banks									1	1	1	1	1	1

Note: ♦ First time operation year.
Year represent mid-July of respective year.

Source: Nepal Rastra Bank (2007). Banking and Financial Statistics Mid-July 2007. No. 49
Nepal Rastra Bank (2012). Banking and Financial Statistics Mid-July 2012. No. 58

1.4. Growing and Sustainable phase (2006 onwards)

In order to boost and consolidate the economy and to liberalize the banking and financial sectors, the Banks and Financial Institutions Act (BAFIA) 2006 was enacted. As a consequence, the establishment of new Commercial Banks and Development Banks are rapidly growing after the enactment of BAFIA and end of decade long insurgency. The number of financial institutions at mid-July 2012 is 265, the figure was only 193 at Mid-July 2006 (Table 3-3). In same time the number of Commercial Banks increased from 18 to 32 and number of Development banks increased from 28 to 88. Likewise, number of finance companies, microfinance development banks, SACCOS and FINGOs reached at 69, 24, 16 and 36 respectively by mid-July 2012.

The rapidly growing numbers of Commercial Banks and Development Banks brought many technological and managerial changes in banking sector and it helped to provide more financial services in to the rural areas and bringing unbanked people into banking network. However, it creates the tough competitive banking environment; as consequences it creates unhealthy competition between financial institutions.

To maintain the healthy and sustainable development of banking sector NRB is adopting forced merger policy since May, 2011 with a majority of banks and financial institutions (BFIs). Under the three conditions based on which the central bank can force BFIs to go for merger. Those conditions are 1) If representatives of the same group or family are operating many BFIs, 2) If there is shortfall of capital (minimum capital adequacy ratio - CAR) and 3) If BFIs fail to improve their financial and install good governance. Some 22 financial institutions have acquired final approval from NRB to merge into 10 financial institutions, besides the 23 that have already got a Letter of Intent from NRB[8]. During the fiscal year 2011/12, 7 finance companies went into merger, among them 3 finance companies were merged with 2 commercial banks and 4 finance companies were merged with 4 development banks. Meantime 1 finance company upgraded into 'B' class development bank. Likewise some commercial banks are also in the merging process and some are seeking suitable partner for the merging purpose.

Recently, NRB has increased the required paid up capital for commercial banks, development banks and finance companies. According to the NRB's recent regulation, the commercial banks have to increase their paid up capital to NPR 2 billion (around USD

25.19 million), national level development banks to NPR 640 million (around USD 8.06 million), national level finance companies to NPR 200 million (around USD 2.52 million) and NPR 100 million for national level microfinance development banks. This increased minimum paid up capital requirement is also forcing development banks and finance companies to go into merger. This kind of merger procedure is enhancing the sustainable development of banking and financial institutions as well as creating stable and healthy competitive environment in financial sector in Nepal.

2. Regional Distribution of Banks, Financial Institutions and their Branches

Administratively, Nepal is divided into 5 development region; Eastern, Central, Western, Mid-Western and Far-western development region. Mid-western and far-western development regions are staying in geographically remote and economically back warded.

As at Mid-July 2012, 1425 commercial bank branches, 687 development banks branches, 24 microfinance development banks, 292 finance companies, 16 Saving and credit cooperatives (licensed by NRB) and 36 Financial NGOs (licensed by NRB) are providing financial services in all over the country. Likewise, 434 money changers and 49 money transfers companies are also in operation.

Region wise, large numbers of banking and financial institutions are centered in central development region followed by western development region and eastern development region. In central development region, 1452 banking and financial institutions are located whereas 720 and 461 are located in western development region and eastern development region respectively. Mid-western development region and far western development has only 211 and 119 banking and financial outlets/branches.

From geographic outreach perspective, distribution of banking and financial institutions braches is also uneven and unequal. Larger number of branches per square kilometre indicates smaller distance to nearest physical bank outlet and thus easier geographic access. Demographic outreach of BFIs is shown from per capita measures of branches and it reflects the average number of people served by each physical outlet. Thus higher values supposed to fewer clients per branch or easier access. In, central development region and Western development region has larger number of BFIs branches per sq. km and higher number of BFIs branches per 100,000 population. The Central development region and Western development region have 52.97 and 24.49 BFIs branches per 1,000 sq. km. respectively and 15.04 and 14.61 BFIs branches per 100000 populations respectively. But, in Mid-Western development region and Far-Western development region have lowest in both BFIs branches per 1,000 sq. km. and BFIs branches per 100000 populations. Only 4.98 and 6.09 BFIs branches per 1,000 sq. km. are located in Mid-western development region and Far-western development region. Likewise, these regions have only 5.95 and 4.66 financial institutions branches network per 100,000 populations. Eastern development region has 16.20 BFIs branches per 1000 sq. km. and 7.93 BFIs branches per 100,000 populations. Nationwide, the number of BFIs branches per 1,000 sq. km. is 20.13 and 11.18 per 100,000 populations.

Thus both geographic and demographic distribution of BFIs outlets is unequal and uneven. Geographic and demographic access is significantly higher in Central development region and Western development region. Formal financial institutions are centralized in urban and city areas such as central and western development region.

As a result, there is existence of heavy, tough and unhealthy competition between banking and financial institutions in urban areas of central and western development region. On the other hand, there is lack of banking and financial institutions services in the hill, remote and rural areas, particularly far-western and mid-western development region.

Table 3-4: Regional Distribution of Banks, Financial Institutions and their Branches

（As of Mid-July 2012）

Banking and Financial Institutions	Eastern Dev.Region	Central Dev.Region	Western Dev.Region	Mid-Western Dev.Region	Far-Western Dev. Region	Total
Commercial Banks	255	709	256	120	85	**1425**
Development Banks	92	260	253	59	23	**687**
Microfinance Dev.Banks	4	15	3	1	1	**24**
Finance Companies	35	169	75	11	2	**292**
SACCOS*	4	6	2	2	2	**16**
FINGOs*	6	16	6	7	1	**36**
Money Exchange	65	228	125	11	5	**434**
Money Transfer	-	49	-	-	-	**49**
Total	461	1452	720	211	119	**2963**
Total	461	1452	720	211	119	**2963**
Area（Sq. Km）	28456	27410	29398	42378	19539	147,181
Population（2011）	5,811,555	9,656,985	4,926,765	3,546,882	2,552,517	26,494,704
Indicator for Financial Access						
1. Geographic (Number of bank & financial institutions branches per 1,000 sq. km.)	16.20	52.97	24.49	4.98	6.09	20.13
2. Demographic (Banking and financial institutions branches per 100 thousand population)	7.93	15.04	14.61	5.95	4.66	11.18

* Licensed by NRB

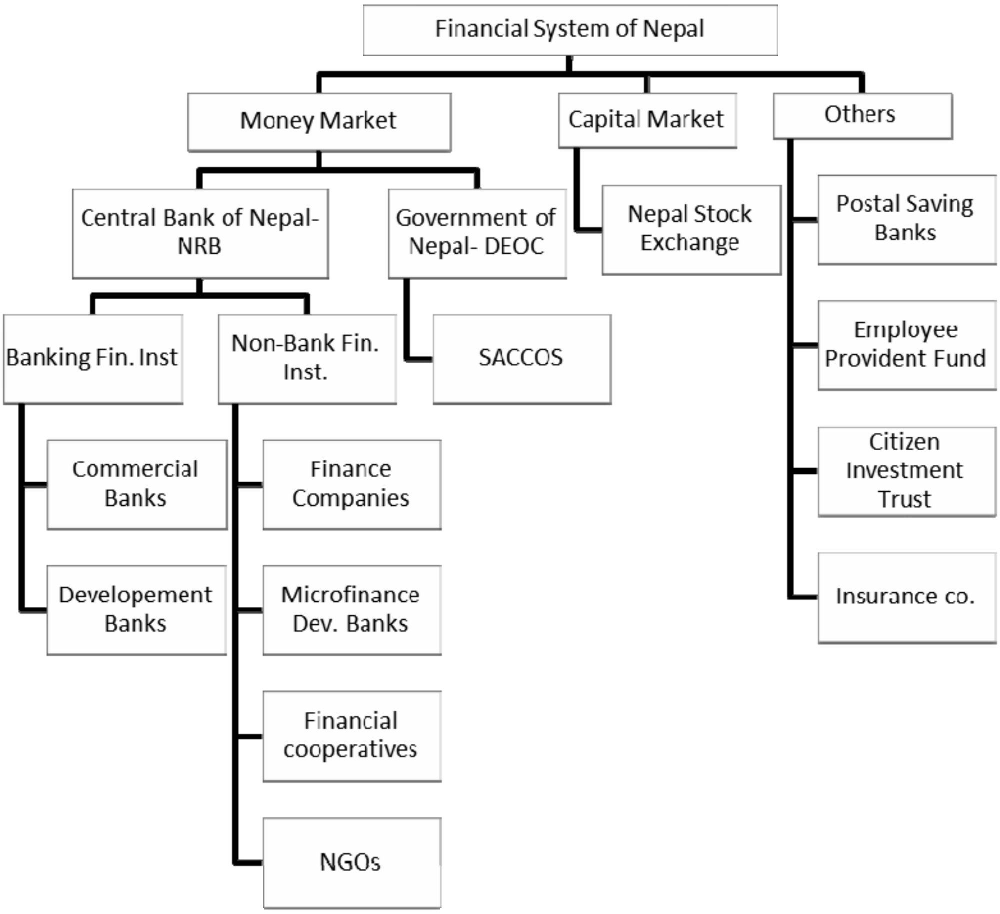
Source: 1. Nepal Rastra Bank (2012), Microeconomic Indicators of Nepal, November 2012

2. Central Bureau of Statistics (2011). National Census 2011

Section 4: Financial System of Nepal

Nepalese financial system comprises major three components named as money market, capital market and other. Among them money market is a key players in Nepalese financial system. Formally financial system of Nepal has started after establishment of first state owned commercial bank, NBL in 1937. The financial system has been controlled and regulated only after the establishment of Central Bank of Nepal, NRB in 1956.

Figure 3-1: Financial System of Nepal



Source: Author

Note: DEOC = Department of Co-operatives, Ministry of Cooperatives and Poverty Alleviation

1. Money Market

Money market is regulated by the central bank, however the economic transaction of Saving and Credit Co-operative Society Limited (SACCOS) are out of central bank's direct supervision and regulation. Money market is divided in to two categories on basis of supervision and regulation viz. banking and financial institutions under the Central Bank and non-bank financial institutions under Government of Nepal.

Further, the banking and financial institutions under central banks are divided in to two categories; Banking and financial institutions and Non-Banking Financial Institutions. The Commercial Banks and Development Banks are in operation under the Banking and Financial Institutions category, whereas Finance Companies, Microfinance Development Banks, Financial Cooperatives and NGOs are in operation under the Non-Bank Financial Categories of the Central Bank. The commercial banks and development banks are the key players in money market. As at Mid-July of 2012, there are 32 'A' class ranked commercial banks, among them 3 state owned banks, 7 private joint venture banks, and 22 private banks.

In Nepal, SACCOSs are regulated by the Department of Co-operatives, Nepal Government Ministry of Cooperatives and Poverty Alleviation. Cooperatives are being one of the best medium to get the easy access of people in the absence of banks & financial institutions in the rural areas. Therefore, the establishment of cooperatives became an unavoidable option for the socio economic development in the rural areas. Here, it should be noted that the interim constitution of Nepal 2006 has recognized the role of cooperatives as one of a pillar of economic development with equal foot to public and private sector. In terms of total assets and transaction volume, SACCOSs are not comparable with the Banking and Financial Institutions, though the outreaches of SACCOSs are remarkable. As at Mid-July 2011, more than 1.958 million people are involved in SACCOSs which nearly 7.4 percentage of national population[9].

2. Capital Market

Nepalese capital market's development took off only after the 1990's momentum of liberalization policies. The Securities Exchange Center Ltd. was established in 1976, later on converted in to Nepal Stock Exchange (NEPSE) in 1993. NEPSE opened its trading floor on

13t[h] January 1994. However, the capital market is still limited in urban and larger cities. NEPSE is only one secondary market of Nepal.

3. Others

Besides, the capital market and money market, other non-bank financial institutions are also operating in the country. Employment Provident Fund, Citizen Investment Trust, Insurance Companies and Postal Saving Bank are collecting different types of saving and mobilizing loans. Especially, Employment Provident Fund and Citizen Investment Trust collect huge scale of deposit from the employees working in government sector, public enterprises and private companies. These two institutions are investing in long-term development project. The concept of insurance is new in Nepalese context; however Insurance companies are growing and developing in Nepal. As of Mid-July 2011, total 25 insurance companies are active in Nepal. But the activities of Postal Saving Banks are not effective and declining day by day.

Section 5: Review of Poverty Alleviation Programmes

1. Current Poverty Condition

Poverty is multidimensional problem. Many developing countries are facing widespread problem of poverty. Poverty is a major challenge for the economic development of Nepal because of difficult geophysical position, socio cultural and economic factor.

Traditional farming, unemployment, higher inflation rate, steady and slow growing GDP, illiteracy factors, unequal distribution of resources are directly affecting the livelihood of the people. Steady and slow economic growth, biased growth pattern and failure of government policy are adding more challenges and difficulties in order to reduction and alleviation of poverty in Nepal.

According to Nepal Living Standard Survey (NLSS), 2010/11, people having an average annual income of NPR. 19,261 (around USD 267) are defined as people below the poverty line and on this basis, 25.16 percent of the total population are found below poverty line (Table 3-4). In 1995/96, 41.76 percent of the total population was below poverty line and this figure stood at 30.05 percent in 2003/04. The data reveals that the poverty is reduced by

5.69 percent within the 7 years period. It is believed that the remittance inflow and migration lead to decrease in poverty.

Poverty condition is different in urban area and rural area. The poor population in urban area is 15.46 percentage, whereas in rural area it is 27.43 percentage. Geo-physically the population below poverty line is highest in the mountain with 42.27 percentage followed by hill with 24.37 percentage and Terai with 23.44 percentage respectively.

Table 3-4: Poverty Condition in Nepal

Area	**No. of Poverty (in %)**			**Distribution of Population (in %)**
	NLSS-I 1995/96	**NLSS-II 2003/04**	**NLSS-III 2010/11**	
Absolute Poverty	42	31.5	13	
Population below poverty line				
National Average	41.76	30.85	25.16	100%
Urban	21.55	9.55	15.46	17%
Rural	43.27	34.62	27.43	83%
Region				
Mountain Region		32.6	42.27	
Hills Region		34.5	24.32	
Terai Region		27.6	23.44	
Gini-Coefficient				
National	0.34	0.41	0.33	
Urban Area	0.43	0.44	0.35	
Rural Area	0.31	0.35	0.31	
Population having income less than 1 dollar a day			19.7	

Source: Central Bureau of Statistics (2011), NLSS 2010/11

2. Poverty Alleviation Programmes in Periodic Plan

Poverty reduction was a goal of many government programs after the establishment of democracy in the year 1951. The Nepal government had adopted planned economy since 1956. The first five-year plan was carried on from 1956 to 1971. Five Year Plan (Here after plan) generally set different socio-economic goals for the systematic and planned development of the country. Each plan has its own different development priorities. For the first time, the problem of poverty was addressed in a Fifth Plan (1975-80), although no specific goals are mentioned.[10] The Sixth Plan (1980-85), included the fulfillment of the basic need of the people as one of its objective. The Seventh Plan (1985-90) realized that, extensive poverty is the main problem of the economy and increasing production is the only solution for gradual removal of prevailing poverty from the country. This plan has continued the objectives to fulfill the minimum basic needs of the people.

The restoration of democracy in 1990 has led to a number of policy initiatives in relation to poverty alleviation and poverty reduction was set as a principal objective of Eight Plan (1992-97). The cooperative movement was taken as an effective means of rural poverty alleviation. In order to effectively operate the co-operative movement, National Co-operative Development Board was established in 1991. Agricultural and rural credit programme was started to provide institutional credit as well as income and employment opportunities to small farmers and tenant farmers, artisans, small entrepreneurs and poor labourers. Meantime, the poverty alleviation credit programme has been further strengthened and expanded among low income household. Poverty alleviation programmes, 'Production credit for rural women' were operated during the plan. In this plan period, population below poverty line has declined from 49 percentage to 42 percentage as target.

In addition, the plan committed to make necessary arrangements to provide credit of up to NPR 10,000 without any collateral from banks, in the case of poor, landless farmers on the basis of group liability and feasibility of the scheme. As mentioned in Eight Plan, during 1991-1996 five Regional Rural Development Banks (RRDBs), (using the Grameen Bank methodology) were established by NRB each one operating in a separate development region, to provide credit facilities to small and cottage industries, income generating and productive agricultural activities and small scale business and trade in rural area.

The Ninth Plan (1997-02) aims to assist private sector and market economy to create more employment opportunities for poverty alleviation. Ninth plan has adopted poverty alleviation as its main objective. It has targeted to reduce population living below poverty line which was 42 per cent in 1995/96 to 32 per cent, 23 per cent, 15 per cent and 10 per cent by 2002, 2007, 2012 and 2017, respectively. Production credit to women had provided from various programs and channels such as; Micro Credit for Women (MCW), Production Credit for Rural Women (PCRW), Small Farmer Development Programme (SFDP), Grameen Bank, Agriculture Development Bank and other banks during this plan period. The plan targeted to channelized, NPR 2500 million micro-credits to 250 thousand deprived rural women for enabling them to operate micro enterprises. However, Ninth plan target of reduce poverty at 32 percentage could not meet and it stood at 38 percentage.

The main objective of the Tenth Plan (2002-2007) was to alleviate poverty and improve the status of overall economic, human and social indicators. The plan set the target to bring down the people living under poverty line to 30 percentage by the end of Tenth Plan. High sustainable and wide economic growth, development of social sectors and rural infrastructure, targeted programs and good governance were four pillars of poverty alleviation during the Tenth Plan. In this plan period, Poverty Alleviation Fund (PAF) was established to run poverty reduction programme effectively. At the end of Tenth Plan, the population below poverty line stood at 31 percentage.

Due to the political transition phase of country, National Planning Commission (NPC) had prepared for Three Year Interim Plan. The establishment of republic state brings different outlook and policies to advocate poverty condition. The Three Year Interim Plan (2007-2009) adopted market economy and gave focus on welfare oriented economic development through government, cooperatives and the private sector. Interim Plan targeted to reduce population below poverty line 24 percentage from 31 percentage. The plan realised that the poverty condition among the ethnic (Janajatis) groups is higher than the other communities due to unequal availability of opportunities, access in the national development sectors and an unequal State system. During the plan, poverty alleviation program had targeted to reduction of economic gap between *Dalit*[1] *Adibasi*[2] *Janajatis*[3] *Madhesi*[4] living below the poverty line and other groups. In this plan, the cooperative sector has been recognized as one of the three pillars of development along with the public and private sectors.

The Three Year Interim Plan (2011-2013) also continued the Eleventh Plan policy towards poverty alleviation. The plan aims to reduce poverty and inequality creating job opportunity via expansion of inclusive, productive and target programmes. The plan targeted to keep population below poverty line at 21 percentages which was 25.4 percentages in the

[1] low profile occupational castes
[2] indigenous people
[3] ethnic people
[4] people live in Terai region

beginning of the plan. In order to attain the target of poverty alleviation, plan gave focus on set up of the legal and institutional framework to ensure employment for poor, marginalized and decent community via operating microcredit, skill development and targeted programmes. Likewise, the plan stress on expansion of microfinance services in rural areas and increase the credit accessibility for poor and marginal community.

From the Eight plan period, the poverty alleviation has been taken as a major task of the plan. Many policies and programmes have been designed to reduce the poverty size. Within the 20 years period, the population below poverty line is decreased to 21 percent from 49 percent (by the end of Seventh plan 1985-90). It is believe that due to the increased wage rate in both the agricultural and non-agricultural sectors, increasing urbanization and inflow of huge amount of remittances, reduced the poverty. However, the gap between poor and rich is increasing and Gini co-coefficient is increased from 0.34 (in 2002) reached at 0.46 (in 2010).

Table 3-5: Poverty alleviation Target and Achievement

S.N.	Plan	Period	Population below poverty line (%)		Gini Co-efficient
			Target	Real	
1.	before eight			49	
2.	Eight	1992-1997	42	42	
3.	Nine	1997-2002	32	38	0.34
4.	Tenth	2002-2007	30	31	0.41
5.	Interim Plan	2007-2010	24	25.4	0.46
6.	Three Year Plan	2010-2012	21	running	

Source: National Planning Commission of Nepal (1992, 1997, 2002, 2007, 2010).

It is found that, agricultural credit, rural credit, microcredit and microfinance are adopting as a means of poverty reduction and generate self-employment. Various microcredit and skill development programs are designed for poor, marginalized people. Some poverty alleviation programs are operated through ADBN, Rural Development Banks and SFDP. But, the authorities failed to create of large scale employment opportunity and attain the high economic growth rate. The double digit growing inflation rate is adding more problems in poverty alleviation.

Section 6: Current Credit Condition in Nepal

The state of country's financial deepening is reveal in the credit condition. The source of credit, use of credit and collateral used for credit are some indicators of financial system development and deepening. In the well developed and deepened financial system, people highly use formal financial channel to get the credit and vice versa. According to Nepal Living Standards Survey 2010/11, 69 percent rural household and 49 percent urban household borrow credit from the informal channel such as relatives and money lenders (Table 3-6). Overall, 66 percent households get credit from the informal channel. In Nepal, only 20 percent household use bank and financial institutions channel for credit. NGO and Relief agency are source of credit for 4.1 percent households. Likewise, 5.1 percent and 4.6 percent households borrow credit from Cooperative Societies and other sources respectively.

Table 3-6: Source of Borrowing

Unit: in percentage

S.N.	Source of borrowing	Nepal	Urban	Rural
1	Bank and Financial Institutions	20	35.9	17.2
2	Relatives	51.1	42.4	52.6
3	Money Lenders	15.1	7.1	16.5
4	NGO/Relief agency	4.1	3.9	4.2
5	Cooperatives Societies	5.1	6	4.9
6	Others	4.6	4.7	4.6
	Total	100	100	100

Source: CBS (2011), Nepal Living Standards Survey 2010/11

In Nepal, only 26 percent borrower use credit in productive sector such as business, farm and enterprises (Table 3-7). The NLSS 2010/11 shows that huge amount of credit i.e. 74 percent are used in unproductive sector like household consumption and other personal use.

Even in urban area high portion viz. 66 percent credit used in personal use. It is necessary to encourage people to utilize credit for productive use.

Table 3-7: Use of Credit

Unit: in percentage

S.N.	Use of Credit	Nepal	Urban	Rural
1	**Business/farm use**	26.2	33.8	24.9
2	**Personal Use**	73.8	66.2	75.1
	a. Household Consumption	30.7	20.5	32.5
	b. Other Personal use	43.1	45.7	42.6
	Total	100	100	100

Source: CBS (2011). Nepal Living Standards Survey 2010/11

In order to get credit, households often use land, housing and property (Gold. Silver and others). Only 20 percent of all household loans in the country are issued with collateral and remaining 80 percent loans are issued without any collateral (Table 3-7). Around 82 percent of rural households and 70 percent of urban households do not used any collateral to borrow credit. For large scale loans, the collateral is necessary. People borrow credit for personal use so the loan amount is not big. The NLSS 2010/11 found out the average amount of loan borrowed is NPR 57,483. The loan without collateral has high risk and due to high risk inherent in these kinds of loan, high interest rate is charged.

Table 3-8: Types of Collateral Used for Credit

Unit: in percentage

S.N.	Types of Collateral	Nepal	Urban	Rural
1	No Collateral	79.9	69.9	81.7
2	Land & Housing	12.4	22.2	10.7
3	Property	4.8	3.8	5
4	Others	2.9	4.1	2.7
	Total	100	100	100

Source: CBS (2011). Nepal Living Standards Survey 2010/11

Furthermore, collateral is widely used to borrow credit from bank and financial institutions. Nearly half loan issued by banks and financial institutions are secured by the collateral (Table 3.8). To take loan from the banks and financial institutions, 39 percent borrower used land and housing as collateral. Less collateral is used in credit borrowed from relatives, NGOs and cooperative societies. Comparatively, the credit borrowed from money lenders is secured by collateral. Survey shows, 31 percent credit borrowed from money lenders are secured collateral. Among them 8.6 percent borrowers used land & housing, 18 percent borrowers used property as collateral.

Table 3-9: Distribution of Household Loans Borrowed by Collateral

S.N.	Types of Collateral	Source of Credit					
		FI	Relatives	Money Lenders	NGO/Relief Agency	Cooperative	Others
1	No Collateral	51.2	93.2	69.2	85.8	76	90.6
2	Land & Housing	39.6	3.4	8.6	7.9	19.3	3.4
3	Property	4.2	1.9	18	1.5	1.3	3.3
4	Others	5	1.5	4.2	4.8	3.4	2.6
	Total	100	100	100	100	100	100

Source: CBS (2011), Nepal Living Standards Survey 2010/11

The above data clearly shows that the Nepalese financial system is still dominated by the informal channel. Low banking network, lack of banking access, lengthy and time consuming banking procedure, urban area centered formal banking services, lack of banking habits and easy access of informal channel are major factor behind the less use of formal banking and financial institutions to borrow the credit. The business and enterprise opportunity should be develop to encourage households to use credit in productive sector. Utilization of credit in productive sector is necessary to attain the economic growth of the country. Banks and financial institutions generally seek fixed assets such as land and building for collateral to secure the loans. Rural households have lack of appropriate collateral to take loan from banks and institutions, which makes them to transfer into other source of credit. In above mentioned credit condition, microfinance services can play significant roles to expand financial inclusion and satisfy credit demand of households with different financial services. In case of lack of formal banking networks, widely use of informal channel as credit source and lack of appropriate collateral to get credit, the MFIs can be a best financial alternative for rural households.

CHAPTER FOUR: MICROFINANCE DEVELOPMENT AND PRACTICE IN NEPAL

Nepal is one of the developing countries, where huge number of population lives in rural areas. Large number of population is dependent on agriculture sector and poverty is big a challenge for government. Financial system is not well developed and many rural areas are out of banking services. Rural and poor households are still financially excluded. Government is trying to provide financial services in rural areas and microfinance is promoting to fight against the widespread poverty. In this chapter, we discuss on the historical development of microfinance, analyse current condition of microfinance service providers, and the status of deprived sector lending program.

Section 1: Historical Background of Microfinance

In Nepal, the concept of modern microfinance is new, but a part of modern microfinance has been practicing from the very beginning. Microcredit is a part of microfinance. Microcredit practice is not new for Nepal but it is integrated with co-operative. There is existence of traditional types of co-operative since the immemorial time. *Parma*[1], *Dhikuri*[2], *Manka-jya*[3], *Guthi*[4], *Dharma Bhakari*[5] are some examples of traditional types of co-operation. The above mentioned all traditional type of co-operation have run for generations to meet the needs of their members through labor exchange, meeting emergencies, providing loans and preserving culture. Dhikuri (Rotating Saving and Credit Association - ROSCA) a traditional informal financial institutions is popular among the urban and rural areas, where members can save deposit, get credit to satisfy short term financial needs and investment purpose. As global practice, the ROSCAs and Credit Cooperatives are roots of microfinance in Nepal.

---

[1] Exchange of labour between agricultural farmers and labourers engaged in cultivating and harvesting the crops
[2] Rotating Credit Association, a traditional informal financial institutions, popularly known as Dhikuri
[3] Common labor contribution
[4] Social organization and a trust aid fund of financial and human resources for emergency and ceremonial activities of the related families especially in the Newar Communities
[5] Grain savings and storage for famine

1.1. Microfinance Development Phase

The microfinance development phase in Nepal can be classified in to three phase i.e. preliminary phase, development & growth phase and institutional development & regulatory phase.

First Phase: Preliminary Phase (1957 to 1990)

The modern concept of microfinance began with the establishment of co-operative department under the ministry of agriculture in 1953. In 1957 April 2, the first time five credit co-operative societies were established in Bakhanpur, Chitawan district. It was the initiation of cooperative movement which partly included the saving and credit component of microfinance. The Co-operative Act 1959 and the Cooperative Rules 1961 were issued in order to bring informal saving and credit groups in legal framework.

In 1975, ADBL through Small Farmers Development Programme (SFDP) started to issue microfinance for the rural farmers. This programme included both components of microfinance, i.e. financial and social intermediation [11]. It is believed that the formal microfinance services started in Nepal from this time.

Second Phase: Development and Growth Phase (1991-2003)

In 1994, Microcredit Project for Women (the Project) specifically targeting women with assistance from the Asian Development Bank (ADB), the Intensive Banking Program targeted at the poor and the Production Credit for Rural Women Project were launched through ADBN, NBL and RBB. These programs could not provide a sustainable model to provide financial services for the poor though these programs reached a certain level of outreach.

The development phase of microfinance in Nepal begins after the formation of five Regional Development Banks (RDBs) by the government during 1992-1996 based on Grameen model. These banks were later transformed into Microfinance Development Banks (MFDBs) as class 'D' financial companies. In mid 90's, NGOs and private microfinance banks also started microfinance programs in the country. Following the Grameen Bank model, in 1993-34, NGOs such as Nirdhan and Centre for Self-help Development (CDF) successfully implemented microfinance programs and later transformed into MFDBs.

In the early 2000s three private MFDBs; Chhimek Bikas Bank Ltd. (CBB), Deprosc Bikas Bank (DBB) and Nerude Microfinance Development Bank Ltd. (NMDB), were established. In the meantime, the central bank (NRB) gave legal recognition and licensed to NGOs involved in community based financial activities.

The first wholesale microfinance system started in Nepal with the establishment of Rural Self-reliance Fund (RSRF) in 1991 by Government of Nepal to provide institutional wholesale credit to the SACCOS and FI-NGOs. Likewise, Rural Microfinance Development Centre (RMDC), the Sana Kisan Bikas Bank Limited (SKBBL) and National Cooperative Development Bank (NCDB) were established in 1998, in 2001 and in 2003 respectively to support the growing numbers of MFIs; SKBBL finance for SFCLs, whereas NCDB finance for cooperatives.

Third Phase: Institutional Development and Regulatory Phase (2004 onwards)

In the decade from the mid-1990s to the mid-2000s, large numbers of microfinance service providers; MFDBs, cooperative societies, NGOs and various funds and programs were established. In the Meantime, Government of Nepal had also given emphasis on poverty alleviation through the microfinance mechanism.

In 2004, Government of Nepal issued the Banks and Financial Institutions Ordinance - BAFIA (Which was converted into an Act in 2006). According to this act, the Microfinance banks are categorized as class 'D' banks. This act helps to regulate growing number of microfinance banks.

Modern microfinance institutions are new for Nepalese financial market. In order to create favorable environment and regulate growing numbers of MFIs for the development of microfinance, the central Bank issued 'National Microfinance Policy-2005' has been formulated. The policy aims to help in the formulation of necessary laws and rules relating to microfinance, to increase the access of destitute and economically weak families and women to microfinance services, to make microcredit supply system easily accessible through MFIs, to develop appropriate institutional machinery for the management of microfinance, and also to establish second tire institutions. According to the policy, Government of Nepal and the Central Bank shall function as promoters, facilitators, supervisors, regulators and monitors the microfinance programmes and institutions. The policy focused on establishment of affiliation between the big financial institutions, MFIs and other community based MFIs. Furthermore, policy aims to establish National Micro-Finance Development Council as high level institutional machinery to ensure policy coordination and function unity for operating micro-financial services. Likewise, the policy declared the establishment of the Microfinance Development fund to operate microfinance services on a sustainable and long-term basis; however till the date it has not been established.

On the one hand, the amendment of BAFIA-2006 and National Microfinance Policy 2005 helps to regulate and guide MFIs. On the other hand, it is encouraging to establish MFIs and expand microfinance services into rural areas. As a result, the number of microfinance service providers increased significantly. By mid-July 2012, 23 MFDBs including 3 wholesale microfinance providers, 34 FINGOs, 26501 SACCOSs, and 291 SFCLs were established.

1.2. Growth of Microfinance Institutions in Nepal

Before Mid-July 1995 there were only 4 SFCLs in microfinance sector of Nepal. In 1995, it reached 239. Between the year 1995 and 2000, the number MFIs became 2070. After the year 2000, whole decade the growth of MFIs especially SACCOSs significantly increased. Due to the central bank's restriction to establishment of Commercial and Development Banks, many bankers and investor diverted in to the establishment of MFDBs in regional and national level. In the meantime, the establishment of SACCOSs was rapid growth in local level.

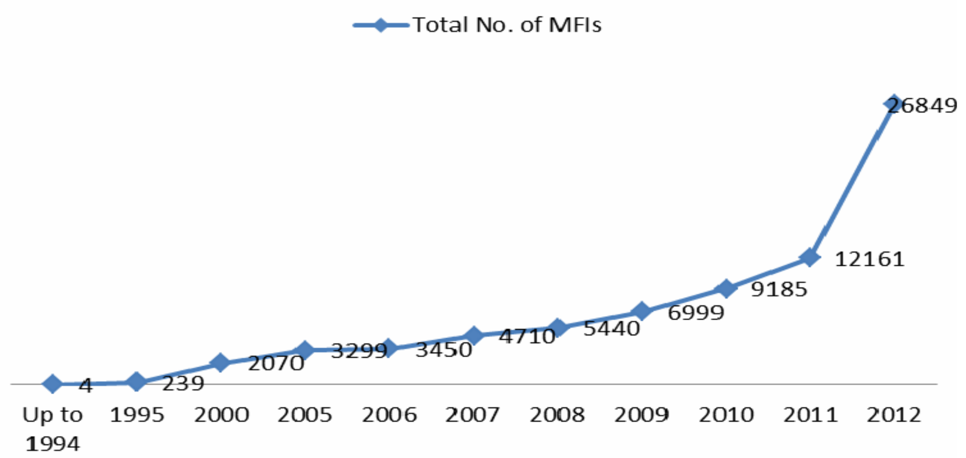
Table 4-1: Growth of MFIs

Unit: in number

S. N.	MFIs	Year (mid-July)										
		Up to 1994	1995	2000	2005	2006	2007	2008	2009	2010	2011	2012
1	MFDBs①		4	7	11	11	12	12	15	18	21	23
2	FINGOs②			7	47	47	47	46	45	45	38	34
3	SACCOs③		228	1971	3241	3392	4432	5162	6715	8888	11851	26501
4	SFCL/ SFDP④	4	7	85	114	141	219	220	224	234	251	291
	Total	**4**	**239**	**2070**	**3299**	**3450**	**4710**	**5440**	**6999**	**9185**	**12161**	**26849**

Source:①②NRB (Bank and Financial Statistics), ③Department of Cooperatives, ④SKBBL, Annual Report

Figure 4-1: Growth of MFIs in Nepal



At the end of Mid-July 2012, altogether 26,849 MFIs are in operation. Out of them, 23 are MFDBs, 34 FINGOs, 26,501 SACCOSs and 291 SFCLs.

Section 2. Microfinance Model Practicing in Nepal

During the past two decades, many financial institutions, cooperative societies and NGOs and community based organizations were providing different kinds of microfinance services in Nepal. These microfinance service providers have been applying different microfinance models. Among them, some microfinance models are designed as developed in domestic environment whereas some models are replicated from the international experiences. Here, the major microfinance models which are practising in Nepal are described:

2.1. Cooperative Model

Since the year 1957, cooperative societies have been practicing saving and credit activities within its member. Some components of microfinance are following by these cooperative societies. In early 1980s, a new generation of community based savings and credit group began to emerge in Nepal. Since the establishment of formal cooperative societies, the cooperative model of microfinance has widely been practiced. These cooperative were initially managed by the members and supervised by the Department of Cooperatives, the ministry of Cooperatives and Poverty Alleviation. Some cooperatives have been licensed by central bank for limited banking transactions. These cooperatives are providing services to non-members as well; and these cooperatives have been regulated and supervised by the central bank. In August 16, 1988, the Nepal Federation of Savings and Credit Cooperative Union (NEFSCUN) were formed as an apex coordinating body of SACCOSs.

According to the Cooperative Act 1992, a group of 25 persons from a community can form a cooperative by registering it with the Department of Cooperatives. The Act also permitted to establish three tired (National, District and local level) cooperatives system.

Modus Operandi

SACCOSs are community based organization, which aims to provide socio-economic benefits for its group member. SACCOS can be formed by 25 persons from different families within a local community. The SACCOSs are doperated on the basis of cooperative norms and principles and its business activities are limite within its members. All the members of

SACCOS are the owner of SACCOS, so the member should hold at least one share but a member can cast vote only on the basis of one person one vote irrespective of the number of shares subscribed by that person. Recently the book value of a share is NPR 100 (Around USD 1.26) each in many SACCOSs. Regular saving is mandatory for all members whereas the regular saving amount and period are different among the SACCOS. Except regular saving, members can save their amount as a fixed deposit and current deposit. Loans are provided on the basis of a member's requirement and SACCOS's policy.

The board of directors of SACCOS is elected from the members and the board lead and handle regular operation of the SACCOS. An account committee of three members including a coordinator is elected from the general assembly of the members, which perform internal audit and give necessary suggestion to the board.

SACCOS is the autonomous, self-regulated and democratic member control organization. However, the lack of control of members over the board of directors and lack of supervision and regulation from higher authorities (government body, the Central bank) let them operate out of cooperative norms and principles. Likewise, lack of cooperative education and awareness among the members, transaction beyond the members, disregard of cooperative norms and principles, loan on unproductive sector, lack of joint contribution of members, lack of efficient and skilled board members, lack of investment funds are the major problems that exist in SACCOS.

By the end of mid-july 2012, altogether 26,501 SACCOSs were formally operating in Nepal. These SACCOSs collected total deposit amount NPR 139.54 billion (Around USD 1.75 billion) and distributed total loans amount NPR 134.03 billion (Around USD 1.68 billion). These SACCOSs are providing saving and credit facilities to the members without lengthy bureaucratic and administrative process. In many rural and unbanked areas, SACCOSs are playing a significant role to provide financial services and satisfy short-term and mid-term credit demand for the consumption and small-medium enterprise purpose.

2.2. Small Farmer Cooperative Limited (SFCL) Model

Small Farmer Cooperative Limited is a group of small farmers[①] choosen as an institutional framework of the Small Farmer Development Program (SFDP) for making self-help cooperatives for the small farmers[②]. SFDP is the Government's first target group oriented microfinance development programme executed by ADBL since 1975[③] . It is a first group based poverty alleviation programme and it organizes small farmers including women into groups at village level and provides them with microcredit in joint liability basis.

In 1987, the Small Farmers Development Program Sub Project Offices run by the ADBN were started to transform into fully self-administered and managed co-operatives of Small farmers named Small Farmers Cooperative Limited (SFCL).

Modus Operandi

SFCL has a three-tier organisation i.e. small farmers groups at village level, inter-groups at ward level and main committee (the board) at VDC level. This feature differentiates SFCLs from other MFIs in Nepal. At the village level, promoters facilitate local small farmers to form groups consisting of 5 to 10 members and every member should buy minimum one share priced NPR 100 of the SFCL. After the formation of group, the group member can enjoy financial and non-financial services provided by SFCL. A representative from each group within a defined area is selected for the inter-group. The second tier-organisation i.e. inter-group works as an intermediary between the groups and the main committee. At the top level, main committee works as board of director and approve plan and programmes of SFCLs as well as set plans and policies. The Small Farmers Development Bank Ltd. was established to provide wholesale fund to the SFCLs.

The SFCLs are the leading microfinance institutions in Nepal. SFCLs are supporting small farmers and farm-less farmers with savings and credit facilities. Women's participation,

---

[①] Small farmer, who holds 0.5 hectare land in hilly area and 1.3 hectare land in flat area of the country. In addition, the condition of the small farmer is, not sufficient to live through the annual production of the prossessed land and annual income is less than 2,500 Nepalese Rupees (USD 1 = NPR 77)

[②] Kayastha, R. (2012). Small Farmers Cooperative Limited (SFCL) model: Appropriate Community-Based Microfinance Institution in Nepal. [J] *Yokohama Journal of Social Sciences* Vol 17 (3) pp 131-140

[③] Shrestha, P.(2007). *Financial Performance of Microfinance Institutions with Special References to Small Farmers Cooperatives Limited (SFCL) in Nepal*.[D] Tribhuvan University, Kathmandu deposits collection and mobilization, operation of different income generating activities, loan distribution and various types of social activities and mobilisation have brought many socio-economic changes within the members. Low repayment rate, second generation problem, lack of business and outreach expansion, lack of sufficient fund and lack of regulatory framework are the major problems in existing during the operation of SFCLs.

2.3. Grameen Bank Model

The Grameen Bank micro-financing model is based on group lending approach. Credit is provided on the basis of group responsibility and joint liability instead of physical collateral in the Grameen Bank Model. The Grameen Bank model innovated by Bangladeshi Economist and Nobel Laurent Muhammad Yunus formally began in Nepal in 1990s with the establishment of Grameen Bikas Banks (Rural Development Banks). In the initiation and investment of the Government of Nepal and NRB, five regional rural development banks were established in each region of Nepal. Likewise, some NGOs has also adopted Grameen Bank model for financial transactions. Now days, Government initiated Microfinance Banks, Privately initiated Microfinance Banks, NGO/INGOs and SACCOS are also replicating Grammen Bank model to provide microfinance services.

Modus Operandi

In this model first a peer group is formed within 5 members. According to the geographical location a centre is established which consists of 3 to 10 peer groups. Every group selects a chairperson and a centre chief in each centre. This Group chairperson and Centre chief's main tasks are to supervise the activities of group members and utilize loans and ensure timely repayment of loan installment. Likewise, they maintain group discipline and work as a bridge between groups and the banks. Each center conduct meeting in regular basis but the time frame is different among the MFIs. Some MFIs follow the typical Grameen modality like meeting every week whereas some replicating MFIs conduct meeting once a fortnight or month. As the Grameen Bank modality, every meeting the MFI filed staff collect loan demand, mandatory and voluntary savings, loan repayment installments and supervise the utilization of loans.

Many Grammen Bank model replicators are practicing group lending method. In the group, first two ordinary members can get the credit at first phase, when they complete repayment of at least two to three installments of credit, other members become eligible to get the credit.

2.4. Community Organizations (COs) Model

The community based organizations model of micro financing is widely practiced in informal groups. Many kinds of informal groups such as Clubs, Social Organization, NGOs, Mother's group (Aama Samuh) are exist in Nepal. A large numbers of COs have been formed and promoted under the social mobilisation, poverty alleviation and income generating programmes by the Government of Nepal and different agencies. Production Credit for Rural women (PCRW-1982), Participatory District Development Program (PDDP), Decentralized Local Governance Support Program (DLGSP) supported by UNDP, Poverty Alleviation Fund (PAF) funded by World Bank are some major COs or SHGs that are active in micro financing sector.

Under the DLGSP, a small revolving fund is provided to these COs for expanding their credit program. These self-help groups are trying to connect with formal banks and financial institutions. Likewise, the PAF has been providing a considerable amount of grant funding (up to NPR 5 million per VDC) to local CBOs for lending to individuals for income generating activities. The programmes under DLGSP and PAF focus on poverty reduction through local capacity building. Some of these informal projects and programs are changed or transformed in to formal organization such as Saving and Credit Cooperatives or FINGOs. However, most of them have remained informal and gradually become non-functional after the projects are phased out. Also, there is risk of creating dependency among the rural community from subsidy-oriented programs of government and development agencies.

Modus Operandi

The operational method of COs is different among the project and programmes. Generally, Government of Nepal and funding agencies motivated people to form the groups in grass root level i.e. Village Development Committee (VDC) level. These community

organizations are organized for separate groups for men or women or both. According to the project and programmes objectives and natures, the credit is distributed among the group members and every group has to conduct regular meeting. Some COs also collects savings from the members whereas some COs also works in animal husbandry and small-cottage industry.
In case of PAF, it provides 90 per cent grant to COs to lunch income generating activities, exclusively for the target groups. The groups of CO members borrow money from CO's Revolving Fund and borrowers pay back the loan on an installment basis to the COs.

2.5. ROSCA Model

The Dhikuri/Dhikuti is a traditional informal financial groups which is similar as ROSCAs. Dhikuti is a group of individuals who come together and make regular cyclical contributions to a common fund, which is then given as a lump sum to one member in each cycle. The rules and regulations are comparatively feasible and determined by the group members as their convenience. This kind of financial activity is popular among all dimension of the society.

Modus Operandi

Generally Dhikuti is practised among the close friends, colleagues, partners with whom they can easily meet. Mostly group is formed within the same community and background, e.g. labourers, farmers, staffs, teacher, business partner etc. The group members meet in regular basis, generally once a month and collect the regular saving from each members. Every member deposits the equal amount regularly. The lump sum credit amount is also distributed on the regular meeting. The lump sum credit receiver is decided by consensus, by lottery, by bidding, by serial ranking or other agreed methods. The lump sum amount receiver should payback the amount in regular/further monthly contributions till all the members get chance to use the collected fund. In this model, instead of interest the members who get the lump sum amount should leave some portion from the lump sum amount. That mean, the borrowers get the lump sum amount after deducting interest rate and transaction cost. This deducted money is kept as surplus money and it is distributed after finishing of full cycle as a bonus or it will spend for specific purpose based on predetermined agreement within the members.

2.6. Village Bank Model

The Latin American Village Bank Model was also used in Microfinance sector of Nepal between 1998 to 2001. At that time Women Empowerment Project (WEP) funded by USAID through PACT Nepal use this model in its programs. The Village Banks are grass root level financial institutions, community managed credit and savings associations designed to provide financial services to rural women of a community through the mobilization of their own resources and achieve financial self-reliance. During the project period, VBs were promoted through the local NGO partner of PACT Nepal.

Modus Operandi

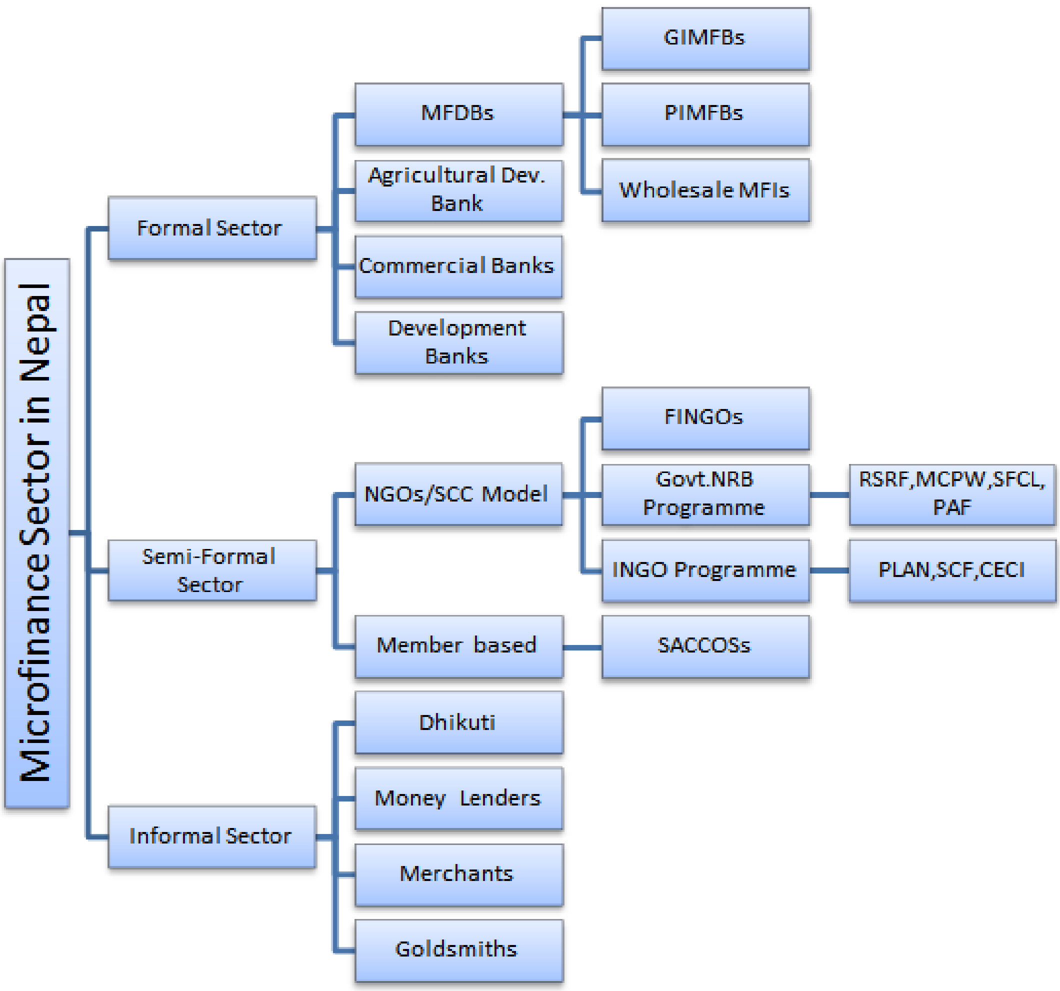
A Village Bank consists of 40-50 women, begins with a literacy class for six months. In the literacy class, saving and credit operation process was also taught. Later, they mobilised member savings and loans for productive or consumption purposes to the needy women members. The members are selected as a chairperson, a secretary and a treasurer to conduct regular meetings and keep all the records, minutes and account book safe and transparent. The loan size depends on the amount available in the Village Bank and interest will not be given in the members deposit but they charged interest on the lending and benefits from lending are shared in proportion to the savings deposits. One loan cycle is ended at the end of 16^{th} week and all the loan must be paid back to get new loans released.

These village banks are not linked with any financial institutions. This model is suitable for illiterate community, rural and remote part. However, village banks are gradually disappearing in Nepal.

Section 3. Current Condition of Nepalese MFIs

The current Nepalese Microfinance sector consists of three sectors i.e. formal, semi-formal and informal. Many semi-formal microfinance service providers have been upgrading to formal sector. The authorities are also trying to bring informal sectors in to the supervisory and regulatory framework but it needs more time and effort to develop such a framework. The Centre Bank of Nepal, NRB directly supervise and regulate the formal sector whereas semi-formal sector are being supervised and regulated by the different government organizations, such as Department of Cooperatives, Social Welfare Council of Nepal etc. Some institutions are jointly supervised by both NRB and concerned authorities of Government of Nepal.

Figure 4-2: Microfinance Sector in Nepal



Source: Compiled by author

3.1. Formal Sector:

Formal sector consists of specialized Microfinance Development Banks, Commercial Banks, Agricultural Development Banks and Development Banks. These banking institutions are directly supervised by the Central Bank, NRB. Commercial Banks, Agricultural Development Banks and Development Banks are not specialized microfinance banks though they are also operating different kinds of microfinance programs for their clients.

a. Microfinance Development Banks

The specialized Microfinance Banks were initiated by government in the preliminary phase. Initially, the Government of Nepal established Rural Development Banks as a microfinance Banks which was the replication of Grameen Bank of Bangladesh.

Table 4-2: Outreach, Saving and Loan Condition of MFDBs

Amount: NPR in million

Description	2009/10	2010/11	2011/12	Increment	
	1	2	3	4(1 to 3)	5 (2 to 3)
No. of MFDBs	18	21	24	25%	14%
No. of Members	610，025	679，072	823319	35%	21%
Deposit	16.84	35.46	52.43	68%	48%
Outstanding Loan	72.37	10.494	127.41	76%	21%

Source: Thapa Ganesh Bahadur (2013)

By the Mid July 2012, 24 microfinance development banks are in operation and they reached among 823,319 members (Table 4-2). In the year 2011/12, the no. of microfinance development banks are increased by 14 percent then the previous year and total members increased by 21 percent then the previous year. Between the fiscal year 2009/10 and 2011/12, total number of members is increased by 35 percent.

In the FY 2011/12 altogether NPR 12741 million amount of credit was distributed by the all Microfinance Development Banks. At the same time, they had collected NPR 5243 million amount of deposit from their members. Year on year deposit collection is increased by 48 percent while loan is increased by 21 percent. Between 3 year period, deposit collection and loan distribution was remarkably increased by 68 percent and 76 percent respectively.

b. Wholesale Lending Institutions

Currently RSRF, RMDC, SKBBL and First Microfinance Development Bank (FMDB) are working as wholesale lending institutions for microfinance service providers institutions. The first wholesale lending institutions RSRF came to the operation in March 1991 to provide wholesale credit to SACCOSs and NGOs. In 1998, RMDC were established to provide wholesale credit to MFIs, which became a major wholesale lending institution in Nepal. Likewise, SKBBL was established in July 2001 to provide necessary loan to the SFCLs. Recently, FMDB was also established in 2009 as a wholesale lending institution.

Table 4-3: Credit Disbursement of Wholesale Lending Institutions

Unit: NPR in million

Year	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	**Increment**	
MFIs	1	2	3	4	5	6	7	8 (1 to 7)	9 (6 to 7)
RSRF①	101	132	161	269	402	558 (9%)	862 (10%)	750 %	54%
RMDC②	982	1943	2468	3313	4515	5813 (88%)	6823 (78%)	595%	17%
SKBBL③	506	697	912	634	955	187 (3%)	267 (3%)	-47%	43%
FMDB④	-	-	-	-	-		805 (9%)		
Total	1590	2773	3542	4218	5873	6558 (100%)	8757 (100%)	400%	**21%**

Source: ①MOF, Economic Survey 2005/06, 2006/07, 2007/08, 2008/09, 2009/10, 2010/11 and 2011/12
②RMDC Annual report 2005/06, 2006/07, 2007/08, 2008/09, 2009/10, 2010/11 and 2011/12
③SKBBL Annual report 2005/06, 2006/07, 2007/08, 2008/09, 2009/10, 2010/11 and 2011/12
④NRB

In the FY 2011/12 altogether NPR 8757 million amount of wholesale credit was distributed by the three wholesale lending institutions (Table 4-3). Among them, RSRF had lent NPR 862 million i.e. 10 percentage of total lending in this year. Likewise, RMDC had lend large portion of wholesale lending 78% of total lending i.e. NPR 6823 million and SKBBL only lent NPR 267 million, i.e. 23% and newly established FMDB lent NPR 805 million, 9 % of total credit distribution.

Between the FY 2005/06 to FY 2011/12, the amount of total credit distribution was increased by 4 fold and year-on-year growth was 21 percentage. In the meantime, the loan distribution capacity of RSRF increased by 7.5 fold and RMDC's 5 fold but SKBBL's loan distribution was decreased by 47 percent.

Outreach of MFDBs and Wholesale Lending Institutions

Current outreach status of 20 MFDBs and 4 wholesale lending institutions are shown below (Table 4-4).

Table 4-4: Outreach of MFDBs and Wholesale Lending Institutions

S.N.	Particulars	Mid July 2012
1	District Cover	59 out of 75
2	Members	823,319
3	Borrowers	606,280

Source: NRB, 2012 (Monthly Banking and Financial Statistics, July)

As of Mid-July 2012, all the MFDBs including wholesale lending institutions cover 59 districts out of 75 and the total members and borrowers reached at 823,319 and 606,280 respectively.

C. Commercial Banks (including ADB/N)

Initially, the Commercial Banks including ADB/N are not directly involved in microfinance sector. But, after mandatory condition made by the Central Bank, these banks have been investing in priority and deprived sector. It includes micro and small enterprises which help increase production, employment and income as prioritized under the national development plan.

NRB has formulated Priority Sector Credit Manual in 1974 and the revised Manual has come into effect from 17 July 2000. Commercial banks provided credit to the ADB/N, MFDBs, SACCOSs, and FINGOs as "Priority Sector Credit". Until FY 2006/2007 it was mandatory for the CBs to invest in the priority sector. But, the NRB changed its policy and the CBs were only bound to invest in the deprived sector. The objective of deprive sector-lending program is to uplift the socio-economic status of poor deprived people of the society.

According to FY 2012/13 monetary policy formulated by NRB, Commercial banks, development banks and finance companies would need to lend 3.5%, 3% and 2.5% respectively of their total loan portfolio to the deprived sector (Table 4-5). Moreover, these institutions will need to raise such loans by 0.5 percent per year for consecutive three years.

Table 4-5: Mandatory Policy Provision for Banking and Financial Institutions

BFIs	1990	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13
Commercial Banks	0.25 to 3.00 %	3.00 %	3.00%	3.00%	3.0%	3.5 %	3.5 %
Development Banks	-	1.5 %	2.0 %	2.0 %	2.5%	3.0 %	3.0 %
Finance Companies	-	1.0 %	1.5 %	1.5 %	2.0%	2.5 %	2.5 %

Source: NRB, 2009 Monetary Policy 2007/08, 2008/09, 2009/10, 2010/11 and 2011/12

In the FY 2005/06, all the CBs had lent NPR 5, 255.13 million amount to deprived sector loans among them NPR 1,208.24 were directly invested by CBs and rest amount is indirectly invested (Table 4-6). The total deprived sector loan reached NPR 23, 180.1 million which is 341 percent more than the FY 2008/09.

Table 4-6: Composition of Deprived Sector Loan Distribution of Commercial Banks including ADB/N

Unit: NPR in million

Deprived Sector Loans	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	Increment	
	1	2	3	4	5	6	7	8 (1 to 7)	9 (6 to 7)
A. Direct Investment	1208.24	2,056	1,090.4	3,481.1	3,243.3	5,517.6	5398.8	346.83 %	-2.15 %
B. Indirect Investment	4,046.89	1,740.5	6,601	10,083.9	11,102.8	10,759.6	14598.4	260.73 %	35.68 %
C. Youth Self-employment Loan			-	-	2,382.9	3,109.8	3182.9	-	2.35 %
Total	5,255.13	6,842	7,691.4	13,565.1	16,729	19,386.95	23,180.1	341.1 %	19.56 %

Source: NRB, 2007, 2008, 2009, 2010, 2011 and 2012 (Banking and Financial Statistics)

The government had established Youth Self-employment and Small Entrepreneurs Fund to provide self-employment opportunities to unemployed youths and small entrepreneurs by providing them loan up to NPR 200,000 amount with 12% interest rate without collateral through different banks, finance companies and co-operatives. The Commercial Banks have issued NPR 2,382.9 million self-employment loan in the FY 2009/10 and it reached NPR 3182.9 million amounts in the FY 2011/12 which is 2.35% more than the FY 2010/11. This program is large scale micro-credit program for unemployed youth and small enterprises group launched by the government. However, there are big challenges and tiny progress in achieving an ambitious goal of providing self-employment to 50,000 people.

In FY 2011/12, commercial banks directly invested NPR 5398.9 million amount through direct lending (Table 4-7). Among them NPR 4,138.7 million in Agriculture, NPR 127.4 million in Cottage Industries, NPR 631.1 in Services and NPR 501.6 million in other sector was invested. Likewise, NPR 14,598 million amount was invested indirectly to deprived sectors. Among them NPR 14,057.7 million amount was invested in wholesale lending to MFIs and NPR 540.7 million amount was invested in share. Direct lending only cover 23.29 percentage of whole deprived sector loans whereas 62.98 percentage investments went through indirect investment. The portion of institutional lending or wholesale lending was big enough which covered 60.65 percentage of total deprived sector loans distribution of commercial banks.

Figure 4-3: Deprived Sector Loans Distribution of Commercial Banks

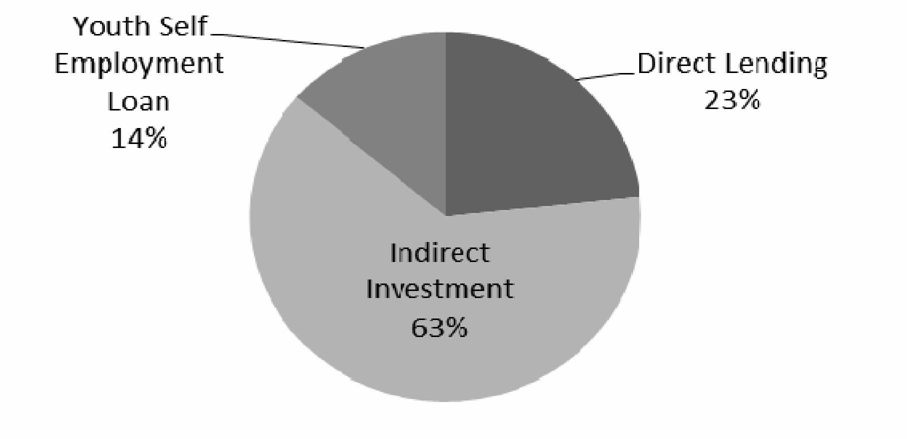


Table 4-7: Composition of Deprived Sector Loans Distribution of Commercial Banks in the FY 2011/12

Unit: NPR in million

S.N.	Description	Amount	Percentage
1	Deprived Sector Loans		
	A. Direct Lending		
	Agriculture	4138.7	17.85
	Cottage Industries	127.4	0.55
	Services	631.1	2.72
	Others	501.6	2.16
	A. Total	**5398.8**	**23.29**
	B. Indirect Investment		
	Institutional Lending-Wholesale	14057.7	60.65
	Share Investment	540.7	2.33
	B. Total	**14598.4**	**62.98**
2	Youth Self Employment Loan	3182.9	13.73
	Total (1+2)	**23180.1**	**100**

Source: NRB, 2012 (Baking and Financial Statistics)

Recently, some commercial banks have started direct investment in microfinance sector, providing microfinance services through their banking outlets. Likewise, some CBs have started branchless banking and mobile banking to collect deposit. Mega Bank Nepal Limited had started micro banking services including micro credit, micro deposits and remittance since inception 23 July, 2010. Till the end of Feb 2013, Mega bank has 3359 members and 1469 borrowers. In the same time it has collected NPR 0.96 million saving and credit disbursed NPR 75.73 million, using group lending model.

D. Development Banks and Finance Companies

Development Banks and Finance Companies are not directly involved in micro financing. These institutions have been investing certain portion of its lending to the deprived sector credit as central banks mandatory policy provision. Deprived sector credit was introduced to development banks and finance companies only in

2008. When the mandatory provision was introduced in 2008, development banks have to lend 3 percentage of its total investment to deprived sector. For the FY 2011/12, the provision was 3 percent and 2.5 percent for development banks and finance companies.

3.2. Semi-formal Sector

The microfinance service providers which are not directly regulated and supervised by the central bank are considered as semi-formal financial institutions. SACCOSs, FINGOs, Government and NRB microfinance programmes (SFCL, RSRF, MCPW, PAF), INGO microfinance programmes (PLAN, SCF, CECI) are players in semi-formal microfinance sector of Nepal. Some semi-formal financial institutions such as SACCOSs and FINGOs are also licensed by NRB with limited banking transaction.

A. Saving and Credit Cooperative Society Limited-SACCOS

SACCOS is the member based semi-formal financial institutions. It is one of the widely distributed financial institutions in Nepal. It has been playing a major role in financially excluded areas and providing financial services in remote, rural and community areas. Recently, the growth and financial transaction of SACCOSs are significantly increasing.

Table 4-8: Outreach, Saving and Loan Condition of SACCOSs

Amount: NPR in million

Description	2009/10	2010/11	2011/12	Increment	
	1	2	3	4(1 to3)	5 (2 to 3)
No. of SACCOS	8,888	10,997	11,851	33 %	8 %
No. of Members	960,648	1489,671	1958,922	104 %	31 %
Capital	7.278	14.167	19.564	169 %	38 %
Deposit	42.93	94.035	109.943	156 %	17 %
Outstanding Loan	48.885	89.308	94.775	94 %	6%

Source: Department of Cooperatives (2067, 2068, 2069)

In the FY 2009/10, the number of SACCOSs in operation was 8,888 and total members were 960,648 which reached 11,851 and 1958,922 in the mid July of 2012. Between these three years the total number of members increased by 104 percent.

Likewise, the capital increased by 169 percent between the year 2009/10 and 2011/12. Deposit collection of SACCOSs is more effective than other microfinance service providers in Nepal. SACCOSs do not have any restriction to collect the deposit from its member but they cannot mobilize the deposit to non-members. Some large scale SACCOSs, which are licensed by NRB for limited banking transactions, are also allowed to mobilize the deposit to non-member. In the FY 2009/10, SACCOSs have collected NPR 42, 930 million and loan disbursed NPR 48,885 million. It stood at NPR 109,943 million and NPR 94,774 million in the FY 2011/12 respectively. During this three year periods the deposit collection and loan disbursement were increased by 156 percent and 94 percent.

B. Small Farmers Cooperative Limited-SFCL

SFCLs are small farmers' oriented specific cooperative societies. These societies are providing microfinance services with animal insurance programme for the destitute and small farmers in local level.

Currently, 291 SFCLs are operating all over the country which was only 141 in the FY 2005/06 (Table 4-9). The numbers of groups in these SFCLs are 32,359 and the total numbers of members are 230,225 in mid-July of 2012. The growth of SFCLs and members are significant. Between 2005/06 and 2011/12 the total number of members' growth by 169 percentage and year on year growth rate is 21 percent.

Table 4-9: Outreach, Saving and Loan Condition of SFCLs

Amount: NPR in million

Fiscal Year	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	Increment	
Description	1	2	3	4	5	6	7	8 (1 to 7)	9 (6 to 7)
No. of SFCLs	141	219	220	224	234	251	291	106 %	16 %
No. of Groups	13,322	20,355	22,346	23,313	24,412	28,423	32,359	143 %	14 %
No. of Members	85,730	129,851	139,368	145,962	159,767	189,877	230,225	169 %	21 %
Deposit	114	203	244	306	530	827	987	770 %	19 %
Capital	73	59	87	132	261	453	625	756 %	38 %
Outstanding Loan	1435	2129	2429	2333	3355	4982	6569	358 %	32 %

Source: SKBBL Annual Report 2009/10 and 2011/12

In the FY 2011/12 the SFCLs have collected NPR 987 million amount of deposit from its members and distributed NPR 6569 million loan amounts which was 770 percent and 358 percent increment from FY 2005/06 respectively. The total capital of all SFCLs was only NPR 73 million in FY 2005/06; it increased by 756 percent and reached NPR 625 million in FY 2011/12. From the above data, it is clear that the SFCLs are expanding its services and financial capacity. Deposit collection and capital is significantly increased during recent 7 years period whereas loan distribution has not highly increased as compared to deposit collection and capital. However, year on year growth of outstanding loan increased by 32 percent in the FY 2011/12.

C. Financial Intermediary Non-Government Organization- FINGOs

After the decade of 1990's, the institutions involved in community based financial activities were started to give legal recognition and licensed by the central bank, NRB. These institutions are registered under Society Registration Act 2034 and licensed under Financial Intermediary Act 2055. FINGOs' are financial intermediary, non-government/not profit organization licensed by NRB. Many FINGOs have already transformed into Microfinance Development Banks and it has played a pioneering role in promoting microfinance in Nepal.

Table 4-10: Outreach, Saving and Loan Condition of FINGOs

Amount: NPR in million

Fiscal Year	2009/10	2010/11	2011/12	Increment	
Description	1	2	3	4(1 to3)	5 (2 to 3)
No. of FINGOs	45	38	34	-25%	-10%
Total Members	400，000	470，000	512，661	28%	8%
Deposit	13	23	24.92	92%	8%
Investment/Loan	41	46.50	51.14	25%	10%

Source: Thapa Ganesh Bahadur (2013)

The central bank is adopting tight registration policy to establish FINGOs and meantime large-scale FINGOs were upgraded into microfinance development banks. As a result, the numbers of FINGOs are decreasing. Above data (Table 4-10) shows that in the fiscal year 2009/10 there was 45 FINGOs licensed by central bank to operate microfinance activities but it decreased to 34 in the year 2011/12. However, the number of total member is slightly increasing and reached at 512,661 in the year 2011/12 which was 8 percent more than the previous year.

Deposit collection is highly increased i.e. 92 percent between the year 2009/11 and 2011/12. In the year 2011/12 total deposit collection is NPR 2492 million; it is 10 percent more than the previous year. Similarly, loan distribution increased by only 25% between three years period and reached at NPR 5114 million in the year 2011/12. Year on year loan distribution growth rate of FINGOs is only 10 percent.

D. Government and Nepal Rastra Bank Microcredit Programme

To provide microfinance service to the deprived sectors, especially in rural area, the central bank of Nepal, NRB have been operating some microfinance programs with coordination of Government of Nepal and various international donor agencies. There are five major donor funded micro-credit programmes that are running in Nepal. They are Production Credit for Rural Women (PCRW), Micro-credit Project for Women (MCPW), Third Livestock Development Project (TLDP), Poverty Alleviation Project in Western Terai (PAPWT) and Community Ground Water Irrigation Sector Project (CGISP). All these programmes are focusing to poverty reduction and microfinance service. Among them PCRW and MCPW are gender based microcredit programmes while TLDP, PAPWT and CGISP are project based microcredit programmes.

Section 4: Sharing Landscape of Microfinance Institutions

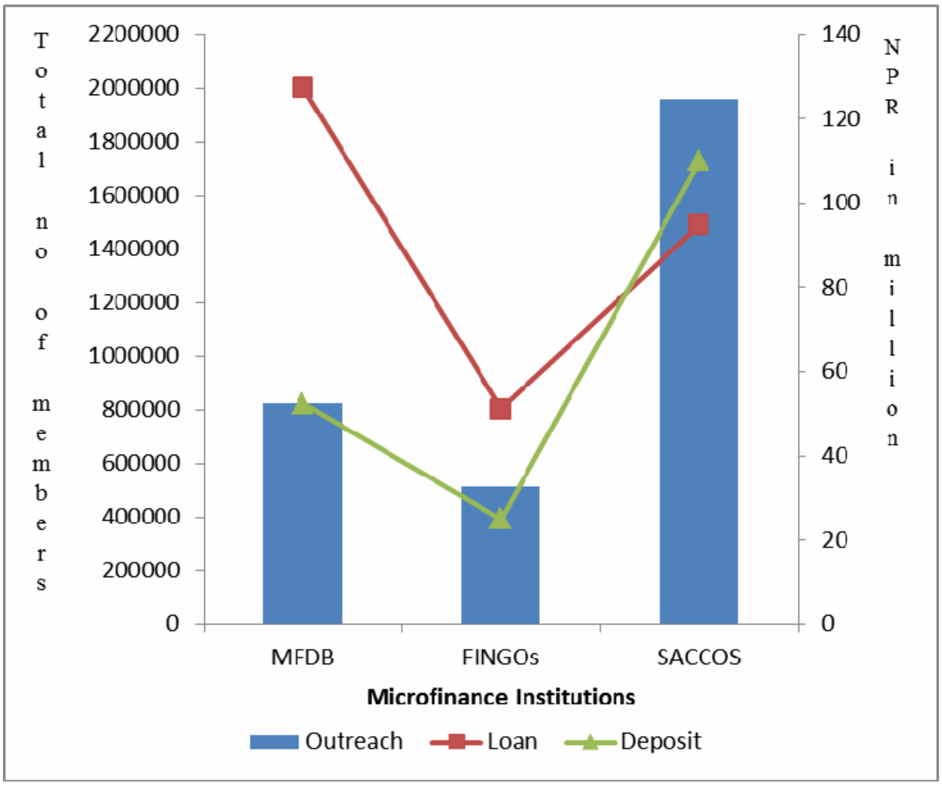
As per current cenerio, number of different types of MFIs in current micro economy of Nepal is widely spread. As per the data available of 2011/12 it can be observed that major player in loan disbursement is leaded by MFDB followed by SACCOS and FINGOs. where as in deposits SACCOs is the leading collector of deposits which is followed by MFDB and FINGOs. And talking about the total number of outreach of MFIs SACCOs has been at the top position similarly followed by MFDB and FINGOs respectively.

Table 4-11: Sharing Landscape of Microfinance Institutions

Date as of Mid-July 2012

Micro Finance Institutions	**Outreach (in number)**	**Loan Amount (NPR in million)**	**Deposit Amount (NPR in million)**
MFDB	823,319	127.41	52.43
FINGOs	512,661	51.14	24.92
SACCOS	1,958,922	94.775	109.943
Total	3,294,902	273.325	187.293

Figure 4-4: Sharing Landscape of Microfinance Institutions

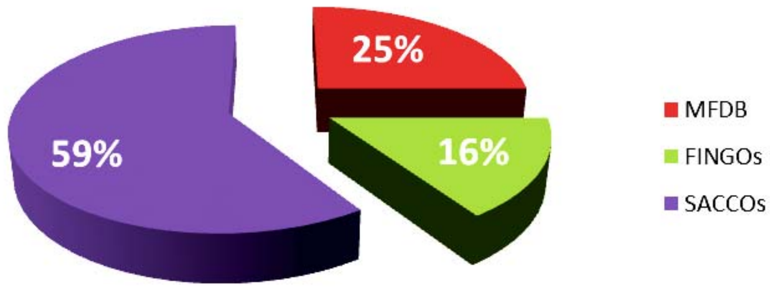


The membership (outreach), loan amount and deposit amount distribution of Nepalese major MFIs are described below:

4.1. Membership Distribution of Nepalese MFIs:

It can be observed that 59 percent of total numbers of members associated to MFIs in Nepal are form SACCOS, followed by MFDB (25%) and FINGOs (16%) (Figure 4-5). SACCOSs has the majority of members since number of SACCOS is comparatively higher than other MFIs because of its wider network. Similarly it has the highest collection of deposit as well form its members.

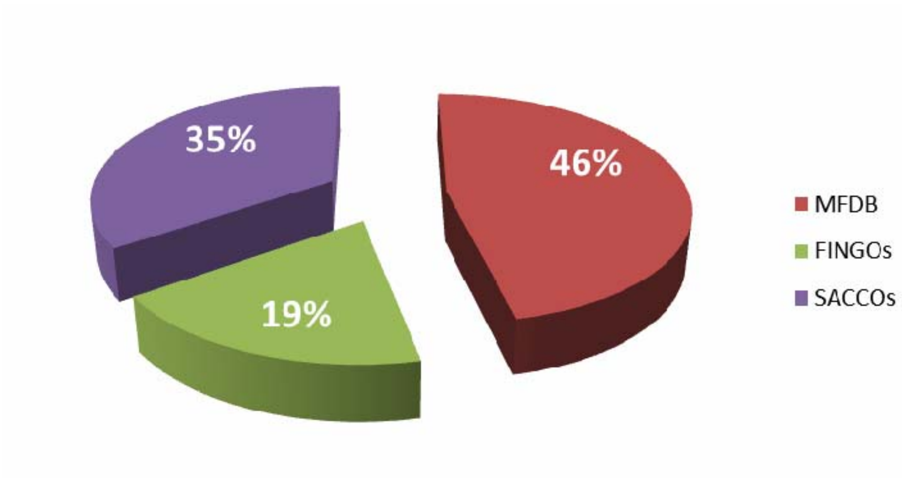
Figure 4-5: Membership Sharing of Nepalese MFIs



4.2. Loan Amount Distribution between Different MFIs:

Disbursement of loan in microfinance sector has been overrun by MFDB which has covered 46 percent of the total loanable amount in the micro economy, since its major focus is on lending, where it's a specialized in microfinance bank. And it is seen SACCOS and FINGOs are following with 35 percent and 19 percent respectively.

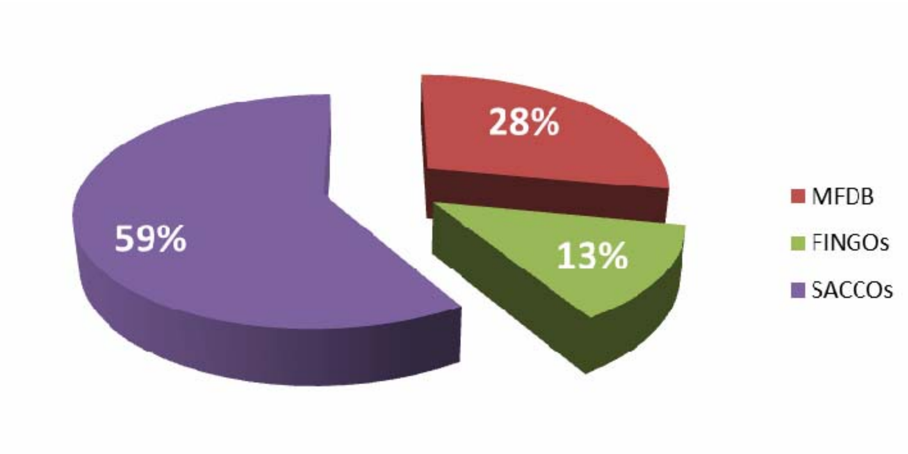
Figure 4-6: Loan Amount Distribution between Different MFIs



4.3. Deposit Amount Distribution between Different MFI's:

SACCOs has been the major collection of deposits from the members, which covers almost 60 percent of the total deposits collection, since it has the highest number of members compared to MFDB and FINGOs. Similarly, deposit collection is followed by MFDB by 28 percent and FINGOs by 13 percent.

Figure 4-7: Deposit Amount Distribution between Different MFIs.



Conclusion

In Nepal microfinance practice is not a new concept. From the very beginning time a part of modern microfinance i.e. microcredit has been in practice. However, modern concept of microfinance began with the establishment of cooperative societies in 1957. The enactment of Cooperative Act-1959, open the door for legal formal transaction of microfinance in Nepal. The historical development of microfinance in Nepal is divided in to three major phases; preliminary phase from the year 1957 to 2000, development and growth phase from the year 1991-2003 and institutional development and regulatory phase from 2004 onwards.

By the Mid-July 2012, altogether 26,849 microfinance institutions are in operation and providing financial service to around 3.5 million members. These MFIs have been following six different microfinance modalities. ROSCA model is highly popular in informal sector and cooperative model is widely being practice in local community, remote and hill areas where formal banking and financial institutions financial services are not easily available. Most of the MFDBs are adopting Grammen model/ Group lending model. But Village Bank model is disappearing from the Nepalese microfinance field.

The central bank, NRB has made policy arrangement for deprived sector lending requirement to the commercial banks, development banks and finance companies, which policy directly supporting to invest more in microfinance sector. However, the proper utilization of deprived sector credit is in doubt and the problems of mission drift in MFDBs, fund parking, duplication, multiple financing and over in debtness, unhealthy competition, inadequate expansion of microfinance in remote and hilly region are visible.

CHAPTER FIVE: FINANCIAL SUSTAINABILITY ANALYSIS OF NEPALESE MICROFINANCE INSTITUTIONS

Financial sustainability of MFIs is an emerging issue in microfinance sector. To meet the financial need of low income households with better financial services for long-term, MFIs should be financially sustainable. Financial soundness of MFIs is more important to boost up economic growth of the lower income households. In this chapter we analyze the financial performance of Nepalese Microfinance Institutions. Six major parameters are chosen to analyze the financial sustainability of MFIs. Meantime, comparative study of four different types of Nepalese MFIs is taken and examines them by using ANOVA test, statistical tools to find out whether the nature and ownership of MFIs does effect on its performance and overall sustainability or not. Finally, try to find out the favourable and suitable microfinance model from the financial sustainability approach.

Section 1: Sample Characteristics

The sample of this research includes 20 microfinance institutions from 4 different types of microfinance institutions in terms of ownership structure. They are 5 Government Initiated Microfinance Development Banks (GIMFB), 5 Privately initiated Microfinance Development Banks (PIMFB), 5 Financial Intermediary Non-Government Organizations (FINGOs) and 5 Saving & Credit Cooperative Societies (SACCOS).These sample microfinance institutions are selected on the basis of operating period and size.

Table 5-1: General Information of Sample MFIs

S.N.	Name of MFIs	Year of Establishment	No. of Active Borrower	Loan Portfolio (USD)	Deposit (USD)
Government Initiated Microfinance Development Banks (GIMFB)					
1	Purbanchal GBBL	Jan 1, 1992	35,923	11,583	1100
2	Madhyamanchal GBBL	Jan 1, 1996	34,366	10051,307	2823,334
3	Paschimanchal GBBL	Jan 1, 1994	40,877	12,510,994	3,875,737
4	Madhya-Paschimanchal GBBL	Jan 1 1995	21,929	9,126,958	3,048,876
5	Sudur-Paschimanchal GBBL	Jan 1 1998	10,648	2,181,596	684,753
Privately Initiated Microfinance Development Banks (PIMFB)					
6	Chhimek Bikas Bank Ltd.	Sep 13, 2001	103,179	25,067,274	14,381,588
7	Deprosc Dev. Bank Ltd.	Jan 1, 2001	47,869	14,892,699	3,472,584
8	Muktinath Bikas Bank Ltd.	Sep 19 2006	26,046	7,232,157	2,901,781
9	Swabalamban Laghubitta Bikas Bank Ltd.	Jan 3 2002	69,211	18,167,644	7,305,807
10	Nirdhan Utthan Bank Ltd.	Jan 1, 1993	98,965	28,421,063	9,063,869
Financial Intermediary Non-Government Organizations (FINGOs)					
11	Centre for Self-help Development	Jan 1, 1991	34,980	7,814,565	3771,966
12	Forum for Rural Women Ardency Development	May 1, 1995	47,858	10,024,014	3,529,951
13	Manushi	Sep 16, 2002	10,429	1,961,412	913,603
14	Mahuli Samudayik Bikas Kendra	Jun 13, 1994	16,903	2,424,776	1,253,376
15	Jeevan Bikas Samaj	Sep 21, 1997	61,258	11,135,920	5,905,110
Saving & Credit Cooperative Societies (SACCOS)					
16	Chandeshwori SACCOS∗	Jan 1, 1990	598	2,368,296	2,279,548
17	Bindhabasini SACCOS	Jan 1, 1993	3526	4,737,283	4,832,065
18	Women SACCOS	Jan 1, 1995	12,654	5,419,363	2,883,698
19	BudhaMahilaSACCOS	Jan 1 1998	836	282,590	242,009
20	Sahara Mahila SACCOS	Jan 1, 1999	43,872	10,500,804	4,555,608

Source: Mix Market Dataset 2012 (FY 2011/12) (Accessed in 2012 December from http://www.mixmarket.org/mfi/country/Nepal)

∗Information of 2008

Section 2: Data Presentation and Analysis

Generally, successful MFIs can be measured by the scope and penetration of the target market and good financial result. To be successful, financial intermediaries that provide services and generate domestic resources must have the capacity to meet high performance standards. They must achieve excellent repayments and provide access to clients and they must build toward operating and financial self-sufficiency and expanding client reach[①].

The sound financial performance indicates the sustainability of financial institutions. Financial sustainability of MFIs can be measured in terms of growth, productivity, efficiency, profitability, control of default, risk management, etc. In practice, it is understood that profitability is a key indicator of measuring financial sustainability of MFIs but it should also consider other indicator while judging the sustainability of MFIs. Thus, to analyze financial sustainability of MFIs', it will be better to study various factor and parameters of the MFIs. Here, financial sustainability of the MFIs is analyzed through seven parameters:

1. Financing Structure
2. Outreach
3. Operating Performance
4. Revenue
5. Expenses
6. Efficiency and Productivity
7. Risk Management

These parameters are most comprehensive and globally accepted indicators of financial health of MFIs as Mix Market uses it across the world for classification.

[①] Vetrivel, S.C. and Kumarmangalsam, S.C. (2010): Role of Microfinance Institutions in Rural Development. [J] *International Journal of Information Technology and Knowledge Management*. Volume 2, (2), 435-441

2.1. Financing Structure

The overall financing position of assets, equity and liabilities of the MFIs is shown by financing performance indicator ratio. Assets mean what the MFIs had or are owed. Liabilities are what the MFIs owe and equity is what MFIs own. These indicators give the answer whether the institutions are dependent upon own resources or not; and how much portion external funds are used in financing.

Table 5-2: Measurement of Financing Structure Indicators

	Key Indicators	Measurement
1	Capital to Asset Ratio	Total Equity / Total Assets
2	Debt to Equity Ratio	Total Liabilities / Total Equity
3	Deposit to Loans Ratio	Total Deposits / Gross Loan Portfolio
4	Deposits to Total Assets Ratio	Total Deposits / Total Assets
5	Gross Loan Portfolio to Total Assets Ratio	Gross Loan Portfolio / Total Assets

The key indicators of financing performance structure are Capital to asset ratio, Debt to equity ratio, Deposits to loans, Deposits to total assets and Gross loan portfolio to total assets (Table 5-2). Capital to asset ratio measures, whether an institutions has sufficient capital to support its assets. Capital adequacy of institutions is measured from Debt to Equity ratio. It indicates the safety cushion that the institution has to absorb losses before creditor is at risk[①]. It measures the overall leverage of an institution and how much cushion it has to absorb losses after all liabilities are paid. Deposits to total assets ratio indicates the portion of deposits in total assets. For the MFIs, lesser the deposits, higher the equity and vice versa. The gross loan portfolio to total assets measures the allocation of assets to its lending activity.

The financing performance of sample MFIs is presented in table (5-3) below.

[①] The SEEP Network (2005). Measuring Performance of Microfinance Institutions: A Framework for Reporting, Analysis, and Monitoring. [M] USA Pp 74

Table 5-3: Financing Structure Indicators of Sample MFIs

S. N.	Indicators	Unit	GIMFB	PIMFB	FINGOs	SACCOS	Average	ANOVA F test P-Value
1	Capital/asset	Ratio	0.008	0.086	0.104	0.124	0.0805	0.311
2	Debt to equity	Ratio	13.45	8.742	11.404	5.89	9.871	0.554
3	Deposits to loans	Ratio	0.258	0.324	0.318	0.318	0.3045	0.922
4	Deposits to total assets	Ratio	0.144	0.228	0.260	0.276	0.2270	0.496
5	Gross loan portfolio to total assets	Ratio	0.576	0.710	0.828	0.774	0.7220	0.722

Note: Data results from SPSS statistical tool and detail SPSS output sheets are attached in Annex.

The average capital asset ratio of GIMFB, PIMFB, FINGOs and SACCOS are 0.008, 0.086, 0.104 and 0.0805 respectively. Average capital asset ratio of GIMFB is very low, which indicates it has very low amount of equity and capital. Remarkably, all Nepalese MFIs' average capital asset ratio is not in satisfactory level. They should increase the portion of capital in their financial composition.

Deposit-taking MFIs and saving-based organizations usually have higher debt to equity ratios than other MFIs, but the above data shows that SACCOS has lowest debt to equity ratio of 5.89. Debt to equity ratio is higher in GIMFB and FINGOs i.e. 13.45 and 11.40 respectively, it means GIMFB and FINGOs has greater creditor risk.

Deposit to loans ratio of GIMFB, PIMFB, FINGOs and SACCOS are 0.1440, 0.2280, 0.2600 and 0.2760 respectively. Deposits to total assets ratio is highest in SACCOS (0.296) followed by FINGOs (0.260) and PIMFB (0.228), but GIMFB has lowest deposits to total assets ratio i.e. 0.144. Likewise gross loan portfolio to assets ratio is 0.5760, 0.7100, 0.828 and 0.774 in GIMFB, PIMFB, FINGOs and SACOOS respectively. In Nepalese MFIs, equity capital should be increased and greater portion of equity capital helps to get sustainable position. In the same way, deposit is internal source of financing so it will be better to expand deposit collection mechanism for sustainable development. It is seen that GIMFB is not properly utilizing its assets in credit distribution so GIMFB should give more attention in credit distribution.

Figure 5-1: Debt to Equity Ratio of MFIs

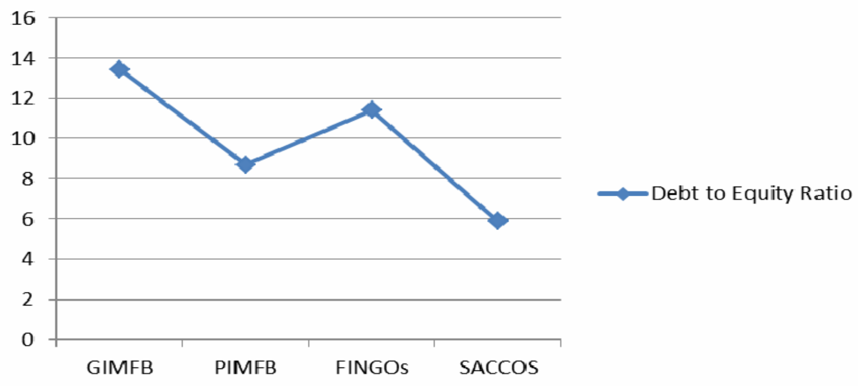
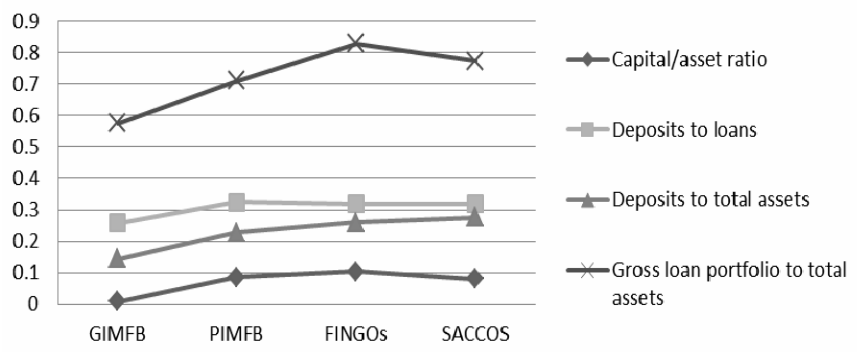


Figure 5-2: Financing Performance of MFIs.



The P-value is not significant in all the above indicators that mean the different model of microfinance institutions does not have any differences in their financing performance.

2.2. Outreach of MFIs

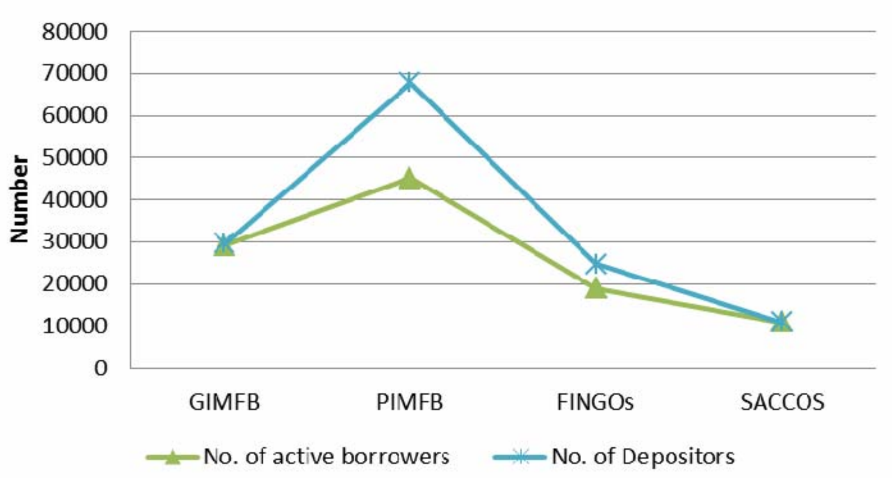
One of the major standard of measuring the success of MFI is the outreach of MFI. It is widely believed that higher the number of member/outreach, higher the possibility of sustainability of MFIs. The active number of borrower, total number of members, total loan distribution is the main key indicator of measuring outreach of MFIs. For the analysis purpose, seven key indicators are chosen which are shown in the table 5-4. Number of active borrowers indicates breadth of outreach, whereas average loan balance per borrower shows the depth of outreach.

Table 5-4: Measurement of Outreach Indicators

	Key Indicators	Measurement
1	Number of Active Borrowers	Number of borrowers who has loans outstanding
2	Proportion of Female Borrowers	Total no. of female borrowers / Total no. borrowers
3	Gross Loan Portfolio	Total disbursement of loan amount
4	Average Loan Balance Per Borrower	Gross Loan Portfolio / No. of Active Borrowers
5	Number of Depositors	Number of depositors having deposit account
6	Total Deposit	Collected total deposit amount in various deposit account
7	Average Deposit Balance Per Depositor	Total Deposit Amount/ Total No. of Depositors

Average number of active borrowers in GIMFB, PIMFB, FINGOs and SACCOS are 29152, 45108, 18850 and 10894 respectively (Table 5-5). Likewise, average numbers of depositors are 29642, 67847, 24628 and 10923 in GIMFB, PIMFB, FINGOs and SACCOS respectively. It clearly shows that the outreach capacity in terms of number of borrowers and depositor of PIMFB are significantly higher among other MFIs. Nepalese MFIs are not only microcredit supplier; they are also collecting deposits from its member so the number of borrowers and depositors are nearly similar in each group. However there is large gap between number of depositors and borrowers in PIMFB.

Figure 5-3: No. of Active Borrowers and Depositors



Basically, microfinance is targeting to the rural and poor women borrower. Grammen Bank experiment proved that women borrowers are loyal and credit-worthy so many Grammen Bank replicator MFDBs and FINGOs are gender based microfinance service providers. The relationship between access to credit and fertility is found in the study. Credit to women has "income effect" and "substitution effect" which reduces the fertility on women[①]. The globally popular Grammen Model of microfinance is also gender based model. In Nepal, most of the Grammen replicator microfinance banks are also only focusing on women borrowers. The data also proved that the portion of female borrowers is 84%, 90% and 94% in GIMFB, PIMFB and FINGOs, whereas SACCOS has only 47% women borrowers.

Table 5-5: Outreach Indicators of Sample MFIs

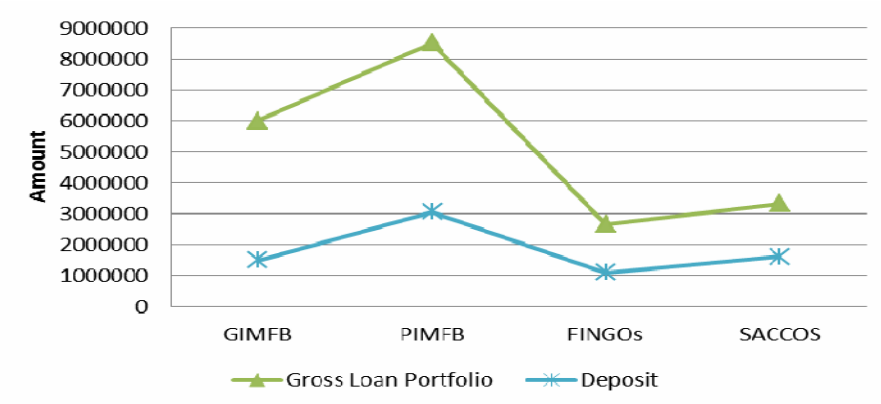
S. N.	Indicators	Unit	GIMFB	PIMFB	FINGOs	SACCOS	Average	ANOVA F test P-Value
1	Number of active borrowers	No.	29152	45108	18850	10894	26001	0.041∗
2	Portion of Female borrowers	Ratio	0.8480	0.9020	0.9380	0.4760	0.7910	0.053
3	Gross Loan Portfolio	USD	6013916	8531617	2661171	3324907	5132903	0.027∗
4	Average loan balance per borrower	USD	206.1960	179.7160	107.1100	872.1100	341.2830	0.076
5	No. of Depositors	No.	29642	67847	24628	10923	33260	0.008∗
6	Deposit	USD	1497045	3056002	1095523	1616034	1816151	0.125
7	Average deposit balance per depositor	USD	36.9680	19.1360	9.2860	39.8640	26.3135	0.116

∗Reject Null Hypothesis of average means at the 95% significant level means there is a significant difference in mean levels of performance between GIMFB, PIMFB, FINGOs and SACCOS.

GIMFB and PIMFB have the greater variation in gross loan portfolio and deposit collection from its member. It shows that many microfinance development banks were not giving more focus on deposits collection and their lending capacity is larger than FINGOs and SACCOS. But the difference of loan portfolio and deposit in case of FINGOs and SACCOS is not too big.

[①] Dowla, A. and Barua, D. (2006). The Poor Always Payback: The Grammen II story. [M].Kumarian Press, Inc. USA. Pp 38

Figure 5-4: Gross Loan Portfolio and Deposit



Average loan balance per borrower is higher in SACCOS, among the sample MFIs. The average deposit balance per depositor is lower in FINGOs among the sample.

The P-value of number of borrowers, gross loan portfolio and no of depositors are below the 0.05. Test result proved that major indicators of outreach, number of active borrowers, gross loan portfolio and number of depositors varies among the sample group of MFIs. However, portion of female borrowers, average loan balance per borrower and average deposit balance per depositor are not significant among the MFIs.

2.3. Operating Performance

MFIs are taken as a socio-financial mechanism to serve vulnerable poor and low income households. The number of charitable and subsidized MFIs is also big. Whether the MFIs are gaining profitability enough to maintain and expand their services without continued injections of subsidies or not are clearly shown from the operating performance indicators. In banks and other commercial institutions, the most common measurement of profitability is Return on Assets (ROA). This reflects the organization's ability to deploy its assets profitably. Likewise, Return on Equity (ROE) measures the returns produced on the owners' investment whereas Operating Self Sufficiency (OSS) shows the covering of financial and operating expenses by own resources. It is the most basic measurement of sustainability indicating whether revenues from operations are sufficient to cover all operating expenses or not. It reflects the MFI's ability to continue their operations if they receive no further subsidies. The positive and higher ROA is preferable. ROE should be near to the market deposit interest rate. ROE is important for profit earning institution.

For long-term sustainability of operation, MFIs should obtain over 100% Operational Self Sufficiency ratio.

Table 5-6: Measurement of Operating Performance Indicators

S.N.	Key Indicators	Measurement
1	Return on Assets (ROA)	(Net Operating Revenue- Taxes)/ Average Total Assets
2	Return on Equity (ROE)	(Net Operating Revenue- Taxes)/ Average Total Equity
3	Operational Self Sufficiency	Financial Revenue/(Financial Expenses+Impairment Losses on Loans+Operating Expenses)

ROA is measured from net operating income minus taxes whole divided by average total assets, ROE is determined by net operating income minus taxes whole divided by average total equity, and OSS is determined by financial revenue divided by sum of financial expenses, net impairment loss and operating expenses.

Table 5-7: Operating Performance Indicators of Sample MFIs

S. N.	Indicators	Unit	GIMFB	PIMFB	FINGOs	SACCOS	Average	ANOVA F test P-Value
1	Return on assets	Ratio	-0.0080	0.0240	0.0320	0.0160	0.0160	0.003∗
2	Return on equity	Ratio	0.0400	0.2760	0.3500	0.1180	0.1960	0.019∗
3	Operational self sufficiency	Ratio	0.9400	1.2200	1.2820	1.0680	1.1275	0.685

∗Reject Null Hypothesis of average means at the 95% significant level means there is a significant difference in mean levels of performance between GIMFB, PIMFB, FINGOs and SACCOS.

ROA of GIMFB seems comparatively below the average to other institutions, whereas FINGOs seems to be highly satisfactorily performing. ROE of GIMFB is the least while PIMFB has the highest. About operating self-sufficiency, GIMFB seems to have the lowest mean whereas FINGOs has the highest level of operating self-sufficiency. Except the GIMFB, all the MFIs have more than 100 percent operating self-sufficiency level.

The indicators of all operating performance show that the FINGOs are maintaining higher and good position in ROA, ROE and Operating self-sufficiency level among other Nepalese MFIs. From the operating performance point of view except for GIMFB, all the MFIs are profitable and financially sustainable, too.

One-way ANOVA test result shows that, ROA and ROE of sample MFIs are significantly different, whereas operating self-sufficiency level of sample MFIs does not have any difference.

2.4. Revenue

The main sources of financial revenue for MFIs are interest income from loan investment, fees and commissions on loan portfolio, income earned from investment and other operating revenue from the provision of financial services such as transaction fees, passbooks fee etc. Among them major source of revenue for MFIs is the interest on loan portfolio. After deduction of financial and operating expenses from financial revenue, we get net operating income.

Table 5-8: Measurement of Revenue Indicators

S.N.	Key Indicators	Measurement
1	Financial Revenue to Total Assets	Financial Revenue / Average Total Assets
2	Profit Margin	Net Operating Income / Financial Revenue
3	Yield on Gross Portfolio (nominal)	Financial Revenue from Loan Portfolio / Average Gross Loan Portfolio
4	Yield on Gross Portfolio (real)	[Yield on Gross Portfolio (nominal)-Inflation Rate]/ [1+Inflation rate]

Higher degree of financial revenue to assets ratio indicates the proper utilization of assets to generate the revenue. Profit margin is derived from dividing net operating income by financial revenue and yield on gross portfolio (nominal) is calculated through dividing the financial revenue from loan portfolio by average gross loan portfolio. Likewise real yield on gross portfolio is drawn from inflation adjustment in nominal yield on gross portfolio.

Financial revenue to assets mean of FINGOs is the highest whereas the GIMFB has the least whereas others have almost close to the overall average. Overall average of financial revenue to assets ratio was 14% and it indicates MFI's ability to use available assets on productive purposes.

Table 5-9: Revenue Indicators of Sample MFIs

S. N.	Indicators	Unit	GIMFB	PIMFB	FINGOs	SACCOS	Average	ANOVA F test P-Value
1	Financial revenue/ assets	Ratio	0.1131	0.1543	0.1817	0.11091	0.1400	0.081
2	Profit margin	Ratio	-0.0999	0.1999	0.1653	0.1298	0.0987	0.006∗
3	Yield on gross portfolio (nominal)	Ratio	0.1500	0.1805	0.1609	0.0563	0.1369	0.001∗
4	Yield on gross portfolio (real)	Ratio	0.0639	0.0892	0.0834	0.0246	0.0653	0.005∗

∗Reject Null Hypothesis of average means at the 95% significant level means there is a significant difference in mean levels of performance between GIMFB, PIMFB, FI-NGOs and SACCOS.

Profit margin of PIMFB is the highest but GIMFB has the negative profit margin. Yield on gross portfolio (nominal) of SACCOS is at the least whereas PIMFB has topped with mean of 18% (0.1805), and talking about Real Yield on Gross Portfolio SACCOS has the smallest and PIMFB has the highest.

Financial revenue earning level of PIMFB is strong, so that all the revenue indicators of PIMFB are highest among all. But the revenue earning of GIMFB is very low and it has been suffering from the loss.

The P-value is significant in profit margin, yield on gross portfolio (nominal) and yield on gross portfolio (real). However, P-value of sample MFIs is not significant in financial revenue to assets.

2.5. Expenses

Financial expenses and operating expenses are the major expenses heading of the MFIs. Financial Expenses includes interest expenses on loan borrowed and loan borrowing processing cost, whereas operating expenses includes the personnel and administrative expenses. The administrative objective of many MFIs is providing financial services to the clients by minimizing the cost. Lower the cost, higher the productivity and efficiency, *vice versa*. Six ratios namely total expenses to assets ratio, financial expenses to assets ratio, provision for loan impairment to assets ratio, operating expense to assets ratio and administrating expenses to assets ratio were computed for expenses analysis of MFIs.

Table 5-10: Measurement of Expenses Indicators

S.N.	Key Indicators	Measurement
1	Total Expense to Total Assets	[Financial Expense+Net Impairment Loss+Operating Expneses]/ Average Total Assets
2	Financial Expenses to Total Assets	Financial Expenses/Average Total Assets
3	Provision for Loan Impairment/ Total Assets	Impairment Losses on Loans/ Average Total Assets
4	Operating Expenses/ Total Assets	Operating Expenses/ Average Total Assets
5	Administrative Expenses/ Total Assets	Administrative Expense/Average Total Assets
6	Operating Expenses/ Loan Portfolio	Operating Expenses/Average Gross Loan Portfolio

Total expenses by assets ratio is measured by financial expenses plus net impairment loss plus operating expense whole divided by average total assets. Financial expense by assets is a result of ratio of financial expenses by average total assets, provision for loan impairment by assets is measured by impairment losses on loans divided by average total assets. Whereas yield on gross portfolio (real) is measured by yield on gross portfolio (nominal) minus inflation rate whole divided by 1 plus inflation rate. Administrative expenses by assets ratio is the result of administrative expenses divided by average total assets. Operating expense to loan portfolio is derived after dividing operating expense by average gross loan portfolio.

Mean of total expenses to assets of SACCOS is the minimum and FINGOs has the maximum. The mean of financial expenses to assets ratio of PIMFB and GIMFB are equally minimal and SACCOS has topped the list. Almost all the MFIs have same financial expenses to assets ratio. The amount of loan impairment is a negative asset on the balance sheet and reduces the gross loan portfolio. Provision for loan impairment to assets ratio is higher in FINGOs and PIMFB has the lowest.

Table 5-11: Expenses Indicators of Sample MFIs

S. N.	Indicators	Unit	GIMFB	PIMFB	FINGOs	SACCOS	Average	ANOVA F test P-Value
1	Total expense/ assets	ratio	0.1179	0.1215	0.1497	0.0936	0.1207	0.270
2	Financial expense/ assets	ratio	0.0511	0.0515	0.0549	0.0585	0.0540	0.976
3	Provision for loan impairment/ assets	ratio	0.0035	0.0049	0.0110	0.0058	0.0063	0.163
4	Operating expense/ assets	ratio	0.0645	0.0651	0.0860	0.0294	0.0612	0.001∗
5	Administrative expense/ assets	ratio	0.0104	0.0168	0.0254	0.0075	0.0150	.020∗
6	Operating Expenses/Loan Portfolio	ratio	0.1139	0.0959	0.1069	0.0338	0.0876	0.001∗

∗Reject Null Hypothesis of average means at the 95% significant level means there is a significant difference in mean levels of performance between GIMFB, PIMFB, FI-NGOs and SACCOS.

In operating expenses to assets ratio, SACCOS has the least and FINGOs has the highest ratio. The mean of SACCOS has the least and GIMFB has the highest on administrative expenses to assets. On operating expenses to loan portfolio ratio, GIMFB has the least and FINGOs has the highest.

Here, the operating expenses to assets ratio, administrative expenses to assets and operating expenses to loan portfolio ratios of SACCOS is lower which indicates that SACCOS's operating and administrative cost is lower. SACCOS model is economic model from the perspective of operating expenses.

ANOVA test result proved that there are no any significant differences in mean level of total expenses to assets ratio, financial expenses to assets and provision for loan impairment to assets ratio between GIMFB, PIMFB, FINGOs and SACCOS. But the average means of operating expense to assets ratio, administrative expense to assets ratio and operation expenses to loan portfolio ratio are significantly difference between Nepalese MFIs.

2.6. Efficiency and Productivity

Efficiency and productivity indicators reflect the ability and skill of MFIs on efficient use of their resources. Efficiency refers to cost per unit of output and efficiency ratios provide indication on cost of providing financial services by MFIs to generate revenue. Cost per borrower and cost per loan measure the efficiency of MFIs.

Productivity is related with the inputs and output. Productivity status of these MFIs were measured from cost per borrower, cost per loan, borrowers per staff member, loans per staff member, borrowers per loan officer, loans per loan officer and depositors per staff member.

Table 5-12: Measurement of Efficiency and Productivity Indicators

S.N.	Key Indicators	Measurement
1	Cost Per Borrower	Operating Expenses/ Average Number of Active Borrowers
2	Cost Per Loan	Operating Expenses/Average Number of Loan Outstanding
3	Borrowers Per Staff Member	No. of Active Borrowers/No. of Staffs
4	Loans Per Staff Member	No. of Loans Outstanding/ No. of Staffs
5	Borrowers Per Loan Officer	No. of Active Borrowers/No. of Loan Officers
6	Loans per Loan Officer	No. of Loans Outstanding/No. of Loan Officers
7	Depositors Per Staff Member	No. of Depositors/No. of Staffs

Average cost per borrower is USD 18.12 and that of average cost per loan is USD 10.18 in Nepalese MFIs (Table 5-13). The cost per borrower is higher in SACCOS i.e. USD 25.09 where the cost per borrower is lowest in FINGOs, only USD 10.27. But the cost per loan in SACCOS is only USD 3.08, which is lowest among Nepalese MFIs. Cost per loan is significantly higher in GIMFB (USD 17.76) which has been leading GIMFB in to heavy financial loss.

The productivity of staff member is good in PIMFB and FINGOs. The borrowers per staff of GIMFB and PIMFB are 221 and 209 borrowers per staff respectively. Likewise, loan per staff member is 241 and 232 in PIMFB and FINGOs. Loan per staff is comparatively lower in SACCOS, it has only 75 loans per staff member. Borrowers per loan officer and loans outstanding per loan officer both are higher in GIMFB followed by PIMFB and FINGOs.

The lower cost per borrower and cost per loan is good for the sustainability of MFIs. The higher ratio of borrowers per staff member and loans per staff member shows the productivity of the staff. The GIMFB has higher cost per borrower and loan, as well as lower productivity among other MFIs.

Table 5-13: Efficiency and Productivity Indicators of Sample MFIs

S. N.	Indicators	Unit	GIMFB	PIMFB	FINGOs	SACCOS	Average	ANOVA F test P-Value
1	Cost Per Borrower	USD	21.33	15.79	10.27	25.09	18.12	0.316
2	Cost Per Loan	USD	17.76	10.28	5.36	3.08	10.18	0.011*
3	Borrowers Per Staff Member	No.	144	221	209	115	172	0.052
4	Loans Per Staff Member	No.	138	241	232	75	172	0.005*
5	Borrowers Per Loan Officer	No.	496	325	203	192	304	0.378
6	Loans per Loan Officer	No.	505	371	298	220	348	0.553
7	Depositors Per Staff Member	No.	154	308	259	191	228	0.142

*Reject Null Hypothesis of average means at the 95% significant level means there is a significant difference in mean levels of performance between GIMFB, PIMFB, FI-NGOs and SACCOS.

The average cost per loan and loan per staff member is significantly difference between sample MFIs. Except these two productivity indicators all other indicators does not have any significant difference between GIMFB, PIMFB, FINGOs and SACCOS.

5.3.7. Risk Management

Finally, high delinquency makes financial sustainability impossible. Risk management is the major part of every financial institution. The management/administrative body should give proper attention to maintain the risk level. Here, three indicators such as portfolio at risk greater than 30 days, portfolio at risk greater than 90 days and write-off ratio are taken for analysis.

Table 5-14: Measurement of Risk Management Indicators

S.N.	Key Indicators	Measurement
1	Portfolio at risk> 30 days	Outstanding balance, Portfolio overdue> [30 days+ renegotiated portfolio/Gross Loan Portfolio]
2	Portfolio at risk> 90 days	Outstanding balance, portfolio overdue>[90 days+ renegotiated portfolio/Gross Loan Portfolio]
3	Write-off Ratio	Value of Loans written-off/ Average Gross Loan Portfolio

Portfolio at risk is the major indicator of risk level of the institutions also often used as the threshold beyond which loans are considered to be at higher risk. Greater value of portfolio at risk greater than 30 days is more risky and *vice versa*. The FINGOs have least portfolio at risk greater than 30 days ratio, i.e. 0.007 but GIMFB has exceptionally higher portfolio at risk greater than 30 days 0.1365, i.e. 13.65%. Likewise, GIMFB has also higher level of portfolio at risk greater than 90 days i.e. 0.1318. It shows that the loan repayment condition in GIMFB is very weak. Except, GIMFB other MFIs's average portfolio at risk level is in normal level. So, that these institutions' loan recollection mechanism is satisfactory.

Write-offs are the challenging job for MFIs because they result in a reduction of the MFI's assets and its current and future earnings ratio. It is believed that higher ratio indicates a problem in the MFI's collection efforts. The write-off ratio is higher in GIMFB and least in FINGOs.

Table 5-15: Risk Management Indicators of Sample MFIs

S. N.	Indicators	Unit	GIMFB	PIMFB	FINGOs	SACCOS	Average	ANOVA F test P-Value
1	Portfolio at risk > 30 days	Ratio	0.1365	0.0318	0.0070	0.0106	0.0515	0.000*
2	Portfolio at risk > 90 days	Ratio	0.1318	0.0224	0.0060	0.0023	0.0490	0.001*
3	Write-off ratio	Ratio	0.0043	0.0010	0.0001	0.0119	0.0028	0.011*

*Reject Null Hypothesis of average means at the 95% significant level means there is a significant difference in mean levels of performance between GIMFB, PIMFB, FI-NGOs and SACCOS.

All the parameter of risk management is significantly differences between the GIMFB, PIMFB, FINGOs and SACCOS.

Section 3: Findings from the Data Analysis

The findings from the above data presentation and analysis are presented below:

1. In this section we have analyzed 35 different ratios from 7 parameters which represent the overall financial performance of the MFIs.

2. 17 out of 35 indicators' P value is significant, it means there is difference between the MFIs performance. Thus the null hypothesis is rejected and the ownership structure and modality of MFIs make differences in its overall performance.

3. Basically, the performance of MFIs outreach, operating, revenue, expenses and risk management are significantly differences between the studied MFIs.

4. Only financing performance and productivity indicators have similarity between the performances of MFIs.

5. Financing Structure:

GIMFB's capital asset ratio is significantly lower so the GIMFB should increase the capital position to meet financial obligations and address unexpected losses. GIMFB and FINGOs has greater creditor risk. All MFIs have been satisfying credit demand of its member through the capital and external sources because the internal source i.e. deposit collection is not efficient to meet the credit demand. Average 30 percent of the loans are covered by the deposit collection in these MFIs. From the sustainability point of view, it is preferable to meet increasing credit demand by mobilizing internal sources. MFIs should focus on 'credit plus' program and should give more focus on economic development of the borrower and saving habit on borrowers.

Average gross loan portfolio to total assets ratio of Nepalese MFIs is 0.722 that mean these institutions are not diverted from the primary business of MFI's is to providing financial services and loans to its borrower.

The GIMFB's capital and gross loan portfolio position is not satisfactory, it should be improved.

6. Outreach analysis:

The outreach capacity in terms of number of borrowers and depositor of PIMFB are significantly higher among other MFIs. Data shows that Nepalese MFIs have greater number of depositors than the active borrowers. It generates the question on effectiveness of lending channel in MFIs. The members are not equally active in lending and borrowing activities. The gap between number of depositor and number of active borrower is remarkably higher in PIMFB. It is observed that there is mission drift problem on microfinance development banks.

Nepalese MFIs are gender based institutions which generally targets the women. Only SACCOS has higher portion of male members. It is estimated GIMFB, PIMFB and FINGOs has nearly 90 % female borrowers.

The GIMFB and PIMFB have the greater variation in gross loan portfolio and deposit collection from its member. Microfinance development banks are running with large scale business so they have large number of outreach and lending capacity is also larger. FINGOs and SACCOS has resource fund problem so these institutions seems dependent on deposit and they have narrow gap between loan distribution and deposit collection.

7. Operating Performance Analysis:

The indicators of all operating performance shows that the PIMFB and FI-NGOs has higher and good ROA, ROE and Operating self-sufficiency position among other Nepalese MFIs. Operating performance is very weak in GIMFB, whereas SACCOS are in satisfactory level. Higher ROA and ROE in PIMFB and FINGOs indicates these institutions are more profit oriented. Due to high equity base and community based operation, return in SACCOS is comparatively low.

All the MFIs have more than 100 percent operating self-sufficiency level but GIMFB is failed to maintain enough operational self-sufficiency level. Nepalese MFIs has ability to continue its operations if it doesn’t receive no further subsidies except in the case of GIMFB.

8. Revenue Analysis:

Financial revenue earning capacity of PIMFB is strong, so that all the revenue indicators of PIMFB are highest among all. PIMFB has sound and abundant amount of profit margin too. FINGOs have also good revenue position. But the revenue earning of GIMFB is very low and it has been suffering from the loss.

9. Expenses Analysis:

All the expenses analysis indicators proved that SACCOS is an economic model, it has very lowest expenses among other MFIs. By nature, SACCOS is the community based institutions following cooperative principles, which help to minimize the operating expenses.

10. Efficiency and Productivity Analysis:

Efficiency analysis shows the mix result among the MFIs. Cost per borrower is higher in GIMFB and SACCOS but cost per loan is lowest in FINGOs and SACCOS. It reveals that few borrowers are reaping more benefits from the SACCOS, loan are not proportionately distribute among the members.

From the productivity point of view, PIMFB has higher productivity followed by FINGOs. Higher productivity shows the effective human resource management in the institutions.

11. Risk Management:

From the risk management point of view, GIMFBs are in higher risk. It has exceptionally higher portfolio at risk; it indicates that the loan repayment condition in GIMFB is very weak. SACCOS has minimum portfolio risk.

Conclusion

Results proved that there are differences between the MFIs financial performance. The ownership structure and modality of MFIs make differences in its overall financial performance which is reflected in 17 out of the 35 parameters studied. PIMFB and FINGOs have sound overall financial performance and operating above the operational self-sufficiency level, though the outreach capacity of these institutions should be increased. By nature SACCOSs' are cooperative based organization and limited with certain geographical area. SACCOSs' performance is only satisfactory since it has comparatively low assets and members. Finally, despite having more assets and large number of members GIMFB's performance is weak. So, institutional improvement is required in GIMFB. The government, as the main stakeholder of GIMFB, has adopted privatization policy and sells its share to private investor. Hopefully, privatization and merging of these weak performers will result in a new spirit and strategy to regain their market share.

CHAPTER SIX: MICROFINANCE DEVELOPMENT AND PRACTICE IN CHINA

This chapter aims to elaborate the current condition of China's rural finance and microfinance practice. China has unique characteristics and problems in rural finance. The overview of China's rural financial system gives general idea about rural financial system, and existing problems in ‘Sannong'. Rural finance and microfinance both have some similar targets to provide financial services to rural and poor households. So, we discuss rise and development of Microfinance institutions in China. Further, analyse the major characteristics of China's microfinance institutions. Finally, sum up the chapter with profound lesson learn from China's rural and microfinance practice, which might be useful for other developing countries.

Section 1: Overview of Rural Financial System of China

The People's Republic of China is the world’s 3rd biggest country in the world situated in the eastern part of the Asian continent with an area covering 9.6 million square kilometer. China is the world’s most heavily populated country with a population of 1.34 billion in 2011[12]. Administratively China is divided into 23 provinces, 5 autonomous region, 4 municipalities (direct controlled by central government), 2 special administration zone. China’s enormous territorial size and the physical diversity resulted in significant provincial economic differences. Since beginning economic improvement and opening up policy in 1978, China has transformed from centrally planned economy to market based economy. As a result, China has been practicing quick economic and social growth with average 10 percent annual GDP growth rate in current decade. Economically, China is the world’s second principal economy with USD 7.318 trillion (RMB 47.564 trillion) in the year 2011, gross national income (GNI) per capita in USD 4,940 ranked 114th in the world[13].

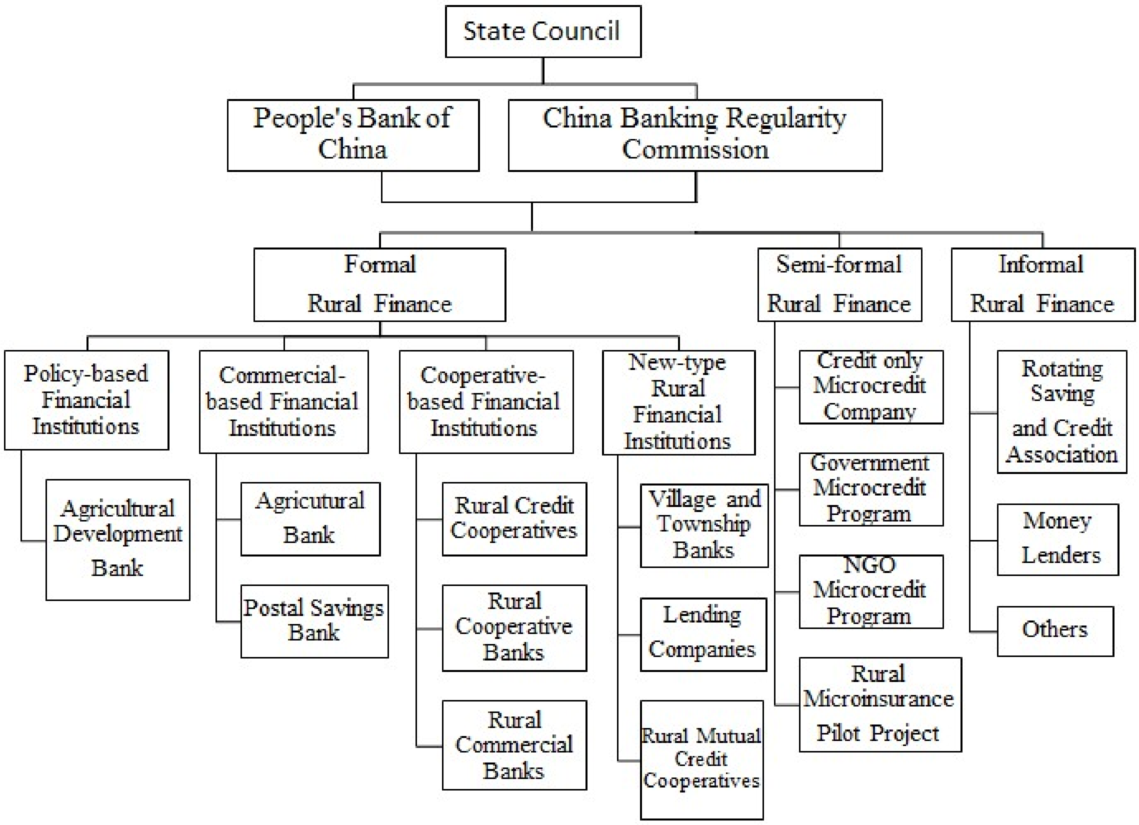
Rural finance is a major part of China’s financial system, where 52% of the whole population still subsists in the rural areas. In China there is a massive gap between urban and rural household income. The average income of urban residents was 3.13 times higher than the rural residents in the year 2011[14]. The per capita disposable income of rural residents stood at RMB 6,977 (approximately USD 1,105) while the urban residents' stood at RMB 21,810 (approximately USD 3,454). By the end of 2011, 48.73 percent of the whole population (1.347 billion) lived in rural areas[15]. However, rural population is reduced by 14.56 million in the same period. According to World Bank data, over 170 million people (around 13 percent) are still living under the USD 1.25 per day international poverty line[16]. It means USD 456 (RMB 2,896) a year is an absolute poverty limit set by the World Bank. But the Chinese officials officially use RMB 1500 Yuan (around USD 229) income in a year which is fewer than the international standard of poverty level. However, on the basis of this criterion around 100 million people live in poverty[17]. Consequently, developing the rural financial system is an imperative part in the effort of building a socialist new countryside. It is also a long-term venture to promote a stable and balanced economic expansion and development of the urban and rural China as well as Eastern and Western China.

Presently, there are four types of recognized financial institutions, namely; Policy based financial Institution, Commercial based financial institutions, Cooperative based financial institutions, and New-type rural financial institutions are active in rural financial market of China . Previously, rural finance started after the self-government of the Agricultural Bank of China (ABC) from People's Bank of China (PBOC) in February 1979. The rural financial system in China comprises of Agricultural Development Bank (ADBC), ABC, Postal Savings Bank of China (PSBC), Rural Credit Cooperative (RCCs), Rural Cooperative Bank, Rural Commercial Bank and various new financial institutions.

The RCCs, ABC and ADBC are not independent form each other. The ADBC is the only policy based financial institution. As an authoritarian body, the China banking Regulatory Commission (CBRC) and PBOC are functioning in China's rural financial system. These rural financial institutions are dedicated to providing rural financial services such as saving, loan, insurance, futures, remittance, securities and many more. Chinese formal banking and financial institutions have unique advantages, such as a larger geographic scope and fewer restrictions in attracting deposits. Moreover, as urban and rural credit cooperatives are less costly financing source than other nonbank financing channels[①].

With the microfinance point of view, formal and semi-formal rural financial institutions are active in China. Formal rural financial institutions such as RCC's, Village and Township banks (VTBs), Lending companies, Rural Mutual Credit Cooperatives (RMCCs) are in service of microfinance business. Also, semi-formal rural financial institutions such as Credit only Microcredit Companies, Government Microcredit Program and NGO Microcredit Programs are directly engaged in microfinance activities.

Figure 6-1：Rural Financial System in China



Source：Bal Ram Duwal and Sun Shaoyan (2013)

Rural financing gap, income disparity between rural and urban area, unequal

[①] Ayyagari,M., Demirguc-Kunt, A. and Maksimovic ,V. (2010). Formal versus Informal Finance: Evidence from China.[J]. *The Review of Financial Studies*. Vol.23 (8) 3048-3097 doi;10.1093/rfs/hhq030 distribution of income and resources between east/coastal region and west region are the commonly discussed issues in China. China has vast rural area which is a powerful engine[18] for future growth with enormous potential for consumer demand. In order to increase the living standard of rural households and speed up rural development process, Chinese government is giving emphasis on 'Sannong' issue and urging financial institutions to support 'Sannong'. Chinese term 'Sannong' refers to the issue related with rural development especially rural areas, farmers and agriculture.

As a traditionally agrarian state with an extra-large percentage of rural population, issues related to San Nong are deemed of vital importance to China's economic prosperity and social stability. At the most recent annual Central rural work conference late December 2012, some major tasks were again laid down for the upcoming year. These include building up intensive agronomy in the country, further raising the average income level of farming households, and stepping up budgetary spending on public utilities and welfare services in rural areas[①].

As other developing countries, China is also facing problem and challenges in rural financing. Higher risk in agricultural sector, high interest rate in small farmers loan, deprivation of rural household from subsidized and low interest bearing loan, existence of underground finance, withdraw of investment from rural areas by four big commercial banks, fund outflow from rural area to other urban area and economic development zone, backward agricultural insurance policy are some general but serious problems in China's rural financial sector.

Since 2006, the Chinese government and relevant authorities are giving more emphasis on the 'San Nong' issue and urging concerned authorities to invest more in this sector. In order to solve the problems in rural financing, the authorities (CBRC, Ministry of Finance and PBOC) have introduced different policies such as the establishment of mutual-aid financial aid projects, the introduction of new-type rural financial institutions, the establishment of banking networks in rural areas and less developed regions. The PBOC and CBRC started microfinance pilot projects in 2005 and 2006 respectively. These initiatives led to the establishment of new types of institutions providing

---

[①] Beijing Review (2013). For the Sake of Sannong [N].2013 Vol 3 microfinance, most importantly Microcredit Companies (MCCs) and Village and Township Banks (VTBs). In 2007, CBRC issued the guideline for banking and financial institutions on development of rural microloan business which support expansion of rural microfinance and allowed for any financial institutions to set-up microfinance institution in China. Since, the development and growth of microfinance institutions took remarkable momentum.

Section 2: Microfinance Development and Practice in China

After the formation of People's Republic of China in the leadership of Communist Party of China, the government had practiced planned and state led economy. From mid 1950s the Socialist cooperative movement was started in China and rural households got involved in the farmer cooperative society. The people commune's (Renmin Gongshe) establishment movement was taken place from the mid of 1958[19]. People's Communes was practiced between 1958 and 1984 in China[20].These communes are largest community unit and works as production brigades and production teams. In other words, these are the center of economic activities of people and at that time, most of the rural people lived in the commune society. All the basic, physical and financial needs of the people were fulfilled by the commune society. Later on, this collective responsibility system was replaced by household responsibility system① and all the communes were changed with townships in 1978 with the implementation of economic reform and opening up policy. Gradually, private and foreign investment was allowed to start private business. Then people started to seek financial sources to open private enterprises. So after entering to market socialism, demand of credit rose heavily and slowly microfinance institutions started its operation in China.

---

① Individual pieces of land contracted by government to the control of rural households that will be responsible for the profit and losses of agricultural production; with a certain quota sold to government at pre-set prices and all above-quota output sold at market prices.

1. Historical Development of Microfinance in China

Microcredit practice is not new in China, but the modern microfinance has short history of 20 years. In China, modern microfinance model is introduced by the government replicating the Grammen Bank, as part of their poverty alleviation initiatives. The first Grammen Bank model microfinance was established in October, 1993. Before the establishment of specific microfinance institutions, the Rural Credit Cooperatives had provided microcredit services to the farmers and low income households. The development of Microfinance in China can be divided into following four stages:

Stage I: Experimental Phase (1980 to 1996 October)

This is an experimental stage, marked by "An Announcement on Helping the Poor Areas", which was issued by the Central Committee of the CPC and the State Council in 1986[①]. This announcement began the microcredit lending from formal financial institutions in China. As a result, microcredit is disbursed from subsidized loans for poverty alleviation program runned by the Poverty Alleviation Office through the Agricultural Bank of China. For the first time in Chinese microfinance history, the Chinese Academy of Social Science, Institute of Rural Development, Du Xiaoshan introduced Grammen Bank model in 1993. Du Xiaoshan, who is also known as "the father of microcredit"[21] in Chinese land. Then, Mao Yushi an economist and pioneer in microfinance and poverty eradication programs launched the microfinance with RMB 500 (around USD 87) through FuPing Development Institute[22].

In the beginning phase, NGO led Grammen Bank replicator microfinance experiments were began in Yi County of Hebei Province, Yucheng county Nanzhao County of Henan Province and Danfeng County of Shaanxi Province。In 1995， UNDP and China International Center for Economic & Technical Exchange jointly started poverty alleviation and microcredit programs in 48 counties (town) of 17 provinces.

During the period, some international projects began their Microcredit experiments but most projects relied on international grants and soft loans, with almost no government funds. Chinese practitioners mainly tested the feasibility of the Grameen Bank methodology, and operated through quasi-official organizations or NGOs.

---

① Cao, Z.J. (2008). China Microcredit Development Research. [M] China Economic Time Press. Beijing. Pp178

2. Stage II: Expansionary Phase (1996 to 2000)

After the success of the experiments with nearly 100 percent repayment rate, the government overcame its scepticism against microfinance and decided to promote it as a poverty alleviation instrument in rural areas and lunched large-scale microfinance programs in 1996[①]. In September 1996, the Central Committee of the Communist Party of China and State Council conducted Central Working conference on the national poverty alleviation policy. The conference announced the delivery of adequate food and clothing for poor households as a national priority and further increased the investment of funds allocated to poverty alleviation and to implement microfinance programs.

In 1997, Rural Credit Cooperatives also started their own Microcredit programs, with both individual and group lending practice. From 1998, the microfinance experiments were introduced all over the country and it also expanded those microfinance projects which had already implemented as experiments. For the first time, the effectiveness of microfinance is ensuring poverty alleviation funds to directly reach rural poor was recognized in 1998, the government microfinance programs reached 600 counties in 22 provinces[②].

In 1999, urban microfinance experiment began in Tianjin Municipality targeting the unemployed urban dwellers which was initiated by Tianjin Women's Association. Tianjin Microfinance program is one of the pioneer urban microfinance institutions, which targeted on laid-off state female works

From this stage, local and central governments entered into microfinance sector by supplying necessary financial, human and organizational resources in order to achieve the goal of poverty alleviation. Likewise the microfinance program is introduced all over the country.

3. Stage III: Rapid Expansionary Phase (2000 to 2006)

From the year 2000 to 2005 is characterized by rapid expansion of microfinance from formal and semi-formal financial institutions in both rural and urban areas with support of local and central government. The PBOC and RCCs launched microfinance

---

① Aimi (2009). Microfinance and Rural Poverty in China [D].Jilin University. Pp 46

② Osthoff, J. (2005). *Is Microfinance an Effective Development Tool in the context of Poverty Alleviation? Evaluating the Case of Rural China* [D]. University of Birmingham activities, quickly expanding them and proving their ability to become the main actor in Chinese microfinance in the future[①]. From the end of 2005 to October 2006, under the promotion of the PBOC and CBRC, local governments (or local branches of the People's Bank of China) of five pilot provinces and autonomous region (Shanxi, Sichuan, Guizhou, Shaanxi and Inner-Mongolia) established 7 microfinance companies. RCCs used loan from central bank and deposit from their members as source of finance for operation of microfinance activities in wide range. As a result, RCCs launched the farmer microcredit loans and group guarantee loans with support of local government.

4. Stage IV: Institutionalization Phase (2006 onwards)

In December 20, 2006, the CBRC released a policy paper number 90 titled "Opinion Regarding Easing Market Access for Banking Financial Institutions in Rural Areas in order to better Support the Construction of a New Socialist Countryside". This policy stressed on two major issues related with the rural financial institution admittance policy i.e., Capital liberalization and Institutional liberalization[②]. In the Institutional liberalization sector, the above policy advocated the creation of three new-types of rural financial institutions viz. VTBs, Lending Companies (LCs), and Rural Mutual Credit Cooperatives (RMCC).

In the Capital liberalization sector, policy allows all types of social capital, banking capital, industrial capital and private capital from domestic and abroad, to be invested in rural financial market. It is permitted to have ownership and restructure the current financial institutions in rural areas, especially the RCCs. This policy adjustment is a landmark phase in deepening rural financial market in China, which make favourable environment to establish microfinance institutions.

In the beginning phase, 31 new-type financial institutions viz. 19 VTBs, 4 LCs and 8 RMCCs were established in 2007. The number of established VTBs gradually increased during the years 2008, 2009, and 2010. In 2011, the number of VTBs reached 635 which is 82% increases compared to 2010's. By the end of 2011, 726 VTBs, 10

[①] Du X.S. (2008a). The Current supply of Microfinance in China [J].World Microfinance Forum Geneva

[②] Sun, S.Y. (2008). Research on the Sustainable Development of Rural Bank in Jilin Province.[J].*Northeast Asia Forum*, Vol 17, No. 6, Pp 62-65.

Lending Companies and 50 RMCCs are in operation. These newly formed new-types of rural financial institutions have started their own way of lending small farmers, rural areas and microcredit.

Table 6-1: The establishment of New-type Rural Financial Institutions (operational)

New-type Rural Financial Institutions	As end of 2011	As end of 2010	As end of 2009	As end of 2008	As end of 2007
1. Village and Township Banks	726▯	349	148	91	19
2. Lending Companies	10	9	8	6	4
3. Rural Mutual Credit Cooperatives	50†	37	16	10	8
Total	**786**	**395**	**172**	**107**	**31**

▯ *726 VTBs (of which 635 already commenced operation)*
† *50 RMCC (of which 46 already commenced operation)*

Source: Bal Ram Duwal & Sun Shaoyan (2013)

In May, 2008, CBRC and PBOC jointly issued the "Guidance on Pilot Microfinance Companies" which clearly specified the local government's responsibilities for regulation and risk handling[23].

In June 2009, CBRC issued provisional rules on transformation of Micro-credit Companies (MCCs) into Village and Township Banks (VTBs). Transformation of MCCs into VTBs brought new shift in microcredit in China. By the end of 2010, in China altogether 2614 microfinance companies were in operation and their total capital was RMB 178.093 billion (around USD 26.308 billion) and loan balance was RMB 197.505 billion (around USD 29.175 billion). After 2006 to till now, microfinance sector is quickly growing, government promotion and policy level support helps to flourish more microfinance companies in China.

From the historical development point of view, Microfinance development in China has passed five major breakthrough events: 1) In the primary phase NGO MFIs as quasi-official organizations was established and began microcredit activities adopting Grammen Bank methodology of group lending. 2) Later on, government gave priority for poverty alleviation and poverty alleviation programme with microfinance project was launched, which was supported and backed by the international agencies and Chinese government. Initially, these microfinance programs relied on grants and soft loans. 3)

Likewise local and central government entered into microfinance through the operation of Rural Credit Cooperatives. The establishment of RCC was the remarkable step towards the institutional development of microfinance institutions in China. 4) The initiation of PBOC and CBRC for establishment of microcredit companies added a new progress towards the deepening microfinance services in rural China. Soon the microcredit company goes viral and thousands of MCCs were established within short time duration. However, government intervention and sustainability problem is widely observed in these institutions. 5) Establishment of new-type rural financial institutions changed the microfinance in China. In one hand, opening private and foreign capital helped to solve the funding problem in rural and microfinance, and in the other hand new microfinance institutions were added in rural finance. Consequently, it creates the competitive environment in rural financing sector between traditional rural financial institutions and new-type rural financial institutions. Such an institutional arrangement significantly supports to financial inclusion, poverty alleviation and extending microfinance services in the rural China.

2. Classification of Microfinance Institutions in China

At the beginning, the main objectives of Chinese microfinance projects were to solve the issues of poor household from poverty alleviation funds to help the poor households and reduce poverty. China is one of the biggest developing and emerging nation in the world. It has also huge number of population below the poverty line. The economic growth and distribution in China is imbalanced so the gap between regions is increasing with the implementation of economic reform and opening up. Geographically remote and rural areas people are still living in poverty. The Central and local governments are giving focus on poverty alleviation and improving life standard of poor households. In this circumstance, the role of microfinance is very meaningful and microfinance is supporting to solve the financial problem of the rural communities with different kinds of income generating programs.

In China, different kinds of microfinance institutions are in operation. From the nature of ownership and initiation, Chinese microfinance institutions can be divided into major nine categories.

2.1. NGO-MFIs

NGO-MFIs were first launched in 1993. There were approximately 300 NGOs engaged in microcredit operations, only around 100 MFIs remain in operation today[24]. These NGO-MFIs are supervised by the Bureau of Civil Affairs along with all other NGOs. Apart from few NGO-MFIs have obtained permission to operate microfinance projects from the PBOC, while the others microfinance projects of NGOs are mainly operated based on the business agreements between fund donors and local governments as informal business permission[①]. There is lack of official supervision and regulation body for NGO MFIs, which makes unstable legal status and an uncertain future. Though these MFIs are widely adopting group lending method and sometime used individual lending. NGO-MFIs, generally issued average loan size ranges from RMB 1000 to 5000 (around USD 144 to 720) in rural areas and from RMB 3000 to 20000 (around USD 432 to 2880) in urban area. Annual loan interest rate ranges from 3% to 18%[②]. The main funding source of these MFIs is donation from multilateral and bilateral international aid agencies, international NGOs and the Chinese government. Private capital, wholesale lending from commercial banks, soft loans from international organizations are the secondary sources of fund for NGO-MFIs.

2.2. Subsidized Microcredit Projects

Second type of microfinance institutions is subsidized microcredit projects for Poverty Alleviation developed by State-owned Banks such as Agricultural Bank of China and Agricultural Development Bank of China. These projects were launched in 1997 and project was operated in poor regions and counties of China. These projects also use the group lending method for credit distribution. On-lending loans from the PBOC and savings from their own depositors are funding sources of these microcredit projects.

2.3. Rural Credit Cooperatives

Rural Credit Cooperatives are major rural financial service providers in the

① He, G., Du, X., Bai, C. and Li, Z. (2009). China Microfinance Industry Assessment Report.[R] China Association of Microinance. Pp 43

② Du, X.S. (2008a). The Current supply of Microfinance in China [J].World Microfinance Forum Geneva

China with vast branch network, which mainly focus on rural areas and give priority to solve 'Sannong' problem. It is one of the rural formal financial institutions with a widespread branch network, directly providing financial services to poor households. Since 2000, RCCs has been operating farmers' microcredit project. It is local government owned rural financial institutions and funded by PBOC. In RCC, borrowers can enjoy with subsidized interest rate. It is estimated that around 90 million farming households accounting 30 % of the overall farming households in the country are serving by the RCCs with around RMB 370 billion (around USD 53.252 billion) of outstanding microcredit and group loans[①].

Basically, RCCs issued three types of loans such as credit loans, group guarantee loans and collateral based loans. RCCs are following group lending, individual lending and "Enterprise+Farmer" loan method. Recently, CBRC allowed RCCs to transform into Rural Commercial Bank or Rural Cooperative Bank.

2.4. Microcredit Companies (MCCs):

In 2005, the PBOC initiated a pilot program in six provinces to establish commercialized microcredit companies (MCCs). These institutions are credit only microcredit institutions, so not allowed to mobilize deposits and other financial products and services. MCCs also follows the same methodology as RCCs to serve its targeted groups. By the end of year 2010, nationwide 2614 microcredit companies are existed in China （Table 6-2）. These institutions have total RMB 178.093 billion (around USD 26.308 billion) capital and outstanding loan balance is RMB 197.505 billion (around USD 29.175) at the end of 2010.

Table 6-2: Pilot Microcredit Companies in China

	End of the Year 2008	End of the Year 2009	End of the Year 2010
Microcredit Company	230	1334	2614
Capital (RMB in billion)	127.49	817.20	1780.93
Outstanding Loan Balane （RMB in billion）	7.703	76.641	197.505

Source: PBOC (2011). Microfinance Bulletin 2010/11. Economic Science Press. Beijing

① Du, X.S. (2008b). Microfinance in China. [R] World Microfinance Forum Geneva. Pp4

The establishment of microcredit companies is too fast but their sustainability is still in doubt. Many policies regarding microcredit companies (MCCs) are issued through local government rules and criteria are divided which create confusion among the microcredit practitioners. The lack of capital sources and many difficulties in bank financing is common problem of these institutions. Heavy tax burden and insufficient regulatory system is also creating the problems in operation of MCCs.

2.5. Village and Township Banks (VTBs)

Since, 2006 the Village and Township Banks enter in the microfinance and rural financial market to serve low income household as well as small and middle scale enterprises. These banks are started as a new-type rural financial institutions. Commercial banks, private banks, state-owned banks, joint stock banks are taking initiation to operate these VTBs in China. Through, urban commercial banks, Rural cooperative Banks and Rural Commercial Banks are main founder of VTBs. Likewise, some foreign banks has also founded VTBs. However, VTBs loan size is larger than the other rural and microcredit institutions, so it is difficult to differentiate the loan distributed by VTBs into microcredit and other loans.

2.6. Rural Mutual Credit Cooperatives (RMCCs)

RMCCs are also newly formed new type financial institutions along with VTBs in 2006. The ownership structure of RMCCs is very similar with cooperative societies where the members became the shareholders of the institutions. It is a kind of saving and credit cooperative society. For loan purpose, members can apply for individual loan and group lend. Likewise, RMCCs accepted voluntary saving from its members.

2.7. Postal Saving Banks of China

By nature this postal saving banks are remittance service provider financial institutions. In China, Postal Saving Banks has large numbers of banking outlets covering remote and rural areas. For internal remittance purpose, this institutions is widely using by the people. In 2006, postal saving banks started its own microcredit pilot project with a time deposit as collateral. After a year long experiences, in May 2007, the bank started non-collateral microcredit services in 7 provinces and cities. Entry of postal saving banks in to micro-lending activities added new hope and new player in Chinese microfinance field. The PSBC has a wide branches network providing financial services, in addition to access to 30,000 branches of China post[25].

2.8. Commercial Bank Microcredit Pilot Project

Some commercial banks has also started microcredit pilot project. Such Commercial Banks, downscaling microcredit activities adding competitive environment in China's microfinance sector. 2005 the China Development Bank (CDB) has started microcredit pilot project with the World Bank from the year 2005. Similarly, Harbin Bank is also operating micro-lending programme. These commercial banks are using group guarantee and warrantor guarantee methodologies in credit distribution.

2.9. International agencies and other private organizations

Since, late 1980's international aid agencies are involved in microfinance in China. International aid agencies and organizations were mainly involved in small scale and poverty alleviation programmme. Since 1994 United Nations Development Pragramme (UNDP) is working with its Chinese counterpart agency, the China International Centre for Economic and Technical Exchange (CICETE) in microfinance sector. Likewise, United Nation's Children's Fund (UNICEF) are active in channeling microcredit to women since 1996. World Bank is participating in poverty alleviation programme whereas Australian Agency of International Development (AusAid), Canadian International Development Agency (CIDA) are also involved in providing micro finance services through the local RCCs and credit cooperative societies in China. GTZ/kfw- German Bilateral Donor Agencies are technically assisting to RCCs and other microfinance institutions.

Likewise International NGOs such as Grammen Trust & Foundation USA (as GO-NGO under the Rural Development Institute of the China Academy of Social Sciences), World Vision International, Oxfam Hong Kong, Mercy Corps International, Opportunity International, Development of Rural Sichuan (British charity), Plan International, Tibet Poverty Alleviation Fund etc are involved in different microcredit programme and poverty alleviation programme in different provinces of China.

In sum, China's rural financial market is very big similarly bigger is rural financial demand. To satisfy the credit needs of rural people only single organization or institutions or project is not sufficient. In order to cover vast rural territory and diverse poor people, different types of organization are active in China. From the perspective of institutional structure, Chinese microfinance institutions can be classified in to seven major groups excluding microcredit programme of traditional commercial banks.

Section 3: Major Characteristics, Problems and Challenges of China's Microfinance Institutions

The microfinance practice in China is new experience in global microfinance sector. China is following Socialism with Chinese characteristics ideology which supports the creation of a socialist market economy dominated by the public sectors. The political and economic condition of China is totally different than the other countries in the world. Microfinance practice in China is directly influenced by the political and economic condition of the country.

In China, the government, central bank (People's Bank of China) and China Banking and Regulatory Commission themself has initiated a large-scale microfinance program. China has its unique "characteristics", that the remote location and focus on agricultural protects in poor areas, make meetings costly and frequent repayment difficult. China's poor are concentrated in remote, mountainous regions where agriculture (cropping and livestock) is more common[①]. The Chinese experience may be instructive for other developing countries. Major characteristics in Chinese Microfinance institutions are described below.

[①] Park, A. and Ren, C. (2001). Microfinance with Chinese Characteristics. [J] *World Development*, Vol.29, (1), 39-62

Table 6-3: Comparison of China's Microfinance Institutions

(Excluded Poverty Alleviation Program, Commercial Banks and Postal Saving Bank)

MFIs	NGO MFIs	MCCs	VTBs	RMCCs	RCCs
Operation Since	1993	2005	2006	2006	2000
Business Nature	No legal status that allows for the provision of financial services	Limited liability company or company limited by shares	Banking financial institution	Community mutual aid banking financial institution	Community cooperative financial institution
Registered Capital		Liability company ≥ 5 million Yuan; joint stock company ≥ 10 million Yuan	County(City) level ≥ 3 million Yuan ; Town (Township) level ≥ 1 million Yuan	Town (Township) level ≥ 0.3 million Yuan; Village level ≥ 0.1 million	≥ 10 million Yuan
Source of Capital	Grants From Multilateral and bilateral aid institutions, International NGOs and government	Capital fund, donated capital and capital borrowed from banking financial institutions, which is not more than 50% of the net capital	Domestic or foreign Commercial Banks as sole proprietorship, or Joint stock partnership with individual and/or institutional investors	Deposits of society members, donations and capital borrowed from other banking financial institutions	Capital fund, deposits, re-loan and interbank loan (rural commercial banks, rural cooperative banks and rural credit cooperatives which are qualified to conduct interbank loan)
Liability Source	Soft loan from International Organizations such as Grameen Trust, KfW, etc and Wholesale loans from banks such as the China Development Bank	Loans from no more than two banks and amount no more than 50% of net capital	Saving from depositors and unrestricted borrowing on inter-bank market possible	Voluntary savings from members and bank loans allowed by law	
Credit business					
Collateral	No	Yes	Yes	No	No
Annual Interest Rate	3-18%	0.9-4.0 times basic rate in law, actual around 20%	0.9-2.3 times basic rate	0.9-2.3 times basic rate	0.9-2.3 times basic rate

Interest Cap	None	Not more than 4 times basic interest rate of PBOC	Not more than 4 times basic interest rate of PBOC	Not more than 4 times basic interest rate of PBOC	Not more than 2.3 times basic interest rate of PBOC
Non-Credit Business					
Savings	No	No	Yes	Yes	yes
Remittance	No	No	No	No	Yes
Members	Mainly Female	Mainly Male	Mainly Male	Mainly Male	Mainly Male
Modality use	Group Lending	Group and Individual Lending	Individual Lending	Group and Individual Lending	Individual Lending
Operational Limitation	Within members	Loan balance of the same borrower should be less than or equal to 5 % of the net capital. The lending ceilings should be set according to the economic conditions and per capita GDP of the places where microcredit companies are located	No limitation	Within members	Most of the loans should be used to support the development of local farmers and agriculture
Regulatory body	Lack of legal status	Provincial financial offices and PBOC	CBRC	CBRC	PBOC

Source: Based on Bernd et al. (2013), Du (2010), PBOC (2011), Planet Finance, China Banking Association (2011)

1. Definition of Microcredit

The definition or practice of microcredit in China is different than other parts of the world. International guidelines often refer to microcredit as loans that are smaller than or equal in size to the region's annual GDP per capita. In China, however, CBRC has raised the official value of a microloan in coastal areas to RMB 100,000–300,000 (around USD 14700- 44100) which corresponds to up to 12 times China's GDP per capita[①]. Generally microcredit refers to farming household, small private business, micro-entrepreneurs. In practice， RMB 10,000-100,000 (around USD 1470- 14700) or the loan below RMB 100,000 is normally consider as microloan which is bigger than the size of microcredit in other developing countries.

① Working Group on Inclusive Finance in China (2010). Microfinance Wholesale Funds: The Case of China.[working paper]

2. Definition of Microfinance

In China, microfinance only consists of microcredit operations and does not include other financial products such as savings, insurance or transfer payments (Sun, 2008). PBOC and NGO-MFIs has define microfinance as tool to reduce poverty and targeting mid/low income and poor clients. But CBRC does not clarify the economic status of the clients however the loan granted to rural households, individual businesses and small enterprise in rural areas are understood as microcredit. Mostly, microfinance institutions targets farming household and rural based microenterprise in rural areas whereas in urban areas laid-off and unemployed workers are target group of microfinance institutions.

2. Government dominated

China's microfinance sector is dominated by the government such as poverty alleviation and microcredit project, RCCs and MCCs. However, foreign and private investment in microfinance is allowed such as VTBs. Local government intervention, influence of elite society in daily operation of microfinance institutions is creating problems in autonomous functioning of MFIs.

3. Business nature

From the business nature point of view, three major kinds of microfinance institutions viz Limited Liability Company or company limited by shares, community cooperative financial institution and banking financial institutions are existing in China. MCCs are Limited Liability Company, RMCCs and RCCs are financial cooperative and VTBs are banking institution, whereas NGO-MFIs lack legal status.

4. Registered Capital

The required registered capital varies according to nature of institutions and area covered by institutions. Registered capital to establish RMCC is low among other MFIs. To operate RMCC in county level RMB 0.3 million is required as register capital and RMB 0.1 million in village level whereas to run VTBs it need RMB 3 million and RMB 1 million respectively. For limited microcredit companies and joint-stock microcredit companies need RMB 5 million and RMB 10 million respectively as registered capital.

5. Source of Capital

NGO-MFIs uses grants and funds from multilateral and bilateral aid institutions, INGOs and government whereas MCCs used capital fund, donated capital and capital borrowed from commercial banks. In case of VTBs, domestic or foreign commercial banks equity share and private capital are major source of capital. Cooperative based institutions used capital fund, members' deposits and loan from commercial banks as a source of capital.

6. Business operation

Business point of view, China's MFIs can be classified into two groups; credit only MFIs and credit plus MFIs. NGO-MFIs and MCCs are credit only MFIs, they are not allowed to do non-credit business such as savings and remittance services. VTBs, RMCCs and RCCs are allowed to collect deposit however RMCCs only accept deposit from its members.

7. Collateral

NGO MFIs, RMCCs and RCCs do not take any traditional collateral for loan guarantee; whereas MCCs, VTBs and PSBC seek traditional collateral to issue the loan.

8. Interest Cap

Interest rates greater than four times the PBOC benchmark rate (basic interest rate) are illegal in China. Regulatory body has imposed the interest rate ceiling in loan for all the MFIs. According to the PBOC, New-type financial institutions and microcredit companies can charge interest rate not more than 4 times greater than the basic rate but in case of RCCs they can only charge 2.3 times of the basic rate. For the year 2011, the basic annual interest rate determined by PBOC was 6%, so maximum annual interest rate that can be set up to around 24% in microcredit.

9. Clients/ Members

Chinese MFIs are mainly focusing for male which is contrast than the internationally microfinance practice. Only NGO-MFIs are targeted to the female borrower as internal practice of microfinance institutions. Except NGO, MFIs, other MFI have large portion of the male borrowers.

10. Modality use:

Generally, Chinese MFIs follow the group lending and individual lending methodology to loan distribution. NGO-MFIs are only following Grammen Bank's group lending model. Grammen Bank model is mixed-up with own creative Chinese system. Basically, these typical models can be classified in to four groups: （(1）Company + Grammen Bank Model + Poor household；（2）Work for the relief + RCCs + Grammen Bank Model+ Poor household；（3）Poverty Alleviation Programme+ Grammen Bank Model+ Poor Household and（4）Company + Poverty Alleviation Programme+ Grammen Bank Model+ Poor Household[①]。Likewise, the peer to peer lending (P2P) through internet is growing and taking place in Chinese financial market. First P2P lending website was launched six years ago. Since then, it has grown to about 200 website[26]. This P2P lending practice is out of government regulator body where, borrower and lenders meet through the website.

11. Mode of System

Most of the China's MFIs are guided by Institutionalist approach rather than Welfarist approach. Being Institutionalist, China's MFIs are operating commercial microfinance activities though many RCCs which has low level of financial performance.

12. Operation Limitation

Except VTBs, all the MFIs are restricted to provide financial services for non-members. Furthermore, MCCs has also set the maximum limit of loan amount to a borrower i.e. not more than 5 % of the net capital. Likewise, RCCs are bound to invest

① Guo, Q. L. (2008).*The Study on Microcredit in the Inclusive Financial System: The Investigation Based on the Experiences of Developing Countries* [D]. Jilin University only for local farmers and agriculture sector. All the MFIs can only do business in their registered administrative region.

13. Regulation

NGO-MFIs are still facing the problem of lack of legal status from the authorities. The government and microfinance donors have to negotiate a temporary legal status for microfinance projects which regards as informal operating permission. MCCs and RCCs are regulated by PBOC while VTBs and RMCCs are regulated by CBRC.

14. Microfinance linked with women's federation

In China, microfinance activities are also linked up with the women's federation. Women federation and Rural Credit Cooperatives have jointly implemented microfinance in many parts of China. For example, since 2005 women's federation and RCCs are jointly participating in development and expansion of microfinance activities in Jilin province[27]. This is also unique case of microfinance practice in China.

It can conclude that microfinance development in China has its unique way. It has modified different international microfinance model and develop its own model on the basis of local condition and necessities. Commercial microfinance institutions are growing quickly in China. So, the sustainability issue of microfinance institutions is emerging with the growing number of microfinance institutions in China.

Section 4. Problems and Challenges in China's Microfinance Development

Microfinance in China is still in development phase and putting its effort to concrete shape of microfinance. During the two decades long modern microfinance history, China's microfinance has experienced many problems and challenges. China's microfinance sector cannot be the exceptional case; it has facing many problems on development of microfinance in China's soil.

1. Lack of legal status for NGO-MFIs

Proper legal status, regular supervision and regulation are needed for sustainable development of MFIs. Still, NGO-MFIs do not have any legal status that allows for the provision of financial services. It prevents NGO-MFIs to get sufficient capital fund to expand the business scale.

2. Lack of supervision

Many banking and non-banking institutions such as NGO, traditional commercial banks, joint venture banks, urban and rural commercial banks, rural cooperative banks, rural credit cooperatives, new type rural financial institutions, microcredit companies etc are providing microfinance services in China. But the problem is lack of adequate and effective supervision of these institutions. MCCs can be upgrade/promoted into VTBs and RCCs can be upgrade into Rural Commercial Banks or Rural Cooperative Banks but the supervisory status of these upgraded institutions are still weak. In case of promoted MCCs' supervision is still entrusted to local governments.

3. Scarcity of fund

China's rural financial sector is facing the problems of fund scarcity. Therefore, the every institutions involved in these sector are also suffering from fund scarcity, particularly credit-only Microcredit Companies. Under existing regulation, these companies are prohibited to mobilize wholesale loans more than 0.5 times of its registered capital from two banking institutions. In addition, microcredit companies and NGO-MFIs are not allowed to collect deposit from the members or public. So to raise the necessary fund for the operations of MFIs, the permission should be given to deposit collection and increase the ceiling of mobilizes wholesale loans.

4. Interest rate cap for RCCs

The regulatory body has determined the interest cap for all microfinance institutions. According to nature of microfinance institutions, the imposed interest rate cap is different. For RCCs and Agricultural Development Bank, interest cap is determined 0.9 to 2.3 times of basic interest rate while other competitor can enjoy up to 4 times of basic interest rate. Due to limited interest ceiling for RCCs, these institutions are not generating enough revenue to cover its own operating expenses.

5. Bounded opportunity for business and expansion

Regulatory body has restricted on business such as interest cap, limitation on the single loan amount and the cap on the outstanding loan of a single client. Likewise, the expansion of RMCC's coverage area is also strict so RMCCs are normally operated only in the registered county. Such obligations and restrictions has made the opportunity for expansion and diversion complicated.

6. Mission drift

MFIs supported by donation and subsidies are following Welfarist approach and serving poor people with lower interest rate however these institutions especially NGO-MFIs has the problem of real ownership. In this condition, the sustainability of these institutions is doubtful whereas privately invested MFIs are operating in commercial way and heading towards mission drift. Commercial MFIs are charging heavy interest rate, targeting middle and rich entrepreneurs and business people, distributing large scale loan and reaping short-term benefit. The mutual conflict between double bottom line of MFIs viz. expansion of financial services to poor people (outreach) and financial sustainability of MFIs is also common in case of Chinese MFIs.

7. Competition with traditional commercial banks

Recently some traditional commercial banks; Agricultural Bank of China, Postal and Saving Banks, Rural Commerical Banks, Rural Cooperative Banks, Shareholding Commercial Banks, Urban Commercial Banks, Harbin Bank(Commercial Bank), Baotuo Commercial Bank, Harbin Bank has downscale their products and operating microcredit business. The entry of commercial banks into microfinance sector has added more competitive environment. Generally, commercial banks have sound potentiality and institutional strength such as large scale capital sources, widespread banking network, and technological advancement, skilled and professional human resources. Definitely entry of commercial banks creates tough challenges for small scale microfinance institutions and it forces them to improve their service quality and institutional capacity.

8. Local government intervention

In China, grass route level microfinance activities are closely linked with government body. Government official has been directly handling and taking leading role in rural financing. Institutionally, RCCs are heavily influenced by local government. Past experience shows that local government influence and intervention lead RCCs into heavy operating loss. Newly formed new-type financial institutions are also facing similar local government intervention in the business operation. Local government put forward local level policies to MFIs, particularly in rural areas. Local government intervention in expansion of business, determining floating rate between deposit and lending interst rate are commonly seen. In addition being a stakeholder of VTBs and other rural financial institutions, local government influence and intervention in daily business operation is creating difficulties to rural financial institutions.

9. Discriminated fiscal policy and heavy tax burden

Tax for MFIs in China is varies according to nature of MFIs. Business tax for VTBs is 3 percent and income tax is 12.5 percent whereas MCCs have to pay 5.56 percent business tax and 25 percent income tax. Tax differences is nearly double between the VTBs and MCCs. Heavy tax burden in MCCs. Also discriminated fiscal policy discouraging MCCs and government is intentionally giving high priority to establish VTBs. Subsidy policy is also not equal for all microfinance institutions in China. New-type rural financial institutions can enjoy 2 percent subsidy on their average quarterly balance of loans in the previous year. This subsidy policy does not cover MCCs.

10. Institutional problem

Some MFIs has institutional problems; low quality of staff, lack of technical man power, lack of financial innovation and low efficiency and productivity. Particularly these problems are seen in RCCs and new-type financial institutions. Postal Saving Banks downscaling microcredit programme has also lack of experienced and technical manpower to efficiently handle the microcredit programme.

11. Lack of advanced technology

Commercial banks in China are well sophisticated in terms of applying advanced technology in their business operation. Transfer payment, internet banking, ATMs, remittance services are easily providing by commercial banks but the clients and members of rural and microfinance institutions does not have access to these services. The high cost bearing these technologies are out of the MFI's capacity too. It is also a reason of not showing interest on these MFIs by targeted clients.

12. Difficult to separate real microfinance institutions from small loan company

In practice, many microcredit companies are providing large scale loans with collateral or guarantees and they are targeting small and medium entrepreneurs. This practice is totally different than the "Microfinance" which is generally understood. However these institutions are named as "Microloan company", but in nature they are like only "Small loan company” rather than microfinance institutions. So, it's hard to separate real microfinance institutions from small loan company in China.

China is big potential market for microfinance so that various microfinance institutions are involved in this sector. The problems and challenges of every institution are different and unique. It is not easy to combine all the problems and challenges facing by all the microfinance institutions in this small section.

Conclusion

The government needs to take more measures to improve the microfinance environment and promote microfinance industry. From policy approach, it is seen that the government is promoting commercial microfinance institutions and the balance between poverty alleviation and financial sustainability of institutions is required.

The government should adopt some relaxation policy to reduce heavy tax burden, permission to collect deposit and mobilize more wholesale fund. Likewise the discriminating tax and interest cap policy should be change. From the government level, equal opportunity should be given to all microfinance institutions for the development and expansion of microfinance operation in China.

For being a large country, it will not be suitable to adopt single or few microfinance model or it will not be efficient and effective too. The government and regulatory authorities should promote the localization of microfinance institutions.

For commercial microfinance institutions, China is a good potential market. Lack of currency risk (stronger and stable RMB), economies of scale (large number of micro-entrepreneurs) and large potential interest from traditional financial firms are reason of prospects for structured microfinance in China[①].

For the development of MFIs, it needs the government aid and assistance; simultaneously it needs to avoid the excessive local government intervention. The intervention of the government in loan disbursement procedure can lead to new-type rural financial institutions' dissimilation; this is the profound lessons of China's RCCs development. This kind of mistake can be minimized in near future for sustainable development of rural and micro financial institutions.

Instead of intervention, local government should assist MFIs in accumulating client resources and explore modes of cooperation between banking institutions and enterprises and modes of cooperation between banking institutions, enterprises and local government. An autonomous function of financial institution can enhance the sustainable development of financial institutions as well as financial inclusion. The growth and development of MFIs in China can play important and significant role in China with the improvement of rural financial system, poverty alleviation, improving economic standard of poor and low level people and steady development of agricultural economy and microenterprises.

Section 5: Lessons from Rural Financing and Microfinance in China

China's modern microfinance history is not long however it has experienced and practiced many modalities of microfinance. China's special socio, economic, geographic and demographic environment is unique among other nation in the world. The China's

[①] Bystrom, H. (2007). Structured Microfinance in China.[Working Paper] Lund University, Sweden. Available at http://www.nek.lu.se/publications/workpap/Papers/WP07_18.pdf experience and success of rural finance and microfinance will be new lesson for developing nation. Here it can summarize some major lessons from rural financing and microfinance in China.

1. Sannong: An innovative approach to address problems related to rural economic development

Since 2006, the issue related with rural development 'Sannong' was especially emphasized. This is the approach to handle major issues correlated with farmers (Nongmin), rural areas (Nongcun) and agriculture (Nongye). Most of the developing countries have common socio-economic characteristics i.e. huge portion of rural population, poverty stricken rural area, agricultural economy, financing difficulties in rural area. The core of "Sannong" policies basically focused on 1) Promoting agriculture production, 2) Driving rural development and 3) Boosting income & well-being of farmers. The Chinese government and relevant authorities are continuously encouraging to expand rural microcredit input through retail and wholesale lending, develop and design diversified microcredit products to meet farmers' financial need. The ideal policies related with 'Sannong' issues are model and unique for much agriculture based developing nation.

2. Government initiation and domination

At the beginning phase, NGO-MFIs were established to satisfy socio-economic needs of rural and poor households. Later on, government realized microfinance can be a tool to alleviate poverty in China and started many microfinance projects with collaboration of development agencies. Focus and priority on Sannong brought milestone changes in policy level. The reformation of RCCs, establishment of microcredit companies and new-type of rural financial institutions added different type of financial institutions in rural and microfinance sector. Particularly RCCs, RMCCs, poverty alleviation microcredit projects, pilot microcredit projects are government led microfinance institutions and government influence is easily seen in these institutions. Government initiation is appreciable however some drawbacks are exists in government influenced microfinance institutions. For the poverty alleviation and institutional development, government role in initiation and facilitation is necessary which we can find in China. However, excessive local government intervention should be minimized or avoid for sustainable development of microfinance institutions.

3. Establishment of specific financial institutions and open for foreign capital investment

In order to address the Sannong issues, specific financial institutions are developed in China. The latest example is establishment of New-type rural financial institutions (VTBs, Lending Companies and RMCCs). These institutional arrangements help to minimize the fund shortage in rural finance and make competitive environment among the rural and micro finance institutions. The idea of accepting foreign capital in microfinance sector via VTBs is helpful for other countries which has fund shortage for rural and microfinance. HSBC, Standard Chartered, Temasek (Singapore) joint venture with Bank of China and Banco Santader (Spain) joint venture with China Construction Bank have opened VTBs in China.

4. Interest rate cap

The regulatory body has imposed the interest rate cap for microfinance institutions. Globally, the trend of commercialization of MFIs is growing day by day. Some critical drawbacks of commercialization are already observed and it leads to borrower suicide. In China, authorities has determined the interest rate range basically up to 4 times of basic interest rate, it helps to control profit seeking microfinance institutions. But, it is also controlling the natural credit flow in the rural area. These excluded needy people are beyond the reach of credit access with various obligations and unavailability of credit from MFIs. Such individuals faces dual problem to seek credit, in one hand they don't have privilege to get loan from MFIs whereas in other hand ceiling of interest rates prohibits them from the access of credit from private lending.

5. Upgrade or promotion mechanism

In order to increase the institutional capacity and client service, microfinance should increase its potentiality and scale. In China, regulatory authorities has launched upgrade mechanism for able and strength rural and micro finance institutions. According to this policy, RCCs can be promoted into Rural Commercial Banks or Rural Cooperative banks, likewise microcredit companies can be transformed into Village and Township Banks. In one hand, this policy arrangement motivate financial institutions and in other hand it encourage financial institutions to increase the quality and professional services.

6. 'Grammen Bank plus' modalities

In China, Grammen bank modality of microfinance is modified on the basis of local requirements and environment. It can be said that Grammen Bank modality is used in different forms and named as 'Grammen Bank plus' modality. Generally these four model is mixed with Grammen Bank model; (1) Company+Grammen Bank Model+Poor household；(2) Work for the relief+RCCs+Grammen Bank Model+Poor household；(3) Poverty Alleviation Programme+Grammen Bank Model+Poor Household and (4) Company+Poverty Alleviation Programme+Grammen Bank Model+Poor Household. Grammen Bank model is linked with company/enterprises, 'food for work' programme, poverty alleviation association and other institutions. It will not be reasonable and suitable to copy the modality use in other countries so the creative use of modality according local needs and situation is preferable.

7. Requirement of registered capital

The requirement of registered capital is varies among the financial institutions. In China, microfinance institutions can be establish as liability company, joint stock company, banking and financial institutions and community and cooperative financial institutions. Registered capital requirement is determined on the basis of business coverage area and nature of microfinance institutions. The minimum range of capital requirement is RMB 0.1 million to RMB 10 million. This "Greater the area occupy, greater the register capital" policy helps to fix the specific business operation area.

8. Microfinance link with third party

In international forum, it is already experienced that microfinance linked with commercial banks (Linkage between Self-help groups and Banks in India). In China, microfinance program are linked with company as "Production, supply and sales" chain loan with the "Bank+Company+Farmer" mode. Third party particularly companies and enterprises are involved in loan guarantee, agricultural input and output process. Enterprises sell agricultural input such as seeds, young animals and purchase agricultural output from farmers at a predetermined price. In this method, if farmers need credit to expand the production scale, enterprises guarantee against the loan from financial institutions.

9. Use of economic resources as mortgage

In China, individuals do not have land ownership. Basically rural land is collectively owned[28] and preventing its use as collateral. Chinese rural household have economic resources, which can be used as effective mortgage. Economic resources such as forest tenure, coastal land tenure and pigs in vivo are commonly used as mortgage, among them forest tenure is most commonly used mortgage[①] Similarly, the model of co-guarantee loans through formation of mutual guarantee group and loan access under joint and several liabilities amongst team members is practicing in China.

The China's microfinance is still in experimental and development phase. Chinese government and authorities are flourishing diversity of microfinance service providers in China. For being a large country with huge population, China has to implement diversified microfinance policy. Chinese microfinance sector has also experienced economic transitional phase of the country. The reformation of Rural Credit Cooperatives may be the lesson for those country adopting state led development model. Strong government organizational structure and resource availability in the rural areas of China, different political system added unique feature in China's microfinance practice and development.

[①] Sapovadia, V.,Patel, K. and Patel, S. (2010). Micro Finance Models Across the Globe. [M]. Lap Lambert Academic Publishing. Pp37

CHAPTER SEVEN: REGULATORY FRAMEWORK AND POLICY RECOMMENDATION

Microfinance service providers are known as microfinance institutions and these institutions are providing different financial services to uplift the economic status of the low and middle income households. Financial institutions which are functioned as financial intermediaries, deposit collector or credit provider are operated under certain act, rules and regulations. Effective supervision and regulation of MFIs is required to prevent fraud and ensure ethical practices. Likewise, act and regulations provide legal base and regulatory framework to promote MFIs. The government and relevant authorities' policy provide guidance and support for the operation of MFIs.

This chapter aims to analyses current regulatory framework and microfinance policy. Further, we present existing problems and challenges in Nepalese microfinance industry. This chapter will be closed with policy recommendation for the sustainable development of Nepalese microfinance industry.

Section 1: Legal and Regulatory Framework

The term regulation is understood in many ways by different organizations having varied purpose. Generally regulation means rules and regulations that banking and financial institutions are obliged to follow or the procedure for deciding and enforcing such rules. Four types of regulations can be seen; self-regulation, prudential regulation, non-prudential regulation and enabling (promoting) regulations. Here, the focus is given only in prudential regulation of banking and financial institutions.

The Nepal Ratra Bank, central bank of Nepal is a single regulatory body to regulate all the banking and financial institutions in Nepal. Nepal Rastra Bank is considered as the leading force to control, manage monitor and supervise the banks and financial institutions so as to protect depositors from fraudulent practices depicted in such institutions[①] .

From the regulation perspective, there are mainly four types of MFIs in Nepal. Category first include non-profit organization, community based organization and FINGOs (Table 6-4). Generally, these institutions are not regulated by the central bank. These institutions are registered under Society Registration Act, 1978 and some of them are regulated under Financial Intermediary Act 1991. The member based institutions like credit union, SACCOS fall in category II, which are established under Cooperative Act 1992 and partially regulated by Department of Cooperatives (Government of Nepal, Ministry of Cooperatives and Poverty Alleviation) and central bank. The specialized banks, deposit-taking institutions and finance companies are category III MFIs. Category D MFIs are commercial banks which are participating in downscale programme. Category III and IV specialized microfinance banks and commercial banks are regulated and supervised by the central bank under Bank and Financial Institutions Act 2006.

[①] Shrestha, M.K. and Bhandari D.B. (2004). Financial Markets and Institutions [M]. Asmita Books Publishers and Distributor, Kathmandu.Pp 33

Table 6-4: Classification of Nepalese MFIs

MFI Type	Ownership Structure	Regulatory Agency	Laws
Categroy I MFIs			
1. Non-profit and community based NGO	Government/ Semi government	None, or Self - Regulatory Organization	Society Registration Act, 1978
2. Non-profit NGO with limited deposit-taking-FINGOs	Private sector entity or members	Regulated or supervised by Central Bank	Financial Intermediary Act 1991
Category II MFIs			
3. Savings & Credit Cooperative Society	Members	Partly regulated by Cooperative department and Central bank	Co-operative Act, 1992
Category III MFIs			
4. Specialized Bank, Deposit-taking Institution, Micro-credit Development Banks, Development Banks or Finance Company	Govt./Private/Institutional Investors	Regulated and supervised by central bank	Company Act, 1964, Development Bank Act, 1996 and BAFIA, 2006
Category IV MFIs			
5. Commercial Banks	Government/ Private Investors	Regulated and supervised by central bank	Company Act, 1964, Development Bank Act, 1996 and BAFIA, 2006

1. Microfinance Development Banks

Microfinance Development Banks including five Regional Development banks of Nepal are the key players in Nepalese microfinance industry. Primarily, Government initiated Regional Development Banks started microfinance services in the five development region of Nepal and later on added privately initiated microfinance development banks. Recently, all the microfinance development banks with commercial banks and development banks are regulated under 'Bank and Financial Institutions Act, 2006'.

The legal and regulatory framework for microfinance development banks are as follows:

1. Incorporation criteria

As per the classification set by the Central Bank of Nepal, microfinance development banks can be set up as a 'D' class banking and financial institutions.

2 .Capital requirements

In order to establish 'D' class microfinance development bank, minimum capital requirement is NPR 100 million (around USD 1.26 million) for national level, NPR 60 million (around USD 0.76 million) for institution operating in regional level, for 4 to 10 districts needs NPR 20 million (around USD 0.25 million) and for institution operating in 1 to 3 districts needs 10 million (around USD 0.13 million). Following table illustrates the current capital requirements for different financial institutions.

Table 6-5: Minimum Capital Requirement to Establish Banking and Financial Institutions

unit: in million

Class and Types	**National Level**		**Regional Level∗**		**4-10 Districts∗**		**1-3 Districts∗**	
	NPR	USD	NPR	USD	NPR	USD	NPR	USD
'A' Commercial Banks	2000	25.19	-	-	-	-	-	-
'B' Development Banks	640#	8.06	-	-	300# 200	3.78 2.52	100#	1.26
'C' Finance Companies	300# 200	3.78 2.52	-	-	-	-	300# 100	3.78 1.26
'D' Microfinance Development Banks	**100**	**1.26**	**60**	**0.76**	**20♦**	**0.25**	**10**	**0.13**

Note : Exchange rate as per 2011/12 average rate USD 1 = NPR 79.4

∗Except Kathmandu Valley

♦ including additional five districts of mountain regions

including leasing business

3. Credit Limitations

Microfinance Development Banks' loanable amount has been classified for individual, group and enterprise lending. In the case of individual group member NPR 20 thousand to maximum NPR 60 thousand (USD 252 to 756) can be borrowed for new member and same can be enhanced up to NPR 100 thousand (USD 1260) for old borrower but borrower behaviour and performance is considered before issuing the loan. According to NRB's monetary policy for F/Y 2012/13, for the microenterprise or microbusiness the maximum limit of loan is extended up to NPR 300,000 (USD 3780) against acceptable collateral.

For the purpose of Solar Home Systems or Bio-gas under renewable energy technology and micro enterprise credit[1] up to NPR 150 thousand (USD 1890) may be provided against acceptable collateral or group guarantee. This limit is extended to NPR 200 thousand (USD 2519) for only good member. However, the banks shall extend such micro-enterprise credit up to 25 percent of the total loans and advances.

4. Financial Resource Mobilizations

Proper allocation and distribution of financial resource plays a crucial role in the smooth operation and functioning of the MFIs. Collection and distribution of funds for the operation of the institution reflects the operational efficiency of the institution. In the context of Nepal, such financial institutions have the authority of collecting and accepting the deposits. Capital, deposit collection from the members and fund from the wholesale lending MFIs deprived sector loan, donations, soft loans are the major financial resources for Nepalese MFIs. The 'D' Class licensed institutions may mobilize financial resources (deposit, borrowing and debenture) up to 30 times of Core capital fund (subject to maintaining CAR of 8 percent). In case of borrowing from foreign source needs approval from central bank.

5. Interest rate ceiling

BFIs interest spread is generally guided by the monetary policy of the central bank, yet the actual interest rate to be allocated to different deposits and loans are not directly controlled by the central bank with no such ceiling levied. There are few general guidelines which are to be strictly followed by all the financial institutions. There shall not be a deviation higher than 2 % in the rate of interest among the same category of loans or deposits.

[1] Enterprises having capital less than NPR 200,000 (USD 22800) and Income generating occupation having less than 10 persons involved enterprises is defined as micro-enterprises loan

As per the circular of the central bank, the licensed institutions other than 'D' Class microfinance development banks are not allowed to fix flat interest rates on the loan. 'D' Class institutions should publish the rates placing the information on its notice board, other than microfinance development banks all the financial institutions should publish the interest rate in newspapers.

6. Deposit collection

Being a 'D' class licensed institution it has the authority to collect the deposits from members, there is no such limitation regarding the maximum deposit acceptability unless its form the group member. As per the regulation set by the central bank 'D' class licensed institutions shall have to maintain a minimum of 2.5 percent of its total deposit liability in the form of liquid asset.

The regulatory authority has restricted microfinance development banks to collect deposit from non-members.

7. Capital Adequacy Ratio

For the flawless operation of the financial institutions , they need to maintain proper capital adequacy ratio which clearly defines the institution's capacity to meet the time liabilities and other risks such as credit risk, operational risk etc. The directives formulated by the central bank of Nepal capital adequacy ratio for a 'D' class financial institution is 4 percent for core capital and 8 percent for capital fund [29]. Capital fund refers to aggregate core capital and supplementary capital.

Based on its risk-weight assets, a licensed institution shall have to maintain the following capital adequacy ratio: -

Minimum capital fund to be maintained based on the risk-weight assets (percent)

Institution	Core capital (%)	Capital fund (%)
A class	6.0	10.0
B and C class	5.5	11.0
D Class	4.0	8.0

8. Provision of compulsory cash reserve

MFDB have to maintain compulsory reserve equivalent to a minimum of 0.5 percent of the amount collected from the members. This reserve should be deposited in a special current account of central bank. In the absence of central bank branch office, this reserve can be deposited in 'A' class licensed financial institutions.

9. Subsidiaries Company

As per the directive issued by the central bank, in case licensed institution of class 'A', 'B', and 'C' desires to incorporate a separate class 'D' micro finance institution and to advance loan to the deprived communities through that subsidiary company. It can have followed the following policy and procedural provisions. According to the policy of exempting at 25% of the paid up capital in the maximum limit of share investment of an undivided family/firm/company or corporate body or a group of companies case of class 'D' financial institution to carry on micro finance transaction being incorporated as a subsidiary company. The promoters share ownership of licensed institution of 'A', 'B' or 'C' class in its subsidiary company (Class 'D' licensed institution) may be 51% of the paid up capital in minimum and 70% in the maximum.

10. Business expansion.

'D' Class licensed microfinance development banks having adequate capital as prescribed by the central Bank doesn’t require any approval of the central Bank to open, close, shift or merge any Branch Office within the approved working area.

To expand the business area/district, microfinance development banks have to add NPR 2.5 million (USD 31486) paid up capital for each additional district to extend additional adjoining districts.

11. Promotion/Upgrade

Unlike other classes of financial institutions, 'D' classed financial institutions don’t have the possibility of upgrading its objective or the class in terms of its functions, missions and visions to higher class of institutions, no matter how well it performs.

12. Tax policy

MFDBs have to pay 30 percent tax along with other BFIs which seems higher for MFDBs.

2. Financial Intermediary Non-Government Organisations - FINGOs MFIs

FINGOs are pioneering and are active player in microfinance industry of Nepal. The role of NGOs as credit agent at first and finally transforming as FINGO was crafted. Based on this Nepal entered into formal FINGO model since 1998[①]. Primarily, NGOs were established under the 'Association Registration Act, 1978' and the 'Social Welfare Act, 1991'. Many FINGOs are also affiliated with Social Welfare Council (SWC). Later on, 'Financial Intermediaries Act, 1998' was promulgated and qualified, interested NGOs have to be registered with Nepal Rastra Bank to offer microfinance services to their group members.

1. Incorporation Criterion:

According to Society Registration Act, at least 7 persons can apply for registration. Currently, these societies are registered in GON district administration office of each district. After the registration the society is changed into legal person and can buy and sell property as natural person. In order to start financial transaction, the organization should get permission from the central bank under 'Financial Intermediaries Act, 1998'.

To get license from Central Bank, NGOs should have at least 500 members in Kathmandu Valley and Terai and 300 members in other districts. Likewise at least 50 percent women members are required to get permission for financial transactions.

2. Capital Requirement:

The minimum requirement to set up a FINGO is NPR 100,000 (around USD 1260).

3. Lending Limit:

FINGOs cannot lend more than NPR 60,000 (around USD 756) per group member. But recently NRB issued new license to 3 FINGOs mentions that credit ceiling per member household should be NPR 30,000 (around USD 378)[30]. This credit ceiling is lower than the microfinance development banks.

[①] Upreti, T.P. (2013). Review of Regulatory Issues in Microfinance.[C] (Paper presented in Microfinance Summit 2013, Nepal)

4. Financial Resources:

FINGOS are mobilizing both internal and external financial resources. These microfinance institutions are allowed to collect deposit from the members as internal financial resources and receive foreign financial resources as grants and soft loans. Some donor agencies and international NGOs are supporting FINGOs through technical assistance and capacity building. FINGOs can also receive preferential loans from the commercial banks and central bank managed Rural Self-Reliance Fund for on-lending to low-income households.

5. Transaction Restrictions:

FINGOs are licensed by central bank for "Limited banking transactions" on the basis of past performance. "Limited banking transactions" means only authorization for collecting deposit and providing credit service to the members but does not have permission to provide other banking services.

6. Transformation or upgrade:

In Nepalese microfinance history, some well performed FINGOs were transformed into microfinance development banks. Still, the proper guidance and regulation lack, for transforming FINGOs into microfinance development banks.

7. Tax Policy

Along with other banking and financial institutions the FINGOs have to pay 30 percentage corporate taxes to the government.

The FINGOs microfinance institutions are licensed for limited banking transactions so the central bank regulates only in few sector. According to government monetary policy, the NRB, central banks gave 'awarded opportunity' for FINGOs to upgrade as microfinance development bank though the regulatory rules are not so strong and tight for these institutions. Within the current regulatory framework, FINGOs are not getting enough space to provide variety microfinance services to the members.

3. Saving and Credit Cooperative Societies - SACOOS

Saving and Credit Cooperative Societies has a long credit history and widely available in nook and corner of the country. As per Cooperative Act 1992, SACCOSs are registered in department of cooperatives under ministry of poverty alleviation and cooperative. By nature, SACCOS follows the cooperative principles and norms so the SACCOSs are different from other microfinance institutions. However, some SACCOSs have been following the typical Grammen Bank model to extend banking services along with its own original method. SACCOS' operation method, principles, objectives are not same with other MFIs, so SACCOS are not considered as MFIs however here we take SACCOs as MFI. Those SACCOs whose business transaction volume is comparatively large have taken limited banking license from central bank. Only 16 out of 12000 SACCOS has got permission from the central bank. NEFSCUN is the national level apex institutions of SACCOSs and it is facilitating and giving technical support for Credit Union Microfinance Innovation (CUMI).

1. Incorporation Criterion

At least 25 persons from different families residing in the prescribed geographical areas and having consensus of applying principles of co-operatives can form SACCOS. According to act, SACCOS can be formed based on the mutual support and cooperatives for the economic and social development of the general public consumers by the farmers, craftsperson, class of people with low capital and low income, labors, landless and unemployed people or social workers of the country. Due to overflow of SACCOS, Nepal Rastra Bank has temporary stopped to register SACCOS in municipality, city area.

2. Capital Requirement

Initial registration capital is fully dependent upon the Bylaws of SACCOS. There is no any criterion for capital requirement to establish the SACCOS in Nepal.

3. Lending Limit

Still, there is not any lending limitation for SACCOS.

4. Financial Resources

Generally financial resource of SACCOS is capital and deposit collection from the members. NRB regulated SACCOS can mobilize resource up to 10 times of their share capital. According to NRB's directives, SACCOS can use the external borrowing as fund resources which should not be more than 15% of total assets.

5. Transaction Restrictions

SACCOSs are restricted to collect deposit and invest loan on non-members. If SACCOS desire to start other banking transactions other than saving and credit, they have to get permission from the NRB.

6. Transformation or upgrade

Still, there is lack of upgrade and transformation mechanism for the SACCOS. However SACCOS are applying its own self-regulation technique in case of upgrade or promotion of SACCOS. Recently, SACCOS are using the ACCESS (A-one Competitive Choice for Excellence in Service and Soundness) branding technique prescribed by Association of Asian Confederation of Credit Unions (AACCU).

7. Cash Reserve Ratio and Liquidity Asset

NRB regulated SACCOs have to maintain cash reserve of 0.5 percent and liquid asset ratio is 15% of total deposit amount.

8. Tax policy

SACCOs are cooperative based non-profit earing organization though the government has imposed 20% corporate tax for these institutions, which is not appropriate for community based cooperative societies.

9. Capital adequacy ratio

SACCOS has to maintain at least 10 % capital adequacy ratio.

From the policy perspective, Nepal Rastra Bank central bank of Nepal has given more space for microfinance development bank. Legal requirement and regulations are microfinance development bank friendly. Government and regulatory authority are giving priority to operate microfinance development banks. Recently central bank has stopped to give license for establishing new commercial banks, development banks and finance companies except microfinance development banks. Thus, many private investors diverted into microfinance development banks.

Section 2: National Microfinance Policy 2008

The government and central bank of Nepal issued 'National Microfinance policy' in May 4, 2008. The main aim of the policy was to assist poverty reduction through sustainable, easy and accessible microfinance service[①]. The policy aims to expand the lending capacity of its microfinance sector by addressing problems that have arisen from the relatively unregulated industry.

Foremost, Policy gave specific focus to form a separate "Second Tier Institution" for inspection and supervision of microfinance development banks, FINGOs and SACCOS undertaking limited banking transactions, which is regulated and supervised by the central bank. The formation of new institutional structure aims to timely regulate, supervise, monitor and evaluate the microfinance institutions for the institutional and sustainable development of microfinance institutions.

Secondly, to enhance credit to poor and deprived sector by expanding base of microfinance the policy proposed to establish autonomous microfinance fund named "National Microfinance Development Fund". "National Microfinance Development Fund" would serve to channel financial resources from local and international investors toward microfinance institutions. Till the date, the fund is not established however the central bank has submitted the draft act of National Microfinance Fund to the Government of Nepal.

Thirdly, this policy encourage to establish wholesale credit microfinance institutions from private and public sector by providing necessary help for the social

[①] Nepal Rastra Bank (2008). National Microfinance Policy 2008 mobilization and empowerment , institutional development and restructuring of those institutions.

Fourth, policy motivate the microfinance institutions to increase the access of microfinance to poor communities and mobilize saving on those communities.

The new policy create more flexible environment for deposit-taking microfinance institutions (MFIs), which can easily attract more commercial MFIs into the Nepalese microfinance industry.

Likewise，NRB is facilitating to build coordination mechanism to boost the microfinance access, technical strength and capacity of microfinance institutions with various poverty alleviation related programme and different microfinance service providers.

The endorsement of "National Microfinance Policy-2008" fulfill the gap between the policy and microfinance practice. It shows the bright future for the development of microfinance industry in Nepal. On the basis of microfinance policy, the NRB has drafted the "Microfinance Act" which can be named as an "Umberalla Act" for all the microfinance service providers; however it is in pending due to lack of legislative body. Hopefully, this act will furthermore create favorable environment for microfinance service providers and fulfill the legal and policy level gap in this sector.

Section 3: Problems in Nepalese Microfinance Sector

Microfinance in Nepal has two decades long history. It has crossed many difficulties, faced lot of challenges and now it is growing up in Nepal. Now, this sector is heading towards the institutional and sustainable development phase by strengthening legal and regulatory framework, policy support and institutional capacity building.

As in global scenario, Nepalese microfinance has also been facing some critical problems. The problems are inherited within microfinance institutions, technical support institutions, facilitator, coordination and network organizations and policy level. In short, the existing problems in Nepalese microfinance industry can be analyzed from Micro level and Macro level perspective.

1. The Micro Level: Microfinance service providers

In the past two decades there has been a rapid and huge expansion of micro level finance in Nepal, with the rapid growth of such grass hood level financial institutions has triggered some problems with such institutions.

1. Mission drift:

The growing number of such MFIs reflects its attraction, main attracting factor is obvious profit involved with it, such institutions are more focused towards the profit rather than the objective of serving poor and low income households. This has resulted as lack of focus on poverty alleviation which resulted as insufficient concern towards the betterment of poor households, which should had been the main agenda.

2. Heavy and cut throat competition

With the attraction and entrance of many new microfinance institutions there has been a heavy and unfair competition amongst such intermediaries. There are 24 MFDBs, 36 FINGOs, and 26501 SACCOSs till date in operation. Besides theses some of the A classed commercial banks have started to downscale its reach to make easy access to deprived sectors and also have started to run micro finance programs to the glass root levels. Whereas development banks and finance companies have initiated aggressive policy to collect deposit and finding new clients which in overall is unhealthy practice.

3. Urban and Terai area centered business:

Nepalese MFIs are following aggressive investment policy in urban and Terai parts of the country which is not the core focus area of such institutions. Such change in focus of the concentrated area has been the result of heavy profit reaping in such areas.

The popularity of such shift in location has caused of higher density of population, easy access of transportation and easy access of loan. This helps such MFIs to expand its market reach where microfinance banks have been serving. Such attraction has resulted as the consumers are well informed and knowledge about microfinance and its procedures, which help to save time, avoid the reinvention of wheels.

Table 6-6: Banking and Financial Institutions Branches in the Hills and Terai

Unit: in number

Banking and Financial Institutions	Hills	Terai	Total	Penetraion in Terai (%)
Commercial Banks	665	422	1137	37.12
Development Banks	264	224	488	45.90
Finance Companies	193	88	281	31.32
Microfinance Development Banks	**137**	**425**	**562**	**75.62**
SACCOs	7631	3097	10728	28.87
Total	8962	4256	13218	32.20

Source: Shrestha Purushottam (2013)

5. Duplication of member and multiple borrowing

With the growing number of institutions new trend of duplication of members have evolved along with it, same individual can take loan from more than one MFIs. Such trend is generating by MFDB's policy to issue more than NPR 20,000 to its first time borrower. Which is not sufficient to initiate any medium or small project at current market condition. As per the current scenario to establish microenterprise minimum loan capital of NPR 100,000 is required and current structure is far from this figure. To bridge such gap individuals seek to other MFIs.

Another issue would the attitude or strategy of the MFI's to attract more number of members and invest heavily on individual member who can yield higher profit within short time to the MFI's which is not as per the norms of the institutions. To show high & better performance result to get more fund from commercial bank's deprived sector loan and from wholesale lending institutions, some MFIs are blindly adding members. Hence, multiple borrowing became the issue which has been ignored by the MFIs with the motive of profit.

6. Increasing non-performing loan (NPL) ratio

Another serious issue would be the rise in non-performing loan ratios, as per the data up to mid-July 2012 the average NPL ratio was 2.4 in Nepalese microfinance industry amongst 23 MFDBs, which in general is not a big issue for the overall industry, when the issue is scrutinized it is seen that some of the institutions have NPL up to 5 to 54%[①] . Besides that few newly opened MFDBs has also high NPL ratio which is 9 to 94 percent that means they have both institutional and corporate governance problem. Being highly profit oriented is a serious issue on this matter.

7. Investment without identifying real clients/ poor households

At the recent time, new trend in investment for MFIs has just evolved, without proper identification of actual service holder, such MFIs has been disbursing loans without hesitation. It shows that MFIs have started to issue loans bluntly without proper identification and study behind the motive of the loans. On the other hand with reference to the such MFIs they have not been in operation as per the norms, where as some of them have not even conducted the central group meeting on regular basis, and even those who have conducted such meetings are just in papers not in actual, which has raised a serious question on foundation of such MFIs.

8. Problem in debt recovery procedure

There have been some errors in the operating procedure of the MFIs, ignoring the norms and criteria's for the operation has been seriously evade which has resulted as problem the recovery procedure. It's clearly seen that MFIs have not been following the Grammen Bank methodology though they are Grammen Bank replicator to collect deposit by not conducting group and central meeting. This caused due to lack of regular supervision form internal problems staff members. Furthermore, there is lack of interaction and communication between banks and borrowers which resembles weak follow up procedure.

9. Lack of competitive and professional human resource

Corporate and professional efficiency can be measured form the operating efficiency of any institute, if there is some problem with the institute there must be

[①] Pradhan, K. (2012-10-2). NPA Level Evaluation of Microfinance Development Banks. [N] retrieved from http://www.abhiyan.com.np/article-dristikone_16ashoj2069_laghubitta#.UQpH0eRhAoE problem with the available resource i.e. people working in it. Staffs working on such MFI's are quite passive in attitude, with low morale and not much hope for the further growth. This sector has not been able to attract much of the skilled human resources. It's important to communicate that microfinance is not only for saving and credit activities but also its one of the mechanism to empower rural and poor people. Its important to have the staffs who are dedicated and having social service attitude and social motivator or develop such skills in existing human resource.

10. Lack of professionalism in staff

Lack of professionalism is the serious problem in Nepalese MFIs. There are frequent strikes by staff in government initiated MFDBs and some well-established MFDBs as well. Some of the government initiated MFDBs are facing the problem of over staffing, which makes them less efficient and higher is cost. Interpersonal and public relations are the most important skills required by the staffs working in such MFI's with lack of such skills there cannot be proper communication. As a result, MFDBs are losing the positive impact and it also changing as 'Traditional commercial bank' from 'People's Bank' or 'Bank of Poor'.

11. Inadequate use of technology

To remain competitive and up dated in this modern society, there is need of innovation and use of new technologies available to improve the operating efficiency and minimize the cost as well as time which will result as corporate efficiency. Currently, most of the MFDBs are using old and traditional record keeping system, which is paper based. Being unaware about the changing technology is a serious threat to the institute as well. Such traditional systems of book keeping can be replaced by electronic systems by using different accounting and information software. The use of free/open source software can increase outreach of microfinance through small and large MFIs within a self-sustainable approach[1]. Similarly, inadequate use of technology to serve members such mobile banking service, door step service has also been the major emerging issue.

12. Lack of financial innovation and products

With the change in time and need of the society, MFI's need to develop new product as per the need of changing society. Which can we promoted with limited credit product such as individual lending, group lending, microenterprises loan. MFI's can strengthen its product length with the expansion of new types of credit package to attract more borrowers and similarly should initiate different types of saving schemes to attract more deposits.

13. Poor operating and financial performance of GIMFB

There has been huge difference between the operating efficiency of institutions operated by private sector and government, GIMFB have highly underperformed due to lack of common interest, and there has been huge political motivation rather than objectives of institutions. Government initiated MFDBs has poor operating performance which resulted as revenue earning of GIMFB is very low and it has been suffering from the loss and low productivity. It has been facing negative ROA and below the operating self-sufficiency level, due to such problems GIMFB has been privatized.

14. Low productivity but higher operating cost in GIMFB

Due to imbalanced operating procedure, productivity has been extremely low and cost of operation is very high. Mainly, due to over staffing cost has drastically increased and output has not been as expected. There are frequent occurrence of strikes, which is caused by weak command and control over the internal situation. As overall result GIMFB has higher cost per borrower and cost per loan.

---

[1] Augsburg, B., Phillip, P., Schmidt, J. and Krishanaswamy, K. (2009). *Free & Open Source Software for Microfinance: Increasing Efficiency and Extending Benefits to the Poor. Advanced Technologies for Microfinance Solutions and Challenges* (ed. Arvind Ashta).Business Science References, USA.Pp29

15. Investment in unproductive sector

Overall Nepalese banking and financial institutions are investing in unproductive sector, particularly in land and housing sector. Land and housing loan issued by SACCOS particularly urban centered SACCOS' lending in this sector is significantly high. It is against the norms and principles of cooperative and goal of poverty alleviation. As a result, the problem of asset price bubble was occured and NRB has to tighten the regulation criteria and control over high investment in land and housing loan.

Member passiveness, misusing SACCOS for individual benefit, ignorance of cooperative values and principles, lacking in deposit guarantee system and absence of inspection and weak internal control mechanism are some SACCOS specific problems.

2. Macro level problem: Government and Regulatory body

Nepalese Microfinance industry has been facing problems from the government and regulatory body level which is termed as macro-level problem. The macro level problems in Nepalese microfinance industry are presented below:

1 .Waive off microcredit loan:

Waive off the microcredit loan has become the tools for the political parties and government to direct support small farmers and victims of conflict and natural disaster, such quote sound quite reliving to individual but it causes devastating damage to the economy in long run by making the MFIs and banks hopeless and causing huge loss which might take much more years. During the year 2009, government decided to waive off loans up to NPR 30 thousand (USD 390) and interest of loans up to NPR 100 thousand (USD 1300) taken from state owned banks; Agriculture Development bank, Rastriya Banijya Bank, Nepal Bank Limited, Small Farmers Development Banks and five Rural Development Banks. Recently, same decision of waiving off loans up to the same amount of conflict victims, small farmers and victims of natural disasters is taken by government in February 21, 2013.

Microcredit borrower of private MFDB and FINGOs were not included in this waive off policy but these borrowers had also demanded for waive off such borrowers didn't repay intentionally the loan amount. Such, practice have developed wrong and unethical trend to raise the defaulters list.

2. High corporate tax

There has been unfair tax policy in relation the MFIs, which seems to be a burden to its growth and promotion by increasing its cost. MFIs are entitles to pay 30 percent of corporate tax as other banking and financial institutions, whereas 20 percent for SACCOS, such MFIs are not profit oriented financial institutions but the corporate tax is equal for all MFIs, with such huge burden of tax they can't operate at fullest efficiency. Such activity directly discourages MFIs with heavy tax burden should be minimize and need encouragement and motivation for establish Welfares MFIS.

3. Inadequate supervision and regulation

Without proper check and balance, none of the institutions can perform at its best, every institutions needs proper guidance and supervision, with lack of such cross check and balance malfunctions are frequent. MFDBs, FINGOs and SACCOS get permission from the NRB but the supervision is very weak in these areas without proper communication and updates its makes quite uneasy to perform as per the expectation. NRB has licensed to FINGOs and SACCOSs for limited banking transactions but NRB is unable to supervise them due to lack of proper mechanism. Some big SACCOSs are operating their business as finance companies. In addition, to protect the savers there is a need to regulate SACCOSs.

4. Delay in establishment of microfinance development fund

There has been tremendous delay in establishment of microfinance development fund, government have already declared on 2008 to establish microfinance development fund, decision made without proper planning and investigation show that Government has not been able to concentrate at this sector as it should had been. Which in long run would affect the overall economy not just the microfinance industry.

5. Lack of microfinance act

Without set of code of conduct and act it's quite irrelevant to expect much from the MFIs, without such concrete acts and guidelines none of the micro finance programs can be develop and flourish. Without appropriate legislative body it’s useless to keep any expectation for systematic operation of MFIs. Whereas, NRB has submitted its proposed microfinance act which needs to authorized after making necessary amendments if required.

6. Lack of proper coordination between poverty alleviation programme and microfinance.

There is deep relationship between poverty alleviation programme and microfinance; microfinance programs are operated with the objective to uplift the deprived sectors whose ultimate aim is also poverty alleviation. These two programs are correlated with each other which had trickledown effect if one is touched, without proper coordination and communication between poverty alleviation programme and microfinance anything done would be just waste of valuable resources.

7. Low interest rate in deprived sector loan

With provision of lower rate on interest to deprived sector it has indirectly forced MFDBs the competition , which might not be in the assistance for MFDBs. Currently, NRB is issuing deprived sector loan in annual 7% interest rate, the low interest charge is good for the poor households but it has create the indirect interest ceiling for all MFIs. In one hand, it gives pressure to minimize the interest rate; other hand, MFDBs are reaping high profit by utilizing these low interest bearing wholesale fund from NRB and investing it with high interest rate

8. Lack of financial access

It is estimated that only 35% Nepalese have banking access including microfinance services[31]. It shows that the banking and financial infrastructure is weak in Nepal. Expansion of financial access and financial deepening is challenging task for the government and relevant authorities.

Section 4: Policy Recommendation

For the sustainable development of Nepalese microfinance industry and resolve the existing problem in it, some remedial measures and few policy recommendations are presented below.

1. The Micro Level: Microfinance Service Providers

From micro-level perspective, microfinance service providers viz. MFDBs, FINGOs and SACCOSs have to bring some internal and managerial level improvement for better performance and development of MFIs. The possible remedial measures are listed below.

1. Financial product innovation

With the change and introduction of new products and services in financial sector to fulfil the demand of poor and low income households, MFIs also need to focus on financial innovation and new product design which can satisfy the need of poor households. Similarly, which the change process there should be introduction of modern concepts of micro insurance, agriculture sector insurance, mobile banking to make the easy access of banking needs and remittance service to wide reach.

2. Cooperation with rural financial institutions

As per the needs of advancing economy there is need of joint effort and cooperation between different types of financial intermediaries to fulfil the actual need of poor community. With the growing demand of MFIs, new concept of joint cooperation between MFIs, Agricultural Development Banks and Commercial Banks can be much fruitful. Such kind of cooperation will benefit the poor and low income level people with wider reach to credit and easy access at the grass hood level.

3. Build friendly and supplementary relationship with trade union

Trade unions have become quite popular with its indirect involvement in almost all the work forces. Most of the MFDBs have formed separate trade unions; such unions are backed by political parties and are usually try to fulfil the politically motivated policies. But, however it’s not possible to maintain distance from the unions, its needs to maintain smooth relation with such unions as well for better functioning. To ensure the sustainable development of MFDBs both trade unions and board of directors of the banks should cooperate and have friendly relation. Such harmonious relationships help to ensure timely and proper communication and better understand amongst each other. Internally, BOD should keep close concerns on staffs' welfare, their personality and interpersonal skills development and proper growth with the time. Similarly, staffs themselves also need to build ownership and their contribution for the institutions with well-defined visions and ideas.

4. Introduce new technology

With the changing time and demand of people, there is need of change of technology as well by replacing old one by new, both government and meso-level organizations should facilitate to bring new technology in microfinance industry. Introduction and application of new technology in MFIs will help to attract more clients and to strengthen its organisational capacity with quality services. With emerging new concepts of modern banking such as wire transfer, microfinance transactions via mobile phone, mobile banking, E-banking, remittance etc. should be brought in under the reach of general consumers of such institutions.

5. Research and development required in MFIs

The methodologies and techniques used in other countries might not be fully fit in Nepal. So, it’s full of diversity in terms of geographic and demographic condition one particular model cannot be suitable for whole country. Different models of MFIs might be needed to fulfill the needs of various regions and sectors of micro economy. Therefore, localization of the MFIs should be promoted as per the necessity and adequate structure. To expand outreach and business research and development practice should be develop, necessary research and study should be encouraged. To ensure the rapid growth both government as well as other regulatory bodies should assist financially and technically with available resources.

6. Develop employment based microcredit programs

The employment based microcredit programs should be developed and linked it with poverty alleviation target to address the poverty reduction strategy.[1] MFIs should design proper employment and income generating programs for improvement economic status of the borrowers. Development of entrepreneurship will support both borrowers and MFIs. It is necessary for the sustainable development of MFIs otherwise the possibility of unproductive and misuse of credit will be increased.

7. Strengthening the meso-level organization:

Building up a groups and associations of MFIs help to unite and create harmony amongst the MFIs which can give proper guidelines and directives to each other by sharing knowledge and experience of each other. Similarly, establishment of meso-level organizations helps MFIs with technical support and capacity building by sharing expertise amongst each other. Some meso-level organization such as Nepal Microfinance Bankers Association network of MFDBs, Microfinance Association of Nepal network of FINGOs, Nepal Federation of Saving and Credit Cooperatives Union Ltd network of SACCOS, Center for Microfinance for technical assistance are already in operation. Still there is lack of Microfinance Rating Agency and Microfinance Credit Information Bureau, thus MFIs as a principal actor should take initiative action to form these kinds of institutions. These networks and technical service providers help to build self-discipline and self-regulated mechanism.

8. Leasing of Agricultural equipment and machinery

It is true that most of the farmers in Nepal are economically poor who are unable to think of modern farming concept. They are still relying on traditional ways of farming which is less productive. In order to improve the productivity substantially, it is very essential to use modern equipment and machineries in agricultural production which seems to be more efficient, effective and productive. However, the bitter truth is that individual farmer is not in position to afford expensive machines alone. It is beyond their capacity. So, in this regard, MFIs can play a vital role in introducing essential but

[1] Mathema V. R. (2008). Microfinance in Nepal [M]. Pp 179

expensive machines and equipment in subsidised cost. MFIs can buy these expensive useful machineries and lease them. By doing so, the both parties will benefit from it. On the one hand, farmers could afford them and increase the production, and hence improve their economic condition. On the other hand, MFIs can get a good and long term investment environment which helps them to improve their financial condition.

9. Operation of Remittance services

Remittance inflow has become one of the financial sources for Nepalese households. Remittance income is contributing about 23% to overall country's GDP and approximately 55.85 per cent of total household is receiving remittance from abroad. Now days, money transfer service providers and some commercial banks are playing a bridging role between remittance sender and receiver. Moreover, migrant workers and students need pre departure loan and for this they use informal sources and semi-formal sources. NLSS-2011 shows that 79% of remittance income is being used in consumption while 7% is used in repayment. If MFIs can introduce this remittance services to its member, on the one hand, it helps to minimize the funding gap and on the other hand, it will encourage the remittance receiver for productive use of remittance and to develop microenterprises.

2. The Macro Level: Government and Regulatory Body

Government and regulatory body's role in promotion and expansion of microfinance services is essential and crucial. In order to solve the difficulties and problems of microfinance industry and to well develop microfinance sector, the following recommendation is proposed for government and regulatory body.

1. Relax tax policy

Tax imposed to the MFIs are directly affected with its operation since higher the tax there would be lower the return; however most of MFIs are not profit oriented but with a relaxed tax policy would be highly feasible for smooth functioning and encouraging of MFIs. It can be started by reducing current rate from 30 percent and 20 percent as corporate tax to somewhat lower than this. Such high rate of tax is similar to other industries and profit motive organizations.

2. Special promotion package

For promotion of new MFIs there should be new promotional programs, it should come in package to meet the higher demand of Microfinance intermediaries for grass hood level. Such urban area centered MFIs can be promoted to shift their focus to rural sector which has the actual need of such institutions. It can be done with different promotional programs such as some kind of tax reduction or exempt for short period of time, as like other deprived industrial sector it can heat up the pace up the distribution process.

3. Interest rate

There should be proper monitoring and control over the interest rate, since MFIs can't be a rival with other financial intermediaries which have strong financial foundation. It resembles that interest rate is out of regulation through deprived sector loan policy, loans issued by commercial banks and rural self-reliance fund is much cheaper which suppresses the market interest rate and compels the MFIs to operate at very low margin with least possibility of growth and improvement. Healthy rate of interest rate should be formulated so that borrower and MFIs both enjoys the win- win situation.

4. Government and political Interference should be avoided

Nepalese MFIs should learn from mishap of Government initiated micro finance banks. There has been unnecessary political and governmental interference in MFIs since it's directly related with the grass hood level which can be great reserve of votes during elections, to gain limited timed popularity government has been using such institutions as the means to persuade personal benefit of limited individuals. It has been developed as recruitment center for political followers.

5. Set up new rural financial institutions

Government should focus the need of such MFIs at the rural and remote areas to provide basic financial solutions to needy deprived sectors. With the growing credit demand and financial services in rural sector such general intermediaries needs to be expanded timely so that it can keep up the pace of economic betterment of the deprived sectors. From government level also there should necessary and timely focus on mobilization of new financial institutions in rural and remote areas. At current scenario, only Agricultural Development Banks has been performing its functions as financial institutions at such rural and agriculture sectors. MFIs can be developed as rural financial institutions with some concrete policies and amendments.

6. Opening up foreign capital

With the current financial structure of Nepal, no foreign direct investments are allowed to be associated with the micro level financing; there might be both pros and cons associated with the involvements of such investments. But for the betterment of the deprived sectors and reduce rural financing gap, direct foreign investment should be allowed with certain norms and criteria which will not demotivate the local level financial institutions. Like in China, development of Village and Township Bank structure should be promoted.

7. Build new criteria to differentiate commercial MFIs and non-profit MFIs

There should be different views to looks after the commercial and non-profit motive MFIs, since both the institutions have different agendas. At the recent time we can observe massive mission drift in microfinance industry which have become more of profit oriented and have been looking for easy credit and high interest rates rather than the deprived sectors. After restriction of opening Commercial Banks and Finance Companies, investor have started to divert into Microfinance Development Bank. Since commercial MFIs are more inclined towards the profit rather than the service to deprived sectors, they should be governed with different sets of rules and regulations. Likewise, allow commercial MFIs to go for Initial Public offering (IPO) and encourage to be listed in stock market. New regulations are to be introduces based upon the nature of the institution.

8. Supervision and regulation of SACCOS

There has not been proper monitoring and evaluation of MFIs under the SACCOS, since it is not under direct supervision of NRB, there are higher changes of occurrence of faulty transaction with the hidden motives of board members of the MFIs. Department of Cooperative is responsible for supervising SACCOSs but it lacks a proper mechanism and skilled human resources. So, it is necessary to build up strength and effective regulation mechanism under Department of Cooperatives too. Currently, only in 38 districts out of 75 districts, there is the Division Cooperative Office and in the remaining districts, operators of SACCOS should go to near districts for registration and so on. As being a regulatory body of SACCOSs, the Division Cooperative Office should be established in each and every district needs to strengthen its supervisory and regulatory role. Proper mechanism should be developed to maintain the check and balance to neutralize the occurrence of mischief.

9. Supportive legal and regulatory framework for meso-level institutions

There is immense need of supportive legal and regulatory framework for Microfinance Credit Information Bureau, since it's important to know the current status of microfinance institutions and their performance. Such Credit information bureau will help microfinance institutions to reduce the credit risk associated with the financial transaction with the review of history of individuals or the groups seeking for such micro credit. On the other hand, it also helps to minimize the chances of multiple borrowing and risky borrowings. In addition government regular support and encouragement for various MFIs' network is also essential.

10. Strengthening and regulating micro-insurance and agricultural insurance system

In Nepal, Agricultural insurance system is weak and still in primary stage. On one hand, farmers have lack of awareness and knowledge about agricultural insurance on the crops and livestock. On other hand, there is absence of agricultural insurance legislation and lack of clarity over the legal status of current informal crop and livestock insurance programs implemented by the MFIs. Thus, micro-insurance and agricultural insurance services provided by MFIs, does not supervise and regulated by insurance authority, Beema Sansthan. In order to serve rural and low income households and to strengthen insurance services, it is essential to formulate proper Micro-insurance policy and to establish effective regulatory and supervisory mechanism. Moreover, expansion and strengthening of existing agricultural insurance system can improve the repayment ability of farmers, thereby reducing loan risk and increasing their loan enthusiasm. The government and insurance board should permit to operate micro-insurance and the provisions of financial support to agricultural and micro insurance product should be formulated.

11. Allocation of tax received through MFIs in to separate fund

It has been clearly seen that MFIs have to pay an equal tax as other established banking and financial institutions and this provision seems to be unreasonable for MFIs. In order to minimize the heavy tax burden and assist MFIs, the author suggests that, the certain portion (about 50-60%) of the received tax can be utilized as the subsidized fund for MFIs which are working especially in rural and remote areas though the same amount of tax is received from MFIs as is collected from other banking and financial institutions. In this way, the government could motivate MFIs channelling such funds to serve the poor community better in remote areas.

12. Redefining Microenterprises or micro business

As per the current definition given by NRB, enterprises having capital not more than NPR 200,000 (around USD 2280), annual business transaction not more than NPR 2000,000 (around USD 22800) and staff having less than 10 are considered as microenterprises and micro business. Since last 10 years, annual inflation growth rate is around 10 percent in Nepal. Within the highly growing inflationary condition, NPR 200,000 is not enough to setup a well and sound micro-enterprises. In this condition, lot of possible micro-entrepreneurs are excluded from the MFIs to start micro enterprises. In order to establish a sound enterprise, capital amount of NPR 200,000 is not enough. So to encourage micro-entrepreneurs and to extend the MFIs credit area, it is suggested that the current criteria of defining micro-entrepreneurs in terms of capital, annual business transaction volume should be increased.

In general, there are lots of institutional and regulatory changes and improvements to be made in current rural and micro finance market. It's taking the pace but not as much as it should have excelled, still there are wide areas to be explored and practice new strategies with joint effort of government, private sector and foreign direct investment. Promotion of knowledge and benefits of micro financing is to be conducted to the targeted areas, so that deprived sectors would get detained information regarding micro finance.

On other hand, joint cooperation between different elements of the lending procedures should be made effective and efficient with skilled human resources as well as advancement in technological use. In order to address increasing credit and financial needs in rural market and to improve socio-economic status of poor and low income households, the government and regulatory authorities should establish and enhance necessary institutional mechanism with well-defined sets of rules and regulations.

SUMMARY AND CONCLUSION

Microfinance is a financial innovation which contains different financial and social services. The scope of microfinance is growing day by day. Generally, microfinance mainly covers the areas of credit, saving, insurance and remittance services. It is not only the financial product but also a tool of social transformation.

In many developing countries, microfinance is being used as a tool for poverty alleviation. The poverty alleviation programmes are linked with microfinance programme. However, the microfinance methodology is different among the countries. Theoretically microfinance institutions are guided by two approaches "Institutionalist" and "Welfarist". Poverty alleviation and economic upliftment of poor, low and middle income household are the primary goals of the MFIs which follow Welfarist approach. These kinds of microfinance institutions try to provide financial services with the lowest margin using donation, charity funds, and subsidies as major financial resources. In contrast, the followers of Institutionalist approach try to mobilize own financial resources and reduce the dependency upon subsidies and donation. These institutions try to obtain financial self-sufficiency level, and sustainability. The independency of these institutions is only possible after achieving financial self-sufficiency level. But, the entry of commercial microfinance institutions in microfinance industry began the new chapter in microfinance history. Some commercial microfinance practioners are supposed to be good follower of Institutionalist approach.

The author believes that commercialized MFIs are more than Institutionalist whose primary objective is to reap profit rather than obtaining sustainability. The author gives emphasis on financial sustainability of microfinance institutions for the long-term sustainability of financial institutions. A well developed, strong and large scale financial institutions are needed to provide better financial services for long-term with product innovation and new technology. In this high-tech century, technical advancement in MFIs is required to satisfy different financial needs of the rural, poor, low and middle income household and micro-entrepreneurs. It is observed that the misuse of subsidized loan, unproductive use of donation fund. Those institutions which are more dependent upon subsidies, grants, and donation have serious problems in institutional development.

Sometimes, donor agencies also put pressure to lunch programs as per their own plan and strategy. Poverty is not only the reason for the lack of financial accessibility and services, but overall socio-economic factors are also responsible for creating poverty. So, only providing financial services to the poor and low income households will not guarantee the task of socio-economic improvement of those groups.

The objectives of the research are to study the status and financial performance of Nepalese MFIs. We have also presented overall economic status of the country and discuss the financial system, problems in economic development and reviewed poverty alleviation programmes. In Nepal from the eight plan period, the poverty alleviation has been taken as a major task of the plan. Many policies and programmes have been designed to reduce the poverty size though the result is not satisfactory. There is a gap between policy and implementation. Implementation mechanism is weak and poverty alleviation policy was not set on the reality basis. To reduce the poverty and to generate self-employment for increasing the income level of the rural and poor people, agricultural credit and rural credit along with microfinance programme are being used in Nepal.

In Nepal, formal Saving and Credit Cooperative began date back to six decades ago with establishment of Cooperative Society. The establishment of Small Farmers Development Programme under ADB/N in 1975 is known as the beginning point of formal microfinance institutions. After year 2000 the MFIs grew significantly, SACCOS contributed more for this. Recently, NRB temporarily stopped to issue a new license to open Commercial Banks, Development Banks and Finance Companies, which makes investors divert into Microfinance Development Banks. But, the increasing number of Microfinance Development Banks brought the numerous numbers of malformations and malpractices in microfinance practice that contributes to the loss of the originalities and values of the real microfinance.

Basically, Nepalese MFIs are following Bangladesh's Grameen Bank group lending model. Microfinance Development Banks and FINGOs are Grameen Bank replicator whereas SACCOS have its own way of saving and credit practice though some SACCOSs are also replicating Grammen Bank lending model as a new product line. In informal market, ROSCA model in the name of Dhikuti is widely being practiced in urban and middle income level group. The blind copy of international model may not be suitable for other countries. So, for the effective operation of MFIs, they should be designed and promoted considering the local environment and the needs of local people. Likewise, Dhikuti type of informal groups should be brought into formal procedures. For this, regulatory body has to lunch appropriate legal and regulatory framework.

NRB's mandatory provision of deprived and priority sector lending requirement to the banking and financial institutions is directly supporting microfinance sectors. As a result, it minimizes the financing gap in rural area and microfinance sector. It has become the major financing source for MFDBs and FINGOs. However, the proper utilization of deprived sector investment is in doubt.

One of the main objectives of research is the financial sustainability analysis of Nepalese microfinance institutions. Seven parameters such as financing structure, operating performance, revenue, expenses, efficiency & productivity and risk management are taken into account for the analysis purpose. Data analysis results show that overall financial performance of PIMFB and FINGOs are sound; SACCOSs performance is in satisfactory level while GIMFB's performance is weak. Nepalese MFIs are allowed to collect deposit from the members though deposit collection is not effective but SACCOS other MFIs are not focusing in deposit collection from its own members. Dependency in external funding sources is high in Nepalese MFIs.

Remarkably, there is a huge gap between number of depositor and number of borrower in Nepalese MFIs. Limited members are active in credit transaction; the MFIs should encourage and motivate to its members to actively participate in credit program. Other than SACCOS, all MFIs are gender based and targeting to female members. Both governments initiated and privately initiated MFDBs are operating in large scale with covering large geographical area and outreach in large.

PIMFB and FINGOs have higher ROA and ROE ratio and their earning level is also higher than others. GIMFB has negative ROA and ROE ratio. So, institutional improvement is required in GIMFB. The government main stakeholder of GIMFB has adopted privatization policy and also sells its share to private investors. Recently, NRB is encouraging banking and financial institutions to go for merger procedure for developing strong financial institutions. So, the result of GIMFB's merger will easily affect the whole microfinance industry.

Nepalese MFIs are running in operational self-sufficiency level except problematic GIMFBs. Based on the empirical data, it is proved that the financial performance of Nepalese MFIs varies in accordance with the applied modalities of the MFIs.

Rural financing gap and poverty alleviation are existing challenges for emerging China. Chinese government and authorities are giving focus on "Sannong" problems concerning rural development. Establishment of new-type financial institutions and microcredit companies is important policy level decision taken by Chinese authorities, which supports to minimize financing gap in rural areas and increase financial inclusion.

The political and economic condition of China is different from the other developing countries. Microfinance practice in market socialist system is unique example for the rest of the world. Except poverty alleviation program and commercial banks, five major financial institutions are providing microfinance services in China namely NGO-MFIs, Microcredit companies, VTBs, RMCCs and RCCs.

In China, microcredit refers to farming household, small private business and microenterprises loan and loan up to 300,000 Yuan (USD 48,000) is considered as microcredit, this loan size is comparatively larger than the other developing countries. The unique feature of Chinese rural economy is rural farmers do not own land property and land belongs to local government. Generally, formal traditional commercial bank do not issue loan without reasonable and adequate collateral. In this condition, microfinance without collateral lending programme is strongly supporting rural households in China.

Theoretically, financial repression in the form of controlling interest rate leads to stagnant financial development and further seriously restricts the financial development in developing economy. In China, interest ceiling is fixed for MFIs up to four times of basic interest rate. From the philosophical approach, microfinance is a service business targeting to uplift socio-economic status of poor, low and middle income people. Microfinance borrower should prevent from excessive usury imposed by commercial MFIs. In this base, the interest cap on lending for MFIs in China is reasonable but for deposit taking institutions interest cap should not be imposed. In the case of financing gap, capping on interest rate will add more funding gap. So, to attract more investment and smooth flow of fund in market, free market interest rates should be encouraged instead of interest cap.

Chinese microfinance has modified different international microfinance model on the basis of local conditions and necessities. Commercial MFIs are growing quickly in China. So, balance between the microfinance mission of serving poor people and financial sustainability should be maintained.

In order to promote and encourage more MFIs in rural area, Chinese government should adopt a relax tax policy, remove discriminating tax and interest cap policy, and permission should be given to collect deposit from members and government intervention must be avoided for the smooth operation of MFIs.

The innovative approach of 'Sannong' to deal with rural development issue, establishment of new-types rural financial institutions to provide more financial services in rural area, the promotion policy for RCCs and MCCs, microfinance link with banks and permission given to foreign investment in rural and microfinance sector are the major lessons of rural and microfinance in China, which are also useful for other developing economies.

The research has also set objectives of policy recommendation for sustainable development of micro finance institutions in Nepal. In micro-level (Microfinance service providers), MFIs should pay attention to product innovation, build cooperation with rural financial institutions, introduce new technology, research and development, reduce dependency on deprived sector loan and grants from donor agencies, and build incentive system for both members and staff. Leasing of agricultural equipment and machinery to the farmers may be good and new financial products for MFIs.

Furthermore, supervision and regulation of growing number of SACCOS is required; relaxed tax policy should be adopted; special promotional package should be developed to encourage and extend microfinance services in rural and remote areas. Moreover, setting up new rural financial institutions and opening up foreign capital to meet financing gap is highly recommended. In order to minimize the heavy tax burden and assist MFIs, the author suggests that the certain portion of the received tax can be utilized as the subsidized fund. There is a need of a policy that differentiates commercial MFIs and non-profit MFIs and allows commercial MFIs to go for IPO. In addition, need to formulate legal and regulatory framework for meso-level organizations viz. associations, technical service providers, information bureau etc. for enhancing self-discipline, self-regulation and technical support. The most important thing is the enactment of Microfinance Act which gives more legal and regulatory space to foster MFIs and setup pre-announced Microfinance Development Fund for the development of overall microfinance sectors.

Information asymmetries and higher transaction costs are major problems to financial institutions in financing rural areas and poor households; consequently the adequate capital is not flowing from the rich to poor. The entrant of MFIs in financial market, particularly in rural financial markets is helping to the flow of capital and fund into rural and poor households. Due to these problems, different kinds of MFIs have been emerging against traditional money lenders and formal banking and financial institutions.

Informal financial sectors have lower costs and lower information asymmetry, while formal financial sector have higher costs and higher information asymmetry. Moreover, formal financial institutions have higher risk of adverse selection and moral hazards (Ex-ante moral hazard and Ex-post moral hazard). The higher the level of institutional formalization, lead to the higher problem of information asymmetries, risk of adverse selection, moral hazards and transaction costs and vice versa.

The cost of supplying financial services to MFIs is dependent upon the location of the MFIs. The cost of supplying financial service to MFIs is higher in rural and remote area than in urban areas. Client and borrowers are also dispersed and population density is very low in rural areas than the urban areas which increase the transaction costs for MFIs. Those higher transaction costs often cannot be fully covered through the interest charges. It creates additional challenges for the MFIs which are serving in rural and remote area and it forces them to seek for subsidies and donation fund. Generally, while discussing about MFIs, the hidden cost of borrowers or members are ignored. In group lending modality, particularly in Grammen Bank model, a borrower or member has to spend a long time in regular group meetings, branch meetings and also they need to spend time to build relationship with banks and bank personnels. Of course, these factors increase the opportunity costs for the members. Middle income and micro entrepreneurs are comparatively sensitive on opportunity cost, and in order to minimize opportunity costs they prefer individual lending and avoid regular group meetings.

From these information asymmetry, adverse selection, moral hazards transaction cost and opportunity cost perspective, based upon this research, the author suggests and proposes a suitable MFIs and best microfinance modality for different income groups (Table: 8-1). The Government or donor agencies subsidized poverty alleviation programs, non-profit MFDBs and FINGOs are suitable for extremely poor community. To provide financial services in this group for MFIs transaction cost is comparatively higher and extremely poor communities have to bear less opportunity cost in group lending method. So, the author recommends that 'Poor Household + Poverty Alleviation Programme/Development project + Group lending' modality can be applied for extremely poor communities. Extremely poor household need special subsidized program from government or donor agencies to meet the demand of consumption and income generating loan. To minimize the credit risk, group lending method may be useful.

Likewise, SACCOS, FINGOs and MFDB (both non-profit and commercial) are suggested for moderate poor and low income households. Particularly SACCOS is recommended for hill and remote areas where population is scattered and regular centre meeting (Grameen Bank method) is not convenient. For this group; "Moderately Poor/low income household + Third party involvement +Group/individual lending" modality is prescribed. Third party such as business enterprises, companies or local community organization's involvement in microfinance will solve the collateral problems and support to linkup with market. To minimize the opportunity cost of borrowers, individual lending can be applied for this group.

MFDB and commercial banks could be suggested for middle income and micro-entrepreneurs. Middle and micro entrepreneurs need large scale loans for comparatively long period. Due to transaction of comparatively large scale loans, the transaction cost is comparatively lower in this group. So, many private and commercial MFIs easily enter in to this market segment. Likewise, clients from this group are comparatively financially literate too and many of them have already possessed their own business or enterprises. From this perspective, MFDB and commercial banks prescribed for this services to this group. "Household/entrepreneur + Company + Bank + Individual lending" modality could be used for this group. Middle income people and microenterprises do not want to involve in group lending so individual lending may be more effective for them.

In order to address the financial needs of socio-economically diversified community, different varieties of microfinance models should be adopted. For mountainous and hill region where people are scattered and the physical infrastructure is not enough, the cooperative model is more suitable. Strengthening community based institutions and mobilizing financial resources from those organizations might have good economic impact in the society. Microfinance linked up with local community group, production unit (factory, company), insurance companies and formal banking and financial institutions will contribute to sustainable development of Nepalese microfinance institutions and economic improvement of low and middle income households as well.

Table 8-1: Proposed Microfinance Institutions and Modality for Different Income Level people

Income Level / Financial Needs	Extremely Poor	Moderately poor and Low Income	Middle Income and Micro Entrepreneurs
- Consumption Loans: Livelihood and Emergencies	Subsidized poverty alleviation programs		
- Income generating loan	- Non-profit MFDB - FINGO	- Non-profit MFDB - FINGO	
- Saving : Safety and Investment - Credit : Productive and agricultural loan		- SACCOS - Non-profit MFDB	
- Insurance: Life, accident, farming, livestock - Remittance and transfer		- Non-profit MFDB - Commercial MFDB	- Non-profit MFDB - Commercial MFDB
-Micro enterprises loans			-Commercial MFDB -Commercial Banks including policy banks
Proposed Modality	**1**	**2**	**3**

Source: The author

Proposed Modality

No.1: Poor Household + Poverty Alleviation Programme/ Development Project + Group Lending

No.2: Moderately Poor/Rural Household + Third Party Involvement (Enterprise or company) + Group/Individual Lending

No.3: Household/Entrepreneur + Company + Bank + Individual Lending

Notes

1. Gilbert, M. (2010.04.15). Poverty: Half the Worlds Lives on Less than $ 2.50 a Day [N]. Available at http://newsjunkiepost.com/2010/04/15/poverty-half-the-world-lives-on-less-than-2-50-a-day/
2. Shantayanan, D. and Ijaz, N. (2006)." Economic Growth in South Asia: Promising, Un-equalizing,…Sustainable?"[R], South Asia Region World Bank. Pp 3. Available at http://siteresources.worldbank.org/SOUTHASIAEXT/Resources/South_Asia_growth_June_2006.pdf
3. IFAD (2011). Rural Poverty Report 2011: Facts and Figure http://www.ifad.org/rpr2011/media/kit/factsheet_e.pdf
4. Central Bureau of Statistics, Nepal (2012). National Population and Housing Census 2011. Vol 1
5. Central Bureau of Statistics, Nepal (2011). Nepal in Figures 2011
6. Nepali Times ((2010-12-17)). Helping Workers Abroad [N].Retrieved from http://nepalitimes.com/news.php?id=17743 (2010-12-17)
7. Nepalese Economic Review (2009). Retrieved from http://www.ner.com.np/vol-1/issue-1/59-understanding-nepals-economy-and-expediting-growth.html (2009-06-15)
8. Himalyan News Service (2012). More Financial Institutions opt for mergers [N].Retrieved from http://thehimalayantimes.com/fullTodays.php?headline=More+financial+institutions+opt+for+mergers+&NewsID=354732 (2012-11-27)
9. Department of Cooperatives (2012). Statistical Data of Nepalese Cooperative Societies 2011/12
10. Wikipedia. http://en.wikipedia.org/wiki/Five-Year_Plans_of_Nepal
11. Shrestha, P.(2007). Financial Performance of Microfinance Institutions with Special References to Small Farmers Cooperatives Limited (SFCL) in Nepal.[D] Tribhuvan University, Kathmandu.

12. National Bureau of Statistics of the People's Republic of China (2012). China Statistical Yearbook 2012. Beijing, China Statistics Press.
13. The World Bank (2012.10.09). http://data.worldbank.org/country/china 2012.1.15. China Daily. 100 million in poverty by new standard [N]. 2011-04-02
14. National Bureau of Statistics of the People's Republic of China (2012). Income of Urban and Rural Residents in 2011. Retrieved from http://www.stats.gov.cn/english/pressrelease/t20120130_402787464.htm
15. National Bureau of Statistics of the People's Republic of China (2012). Income of Urban and Rural Residents in 2011. Retrieved from http://www.stats.gov.cn/english/pressrelease/t20120130_402787464.htm
16. The World Bank (2012). Retrieved from http://www.worldbank.org/en/country/china/overview (2012.1.15)
17. The World Bank (2012). Retrieved from http://www.worldbank.org/en/country/china/overview (2012.1.15)
18. Hu, S.(2009-2-17). China Digs Deeper for 'San Nong' Reform[M]. Caijing. Available at http://english.caijing.com.cn/2009-02-17/110069816.html
19. Bijukchhen, N. M. (2010). People's Commune in China [M] 2010. Workers Publications. Nepal, Pp 19
20. Wu,L., Sui, F. and Zheng, L.(2010). China's Economy [M]. China Intercontinental Press
21. Chan, Y. L., Chau, Y.Y., Chow H.Y. and Li, Y. L. (?). Microfinance in China [J]. Available at http://www.microfinancegateway.org/gm/document-1.1.9059/Microfinance%20in%20China.pdf
22. ichinaforum (2012). Fighting Poverty from the Trenches: Micro Finance in China [I] http://www.ichinaforum.com/interviews/fighting-poverty-trenches-micro-finance-china?goback=%2Egde_3151440_member_58239443 (2012-3-3)
23. People's Bank of China(2010). Microfinance Bulletin 2009/10. Economic Science Press. Beijing
24. Du, X.S. (2008a). The Current supply of Microfinance in China [J].World Microfinance Forum Geneva

25. China's Shifting Microfinance Landscape: New Players, Old Problems. http://www.knowledgeatwharton.com.cn/index.cfm?fa=printArticle&articleID=1762&languageid=1 (2013-1-12)
26. Li, X. (2012-11-04). China's peer-t-peer online lending raises risks [N]. http://www.marketwatch.com/story/chinas-peer-to-peer-online-lending-raises-risks-
27. Joint Association of Jilin Province Women's Federation and Jilin Province Rural Credit Cooperatives "Notice on carry out Microcredit promotional and Income generating activities" Ji Fu (2005) No. 32
28. It is uncertain whether this means by the villager themselves of whether township governments which each control several villages, exercise these collective rights on behalf of the peasants has belonged to the people, who were represented by the government. (China Grapples with Thorny Issue of Rural Land Rights. 2013-03-22. http://chinagate.cn/english/choice/48618.htm)
29. Nepal Rastra Bank (2011).Unified Directives-2011
30. Shakya, P. (2013). Issues, Challenges and Transformative Strategies for FINGOS. (Paper presented in Microfinance Summit 2013) Nepal.
31. Nagarik News (2010-09-12). Supervision of Microfinance, NGOs and Cooperatives is start from new department. retrieved from http://archives.nagariknews.com/2010/economy/banking-money/18157-2010-09-12-05-48-39.html

Bibliography

Monographs:

1. Armendariz de Aghion, B. and Morduch, J. (2005), *The Economics of Microfinance*.[M] The MIT Press Cambridge, England
2. Augsburg, B., Phillip, P., Schmidt, J. and Krishanaswamy, K. (2009). *Free & Open Source Software for Microfinance: Increasing Efficiency and Extending Benefits to the Poor. Advanced Technologies for Microfinance Solutions and Challenges* (ed. Arvind Ashta).Business Science References, USA.
3. Bruce, E. M. (2010): *The Great Divide in Microfinance: Political Economy in Microcosm, in Todd A. Watkins, Karen Hicks (ed.)* [M]Moving Beyond Storytelling: Emerging Research in Microfinance (Contemporary Studies in Economic and Financial Analysis, Volume 92), Emerald Group Publishing Limited.
4. Cao, Z. (2008). *China Microcredit Development Research. [M] China Economic Time* Press. Beijing.
5. Dowla, A. and Barua,D. (2006). The Poor Always Payback: The Grammen II story. [M].Kumarian Press, Inc. USA.
6. Dowla, A. and Barua, D. (2006), *The Poor Always Pay Back: The Grameen II Story.* [M] Kumarian Press, Inc., United States of America
7. Helms, B. (2006). *Access for All: Building Inclusive Financial Systems* [M]. CGAP.
8. Khan, D. A. (2009), *Microfinance and Rural Development.* [M] *Banking, Micro Finance and Self-Help Groups (SHGs) in India*, ed, A. Vijaykumar. New Century Publications, Ireland.
9. Legerwood, J.(1999), *Microfinance Handbook:An Institutional and Financial Perpective.* [M] The World Bank, Washigton,D.C., United States of America
10. Manfred , Z. and Meyer R.L. (2002). *The Triangle of Microfinance : Financial Sustainability, Outreach, and Impact* [M].The Johns Hopkins University Press, UK.
11. Mathema, V. R.(2008). *Microfinance in Nepal[M].*

12. Princeton University Press (2009). The Princeton Encyclopedia of the Economy. [M] United Kingdom.

13. Br igit, H. (2006), *Access for All: Building Inclusive Financial Systems*. [M]The World Bank, Washington D.C., USA.

14. Sachs, D. J. (2005), *The End of Poverty*. [M] Penguin Books

15. Sapovadia, V.,Patel, K. and Patel, S. (2010). *Micro Finance Models Across the Globe*. [M]. Lap Lambert Academic Publishing, Germany.

16. Shrestha, M. K. and Bhandari, D. B. (2004). *Financial Markets and Institutions* [M]. Asmita Books Publishers and Distributor, Kathmandu.

17. Vrajalal,S., Kandarp, P. and Patel, S. (2010). [M].Lap Lambert Academic Publishing AG & Co.KG , USA.

18. Wen, Y. C. and Yan ,G.J. (2006). *Western Financial Theory* [M]. Commercial Press,Beijing.

19. Yunus, M. (2007). *Creating a World Without Poverty.* [M].Public Affairs New York, United States of America.

Journals:

1. Acharya, Y. P. and Acharya, U. (2006). Sustainability of Microfinance Institution from Small Farmers' Perspective: A Case of Rural Nepal.[J] *International Review of Business Research Papers* Vol.2 (2),117-126

2. Agrawal, P. K. and Sinha, S.K. (2010). Financial Performance of Microfinance Institutions of India- A Cross Sectional Study. [J] *Delhi Business Review* Vol.11 (2), 37-46

3. Al-Haidi, A. M. (2009). Evaluating the Self-Sustainability of (MFIs) Using the Balanced Scorecard Approach [J]. Available at http://www.microfinancegateway.org/gm/document-1.9.41541/printing%20edition%201.pdf

4. Ayayi, A. G. (2010), What Drives Microfinance Institutions Financial Sustainability. [J] *Journal of Developing Areas*, Vol.44, No.1 Pp.303-324.Teneessee State University College of Business, USA.

5. Ayyagari,M., Demirguc-Kunt, A. and Maksimovic ,V. (2010). Formal versus Informal Finance: Evidence from China.[J]. *The Review of Financial Studies*. Vol.23 (8) 3048-3097 doi;10.1093/rfs/hhq030
6. Baarda, R. J. (2006). Current Issues in Cooperative Finance and Governance. [J] http://uwcc.wisc.edu/info/governance/baard.pdf
7. Berguiga, I. (2008). Social Performance Vs. Financial Performance of Microfinance Institutions. [J] Available at http://www.gredeg.cnrs.fr/Colloques/NFI/Papers/PapierOnLine/Berguiga.pdf
8. Bhusal, B. P. (2011). Developments and the Current State of Financial System in Nepal.[J] *The Keizai Ronkyu*. Vol. 139, 121-143
9. Bisen, A., Dalton, B. and Wilson, R. (2012). The social Construction of the Microfinance Industry: a comparison of donor and recipient perspectives. [J].*Cosmopolitan Civil Societies*. Vol.4(2), 62-83
10. Bogan, V. (2012). Capital Structure and Sustainability: An Empirical Study of Microfinance Institutions. [J]. *The Review of Economics and Statistics*. Vol.94,(4) 1045-1058
11. Bystrom, H. (2007). Structured Microfinance in China.[Working Paper] Lund University, Lund, Sweden. http://www.nek.lu.se/publications/workpap/Papers/WP07_18.pdf
12. Christen,R. and Drake,D. (2001). Commercialization of Microfinance [R]. Available at http://mfbbva.org/uploads/tx_bbvagbmicrof/Commercialization_of_Microfinance.pdf
13. Dacheva , P.(2009). Commercialization in Microfinance -A Study of Profitability, Outreach and Success Factors within the Latin American Context. [J]. Available at http://sbc.edu/sites/default/files/Honors/PDacheva.pdf
14. Dhakal, N. H. (2007), Emerging Issues in Nepalese Micro Finance Sector. [J] *Socio-Economic Development Panorama*. Vol. 1 (2), 35-46
15. Dokulilova, L., Janda, K., Zetek, P. (2009). Sustainability of Microfinance Institutions in Financial Crisis.[J] *Munich Personal RePEc Archive*, Germany. Available at http://mpra.ub.uni-muenchen.de/17696/1/MPRmifcr.pdf

16. Duwal, B. R. and Sun, S.Y. (2013). Research on Rural Financing in China with Reference to Village and Township Banks: An Overview [J]. *International Journal of Business and Management.* Vol. 8(4), 75-84
17. Hamada, M. (2010). Financial Services to the Poor: An Introduction to the Special Issue on Microfinance [J]. *The Developing Economies*. Vol.48(1), 1–14
18. James C. B. and Bary M. W. (2004): Microfinance: A Comprehensive Review of the Existing Literature. [J] *Journal of Entrepreneurial Finance and Business Ventures.* Vol. 9 (1), 1-26
19. Janat, P. A. (2009). Microfinance Institutions in Rural Development and Poverty Alleviation: The Bangladesh Perspective. [J]. *Theoretical and Empirical Reseraches in Urban Management*. Vol.2 (11), 112-133.
20. Kayastha, R. (2012). Small Farmers Cooperative Limited (SFCL) model: Appropriate Community-Based Microfinance Institution in Nepal. [J] *Yokohama Journal of Social Sciences.* Vol. 17(3), 131-140
21. Nargiza, M. (2010). Contribution of Microfinance to Financial Sector Development and Growth. [J]. Available at http://www.microfinancegateway.org/gm/document-1.1.8998/Contribution%20of%20microfinance.pdf
22. Park, A. and Ren, C. (2001). Microfinance with Chinese Characteristics. [J] *World Development*, Vol.29, (1), 39-62
23. Pissarides, F. N. (2004). Sustainability of Microfinance Banks: the Ultimate Goal [J]. from *European Bank for Restruction and Development*. Available at www.ebrd.com/pubs/legal/lit032c.pdf
24. Rhyne, E. (2011). The Yin and Yang of Microfinance: Reaching the Poor and Sustainability. [J] Available at http://www.jointokyo.org/mfdl/readings/Rhyne-yingyang.pdf
25. Schicks, J. (2007). Development Impact and Coexistence of Suitable and Charitable Microfinance Institutions: Analyzing Bancosol and Grameen Bank. [J].*The European Journal of Development Research*. Vol. 19(4), 551-568
26. Schreiner, M. and Colombet G., (2001), Aspects of Outreach: A framework for Discussion of the Social Benefits of Microfinance [J]. *Journal of*

International Development. Vol. 14. Available at http://www.pdfio.com/k-1124301.html

27. Shil, N.C. (2009), Micro Finance for Poverty Alleviation: A Commercialized View. [J] *International Journal of Economics and Finance* Vol.1(2), 191-205
28. Sudaresan, S. (2008), The changing landscape of microfinance. [J] *Microfinance: Emerging Trends and Challenges*, ed. Suresh Sundaresan, Edgar Elgar Publishing Limited, UK. Pp.1-24
29. Sun,S. Y. (2008). Research on the Sustainable Development of Rural Bank in Jilin Province.[J].*Northeast Asia Forum*, Vol. 17(6), 62-65
30. Swope, T. (2005), Microfinance and Poverty Alleviation. [J] *Rollins Undergraduate Research Journal.* Vol.1(1) ,1-61
31. Thapa, G. (2006), Sustainability and Governance of Microfinance Institutions: Recent Experiences and Some Lessons for Southeast Asia.[J] *Asian Journal of Agriculture and Development*, Vol.3 (1&2), 17-38
32. Vetrivel, S.C. and Kumarmangalsam, S.C. (2010): Role of Microfinance Institutions in Rural Development. [J] *International Journal of Information Technology and Knowledge Management*. Volume 2, (2), 435-441
33. Xia, J. and Han, T. (2004). The History and Future of Financial Development Theories:A Revies. [J]. *China Public Administration Review*, Vol.1, 177-197

Conferences and Reports:

1. Asian Development Bank (2009). 'Financial Sector Development, Economic growth, and Poverty Reduction: A Literature Review'. Working paper
2. Barr, M.S. (2005*), 'Microfinance and Financial Development' University of Michigan Law School,* The John M. Olin Center for Law & Economics Working Paper Series, 2005 pp 285
3. Befekadu B. K. (2007). *Outreach and Financial Performance Analysis of Microfinance Institutions in Ethiopia.[C]*African Economic Conference United Nations Conference Center (UNCC), AddisAbaba, Ethiopia
4. China Banking Association (2011). *Research on the Development of Village and Township Banks in China*.[working paper]

5. Department of Cooperatives (2010). *Statistical Data of Nepalese Cooperative Societies 2009/10*
6. Department of Cooperatives (2011). *Statistical Data of Nepalese Cooperative Societies 2010/11*
7. Department of Cooperatives (2012). *Statistical Data of Nepalese Cooperative Societies 2011/12*
8. Du, X.S. (2008a). *The Current supply of Microfinance in China* [R].World Microfinance Forum Geneva
9. Du, X.S. (2008b). Microfinance in China [R]. World Microfinance Forum Geneva. Pp4
10. Gemech, F. and Struthers, J.(2003). *The Mckinnon-Shaw Hypothesis: Thirty Years on: A Review of Recent Developments in Financial Liberalization Theory.* [C] University of Paisley Pp 2.
11. Government of Nepal, Ministry of Finance (2012). *Economic Survey Fiscal Year 2011/12* [R]. Kathmandu.
12. He G., Du X, Bai C., Li Z. (2009). *China Microfinance Industry Assessment Report.*[R] China Association of Microfinance. Pp 43
13. Hellmann, T., Mudock, K. and Stiglitz, J. (1996). *Deposit Mobilization Through Financial Restraint.* [C] Pp 4.
14. IFAD (2011). *Rural Poverty Report 2011: Facts and Figure* [R] http://www.ifad.org/rpr2011/media/kit/factsheet_e.pdf Pp 5
15. Li, L.L. (2008), *Poverty and Sustainability Issues of Microfinance in China: A Case Study in Fu'an, Fujian Province working paper.* Centre for East and South-East Asian Studies, Lund University, Sweden
16. Ministry of Finance (2007). *Economic Survey 2006/07*
17. Ministry of Finance (2008). *Economic Survey 2007/08*
18. Ministry of Finance (2009). *Economic Survey 2008/09*
19. Ministry of Finance (2010). *Economic Survey 2009/10*
20. Ministry of Finance (2011). *Economic Survey 2010/11*
21. Ministry of Finance (2012). *Economic Survey 2011/12*
22. Ministry of Finance (2006). *Economic Survey 2005/06*

23. National Planning Commission (1992). *Eight Plan (1992-1997)*. Kathmandu.
24. National Planning Commission (1997). *Ninth Plan (1997-2003)*. Kathmandu.
25. National Planning Commission (2002). *Tenth Plan (2003-2007)*. Kathmandu. Unofficial Translation
26. National Planning Commission (2007). *Three Year Interim Plan (2007/08-2009/10)*, Kathmandu. Unofficial Translation.
27. Nepal Rastra Bank (2008). *National Microfinance Policy 2008*
28. Nepal Rastra Bank (2011). *Banking and Financial Statistics* Mid-July 2011. No. 57
29. Nepal Rastra Bank (2012). *Banking and Financial Statistics.*
30. Nepal Rastra Bank (2012). *Monetary Policy 2011/12*
31. PBOC (2011). *Microfinance Bulletin 2010/11*. Economic Science Press. Beijing
32. Rural Microfinance Development Centre Ltd (2009). *Annual Report 2008/09*
33. Rural Microfinance Development Centre Ltd (2010). *Annual Report 2009/10*
34. Rural Microfinance Development Centre Ltd (2011). *Annual Report 2010/11*
35. Rural Microfinance Development Centre Ltd (2012). *Annual Report 2011/12*
36. Sana Kisan Bank Limited (2011). *Annual Report 2010/11*
37. Sana Kisan Bank Limited (2012). *Annual Report 2011/12*
38. Sapkota, S. (2008), *Micro Finance and Its Role in Alleviating Rural Poverty in Nepal: A Socio-economic Analysis (Case study of Hill and Terai Region)[R].* Pakistan Institute of Development Economics, Islamabad, Pakistan. Pp 43
39. Shrestha , P. (2013). *Improving Access to Microfinance Services in the Hills and Mountains of Nepal.* (Conference Paper). Microcredit Summit 2013, Nepal.
40. Shrestha, S. M.(2009). *State of Microfinance in Nepal* [R]. Rural Microfinance Development Centre Ltd. Kathmandu.
41. Thapa, G. B. (2013). *State of Microfinance: Social Responsibility and Sustainablity.*[C] (Paper presented in Microfinance Summit 2013, Kathmandu)
42. The International Bank for Reconstruction and Development Agriculture & Rural Development Department (2003*). Rural Financial Services: Implementing The Bank's Strategy to Reach the Rural Poor* [R]. Washington DC. Pp 17
43. The SEEP Network (2005). *Measuring Performance of Microfinance Institutions: A Framework for Reporting, Analysis, and Monitoring*. [R] USA Pp 74

44. The SEEP Network (2006), *Microfinance and Non-Financial services for very poor people: Digging Deeper to find keys to success.* [Working Paper] Poverty Outreach Working Group
45. Upreti ,T. P. (2013). *Review of Regulatory Issues in Microfinance*. [C] (Paper presented in Microfinance Summit 2013, Nepal
46. Working Group on Inclusive Finance in China (2010). *Microfinance Wholesale Funds: The Case of China*.[working paper]

Dissertations:

1. Aimi (2009). *Microfinance and Rural Poverty in China* [D].Jilin University. Pp 46
2. Guo, Q. L. (2008).*The Study on Microcredit in the Inclusive Financial System: The Investigation Based on the Experiences of Developing Countries* [D]. Jilin University
3. Neupane, S. R. (2006), *Co-operative Movement: A People Based Development approach, Its Role in the Economy of Nepal* [D].
4. Osthoff, J. (2005). *Is Microfinance an Effective Development Tool in the context of Poverty Alleviation? Evaluating the Case of Rural China* [D]. University of Birmingham
5. Shrestha P. (2007). *Financial Performance of Microfinance Institutions with Special References to Small Farmers Cooperatives Limited (SFCL) in Nepal*.[D] Tribhuvan University, Kathmandu
6. Svensson, E. (2007). *Microfinance, Financial Systems and Economic Growth-A Theoretical Framework and Findings from Bolivia*. [D] Lund University.

Newspaper:

1. Beijing Review (2013). *For the Sake of Sannong* [N].2013 Vol 3
2. Du, X. (2012-4-26): *Microfinance Institutions Should not be Purely Commercialized* [N]. Available at http://bank.hexun.com/2012-04-26/140831777.html
3. Hu, S. (2009-2-17). *China Digs Deeper for 'San Nong' Reform* [N]. Caijing http://english.caijing.com.cn/2009-02-17/110069816.html

4. Pradhan, K. (2012-10-2). *NPA Level Evaluation of Microfinance Development Banks*. [N] http://www.abhiyan.com.np/article-dristikone_16ashoj2069_laghubitta#.UQpH0eRhAoE

List of Paper Published During Study Period

1. Sun Shaoyan and Bal Ram Duwal (2012). Comparative Analysis of Financial Sustainability of Nepalese Microfinance Institutions [J]. *International Journal of Business Management and Information Technology*. Vol. 4, No. 2, July-December 2012: 233-241

2. Bal Ram and Duwal Sun Shaoyan (2013). Research on Rural Financing in China with Reference to Village and Township Banks: An Overview [J]. *International Journal of Business and Management*. Vol. 8, No. 4, January 25, 2013:75-84

Annex-1: Map of Nepal

Annex-2: Map of China

Annex-3: SPSS Data Analysis Result Sheet

1. Financing Structure

Descriptives

		N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
						Lower Bound	Upper Bound		
CA_Ratio	GIMFB	5	.0080	.14618	.06538	-.1735	.1895	-.25	.10
	PIMFB	5	.0860	.04827	.02159	.0261	.1459	.01	.14
	FINGOs	5	.1040	.03050	.01364	.0661	.1419	.08	.15
	SACCOS	5	.1240	.12341	.05519	-.0292	.2772	.02	.32
	Total	20	.0805	.10211	.02283	.0327	.1283	-.25	.32
DE_Ratio	GIMFB	5	13.4500	16.12271	7.21029	-6.5690	33.4690	-8.27	31.94
	PIMFB	5	8.7420	2.96454	1.32578	5.0610	12.4230	5.22	12.44
	FINGOs	5	11.4040	1.91696	.85729	9.0238	13.7842	8.13	13.11
	SACCOS	5	5.8900	5.09223	2.27732	-.4328	12.2128	1.00	13.30
	Total	20	9.8715	8.44410	1.88816	5.9195	13.8235	-8.27	31.94
DL_Ratio	GIMFB	5	.2580	.06458	.02888	.1778	.3382	.15	.32
	PIMFB	5	.3240	.06877	.03076	.2386	.4094	.22	.39
	FINGOs	5	.3180	.06686	.02990	.2350	.4010	.24	.41
	SACCOS	5	.3180	.32904	.14715	-.0906	.7266	.04	.85
	Total	20	.3045	.16240	.03631	.2285	.3805	.04	.85
DTA_Ratio	GIMFB	5	.1440	.03362	.01503	.1023	.1857	.11	.18
	PIMFB	5	.2280	.04550	.02035	.1715	.2845	.16	.28
	FINGOs	5	.2600	.05244	.02345	.1949	.3251	.20	.32
	SACCOS	5	.2760	.27808	.12436	-.0693	.6213	.04	.72
	Total	20	.2270	.14235	.03183	.1604	.2936	.04	.72
GLPTA_Ratio	GIMFB	5	.5760	.14206	.06353	.3996	.7524	.43	.75
	PIMFB	5	.7100	.10559	.04722	.5789	.8411	.60	.87
	FINGOs	5	.8280	.14890	.06659	.6431	1.0129	.58	.96
	SACCOS	5	.7740	.68734	.30739	-.0794	1.6274	.14	1.81
	Total	20	.7220	.34646	.07747	.5598	.8842	.14	1.81

ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
CA_Ratio	Between Groups	.039	3	.013	1.293	.311
	Within Groups	.159	16	.010		
	Total	.198	19			
DE_Ratio	Between Groups	161.412	3	53.804	.721	.554
	Within Groups	1193.343	16	74.584		
	Total	1354.755	19			
DL_Ratio	Between Groups	.015	3	.005	.159	.922
	Within Groups	.487	16	.030		
	Total	.501	19			
DTA_Ratio	Between Groups	.052	3	.017	.831	.496
	Within Groups	.333	16	.021		
	Total	.385	19			
GLPTA_Ratio	Between Groups	.177	3	.059	.449	.722
	Within Groups	2.104	16	.131		
	Total	2.281	19			

2. Outreach

Descriptives

		N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
						Lower Bound	Upper Bound		
No_of_Act_Borrowers	GIMFB	5	29152.11	15893.463	7107.773	9417.77	48886.46	11009	48995
	PIMFB	5	45108.20	24077.200	10767.651	15212.41	75003.99	12879	70831
	FINGOs	5	18850.40	9903.345	4428.910	6553.77	31147.03	6598	28982
	SACCOS	5	10894.00	18097.157	8093.295	-11576.59	33364.59	158	42900
	Total	20	26001.18	20905.079	4674.518	16217.30	35785.06	158	70831
Portion_of_fem_borrower	GIMFB	5	.8480	.12194	.05453	.6966	.9994	.65	.97
	PIMFB	5	.9020	.22477	.10052	.6229	1.1811	.50	1.01

	FINGOs	5	.9380	.08556	.03826	.8318	1.0442	.83	1.00
	SACCOS	5	.4760	.46198	.20661	-.0976	1.0496	.06	1.18
	Total	20	.7910	.31006	.06933	.6459	.9361	.06	1.18
GLoan_porfolio	GIMFB	5	6013916.20	2669218.827	1193710.949	2699643.28	9328189.12	2009021	8826763
	PIMFB	5	8531617.60	4070346.135	1820314.130	3477615.34	13585619.86	3061789	13946702
	FINGOs	5	2661171.60	1510781.609	675642.075	785288.47	4537054.73	875821	3931632
	SACCOS	5	3324907.07	3236461.384	1447389.532	-693690.51	7343504.66	273691	7927562
	Total	20	5132903.12	3658638.757	818096.497	3420607.47	6845198.76	273691	13946702
ALB_per_borrower	GIMFB	5	206.1960	63.83405	28.54745	126.9356	285.4564	148.42	313.62
	PIMFB	5	179.7160	27.75907	12.41423	145.2486	214.1834	146.47	214.21
	FINGOs	5	107.1100	12.01913	5.37512	92.1863	122.0337	94.43	121.18
	SACCOS	5	872.1100	954.95033	427.06677	-313.6174	2057.8374	30.33	1951.00
	Total	20	341.2830	541.56271	121.09710	87.8238	594.7422	30.33	1951.00
Av_Outstanding_Bal	GIMFB	5	187.0560	55.34586	24.75142	118.3350	255.7770	141.92	274.33
	PIMFB	5	134.1820	53.68198	24.00731	67.5270	200.8370	80.94	211.32
	FINGOs	5	63.1940	13.49590	6.03555	46.4366	79.9514	51.37	83.19
	SACCOS	5	337.1520	389.22000	174.06447	-146.1285	820.4325	20.15	990.09
	Total	20	180.3960	209.37517	46.81771	82.4054	278.3866	20.15	990.09
No_of_Depositors	GIMFB	5	29642.80	11871.310	5309.011	14902.62	44382.98	14287	39047
	PIMFB	5	67847.40	39631.281	17723.648	18638.67	117056.13	17070	108030
	FINGOs	5	24628.40	13069.388	5844.808	8400.61	40856.19	7828	36892
	SACCOS	5	10923.80	14386.098	6433.659	-6938.90	28786.50	450	35911
	Total	20	33260.60	30149.849	6741.711	19150.04	47371.16	450	108030
Deposits	GIMFB	5	1497045.60	636054.054	284452.020	707280.18	2286811.02	518447	2163876
	PIMFB	5	3056002.20	1708615.021	764115.867	934476.44	5177527.96	1046045	4874566
	FINGOs	5	1095523.20	618770.442	276722.554	327218.22	1863828.18	368199	1658364
	SACCOS	5	1616034.40	1697302.535	759056.769	-491445.05	3723513.85	94981	3770250
	Total	20	1816151.35	1401927.675	313480.558	1160029.00	2472273.70	94981	4874566
Av_Deposit_Acc_	GIMFB	5	44.36	16.853	7.537	23.44	65.29	28	73

	PIMFB	5	36.99	7.120	3.184	28.15	45.83	26	44
	FINGOs	5	26.50	2.255	1.008	23.70	29.30	23	28
	SACCOS	5	85.54	83.605	37.389	-18.27	189.35	8	197
	Total	20	48.35	45.506	10.175	27.05	69.64	8	197
Av_Dep_Bal_per_depositor	GIMFB	5	36.9680	15.26114	6.82499	18.0188	55.9172	22.60	60.81
	PIMFB	5	19.1360	8.22478	3.67823	8.9236	29.3484	7.29	27.57
	FINGOs	5	9.2860	1.18409	.52954	7.8158	10.7562	7.81	10.41
	SACCOS	5	39.8640	39.35905	17.60190	-9.0067	88.7347	3.36	99.27
	Total	20	26.3135	23.61676	5.28087	15.2605	37.3665	3.36	99.27
Av_Dep_Acc_Bal	GIMFB	5	36.9680	15.26114	6.82499	18.0188	55.9172	22.60	60.81
	PIMFB	5	19.1360	8.22478	3.67823	8.9236	29.3484	7.29	27.57
	FINGOs	5	9.2860	1.18409	.52954	7.8158	10.7562	7.81	10.41
	SACCOS	5	39.8640	39.35905	17.60190	-9.0067	88.7347	3.36	99.27
	Total	20	26.3135	23.61676	5.28087	15.2605	37.3665	3.36	99.27

ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
No_of_Act_Borrowers	Between Groups	3.272E9	3	1.091E9	3.468	.041
	Within Groups	5.032E9	16	3.145E8		
	Total	8.303E9	19			
Portion_of_fem_borrrower	Between Groups	.682	3	.227	3.178	.053
	Within Groups	1.145	16	.072		
	Total	1.827	19			
GLoan_porfolio	Between Groups	1.085E14	3	3.618E13	3.970	.027
	Within Groups	1.458E14	16	9.112E12		
	Total	2.543E14	19			
ALB_per_borrower	Between Groups	1904833.455	3	634944.485	2.770	.076
	Within Groups	3667679.807	16	229229.988		
	Total	5572513.262	19			

Av_Outstanding_Bal	Between Groups	202444.209	3	67481.403	1.713	.205
	Within Groups	630477.053	16	39404.816		
	Total	832921.261	19			
No_of_Depositors	Between Groups	8.914E9	3	2.971E9	5.689	.008
	Within Groups	8.357E9	16	5.223E8		
	Total	1.727E10	19			
Deposits	Between Groups	1.099E13	3	3.664E12	2.225	.125
	Within Groups	2.635E13	16	1.647E12		
	Total	3.734E13	19			
Av_Deposit_Acc_Bal	Between Groups	10027.185	3	3342.395	1.824	.183
	Within Groups	29318.062	16	1832.379		
	Total	39345.247	19			
Av_Dep_Bal_per_depositor	Between Groups	3192.933	3	1064.311	2.300	.116
	Within Groups	7404.345	16	462.772		
	Total	10597.279	19			
Av_Dep_Acc_Bal	Between Groups	3192.933	3	1064.311	2.300	.116
	Within Groups	7404.345	16	462.772		
	Total	10597.279	19			

3. Operating Performance

Descriptives

		N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
						Lower Bound	Upper Bound		
ROA	GIMFB	5	-.007583	.0193922	.0086724	-.031661	.016496	-.0400	.0091
	PIMFB	5	.023877	.0102705	.0045931	.011125	.036630	.0066	.0305

	FINGOs	5	.031170	.0174252	.0077928	.009534	.052806	.0050	.0516
	SACCOS	5	.015862	.0126649	.0056639	.000137	.031588	.0029	.0350
	Total	20	.015832	.0205497	.0045950	.006214	.025449	-.0400	.0516
ROE	GIMFB	5	.040000	.1356466	.0606630	-.128427	.208427	-.1300	.2300
	PIMFB	5	.276000	.1357571	.0607124	.107435	.444565	.0600	.4000
	FINGOs	5	.350000	.2181742	.0975705	.079101	.620899	.0500	.5800
	SACCOS	5	.118000	.0840833	.0376032	.013597	.222403	.0300	.2300
	Total	20	.196000	.1875998	.0419486	.108201	.283799	-.1300	.5800
OSS	GIMFB	5	.940000	.1430035	.0639531	.762438	1.117562	.7300	1.1200
	PIMFB	5	1.220000	.2257211	.1009455	.939730	1.500270	.8800	1.4100
	FINGOs	5	1.282000	.1943451	.0869138	1.040689	1.523311	1.0100	1.5400
	SACCOS	5	1.068000	.9124527	.4080613	-.064960	2.200960	.2000	2.4000
	Total	20	1.127500	.4658086	.1041580	.909495	1.345505	.2000	2.4000

ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
ROA	Between Groups	.004	3	.001	5.980	.006
	Within Groups	.004	16	.000		
	Total	.008	19			
ROE	Between Groups	.303	3	.101	4.411	.019
	Within Groups	.366	16	.023		
	Total	.669	19			
OSS	Between Groups	.356	3	.119	.503	.685
	Within Groups	3.767	16	.235		
	Total	4.123	19			

4. Revenue

Descriptives

		N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
						Lower Bound	Upper Bound		
Fin_Rev_to_Ass	GIMFB	5	.11316572	.017394351	.007778990	.09156778	.13476366	.092814	.133343
	PIMFB	5	.15430071	.009622372	.004303256	.14235296	.16624847	.145075	.169429
	FINGOs	5	.18174238	.016545033	.007399164	.16119901	.20228575	.159986	.199914

	SACCOs	5	.11091860	.089724451	.040125995	-.00048902	.22232622	.021625	.234168
	Total	20	.14003185	.052536289	.011747471	.11544411	.16461959	.021625	.234168
Profit_margin	GIMFB	5	-.09994914	.183665526	.082137720	-.32800001	.12810173	-.328900	.081429
	PIMFB	5	.19996929	.093522727	.041824635	.08384548	.31609309	.090329	.285471
	FINGOs	5	.16531000	.091930601	.041112614	.05116308	.27945692	.015600	.263143
	SACCOs	5	.12981047	.093770040	.041935237	.01337958	.24624135	.026308	.245700
	Total	20	.09878515	.164557252	.036796120	.02176999	.17580032	-.328900	.285471
Nom_Yield_on_Gross_portfolio	GIMFB	5	.15007714	.036421400	.016288145	.10485400	.19530028	.103157	.192229
	PIMFB	5	.18058000	.022072738	.009871229	.15317308	.20798692	.144800	.204300
	FINGOs	5	.16093000	.024321689	.010876990	.13073063	.19112937	.129529	.185014
	SACCOs	5	.05630807	.058705128	.026253731	-.01658398	.12920011	.004958	.153000
	Total	20	.13697380	.060339624	.013492350	.10873399	.16521362	.004958	.204300
Real_Yield_on_Gross_Porffolio	GIMFB	5	.06393714	.029942888	.013390867	.02675814	.10111615	.033071	.105786
	PIMFB	5	.08921571	.017974793	.008038572	.06689706	.11153437	.062750	.113457
	FINGOs	5	.08347333	.017019053	.007611152	.06234139	.10460528	.064029	.105014
	SACCOs	5	.02467824	.033848314	.015137426	-.01734999	.06670648	.000375	.082733
	Total	20	.06532611	.035087238	.007845745	.04890478	.08174744	.000375	.113457

ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
Fin_Rev_to_Ass	Between Groups	.018	3	.006	2.686	.081
	Within Groups	.035	16	.002		
	Total	.052	19			
Profit_margin	Between Groups	.276	3	.092	6.153	.006
	Within Groups	.239	16	.015		
	Total	.515	19			
Nom_Yield_on_Gross_portfolio	Between Groups	.046	3	.015	10.429	.000
	Within Groups	.023	16	.001		
	Total	.069	19			
Real_Yield_on_Gross_Porffolio	Between Groups	.013	3	.004	6.414	.005
	Within Groups	.011	16	.001		
	Total	.023	19			

5. Expenses

Descriptives

		N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
						Lower Bound	Upper Bound		
Tot_Exp_to_Assets	GIMFB	5	.117900	.0200117	.0089495	.093052	.142748	.0893	.1378
	PIMFB	5	.121529	.0099717	.0044595	.109148	.133911	.1096	.1335
	FINGOs	5	.149717	.0184293	.0082418	.126834	.172600	.1245	.1729
	SACCOs	5	.093691	.0807104	.0360948	-.006524	.193906	.0182	.2127
	Total	20	.120709	.0443163	.0099094	.099969	.141450	.0182	.2127
Fin_Exp_to_Assets	GIMFB	5	.051066	.0084968	.0037999	.040516	.061616	.0392	.0607
	PIMFB	5	.051519	.0087685	.0039214	.040632	.062407	.0424	.0658
	FINGOs	5	.054858	.0114395	.0051159	.040654	.069062	.0439	.0734
	SACCOs	5	.058542	.0574298	.0256834	-.012767	.129850	.0090	.1502
	Total	20	.053996	.0276188	.0061757	.041070	.066922	.0090	.1502
Prov_for_Loan_Imap_to_Assets	GIMFB	5	.003486	.0057858	.0025875	-.003698	.010670	-.0034	.0116
	PIMFB	5	.004947	.0024245	.0010843	.001937	.007958	.0026	.0085
	FINGOs	5	.010991	.0044589	.0019941	.005455	.016528	.0046	.0156
	SACCOs	5	.005777	.0071088	.0031792	-.003050	.014604	.0006	.0179
	Total	20	.006300	.0056160	.0012558	.003672	.008929	-.0034	.0179
Ope_Exp_to_Assets	GIMFB	5	.064451	.0145295	.0064978	.046411	.082492	.0401	.0785
	PIMFB	5	.065057	.0141252	.0063170	.047518	.082596	.0512	.0826
	FINGOs	5	.085985	.0180419	.0080686	.063583	.108387	.0670	.1148
	SACCOs	5	.029356	.0210863	.0094301	.003174	.055538	.0058	.0525
	Total	20	.061212	.0261492	.0058471	.048974	.073451	.0058	.1148
Adm_Exp_to_Assets	GIMFB	5	.010371	.0032087	.0014350	.006387	.014356	.0071	.0148
	PIMFB	5	.016822	.0026141	.0011691	.013576	.020068	.0135	.0198
	FINGOs	5	.025446	.0145341	.0064998	.007399	.043492	.0139	.0500
	SACCOs	5	.007509	.0079516	.0035561	-.002364	.017382	.0010	.0213
	Total	20	.015037	.0105536	.0023599	.010098	.019976	.0010	.0500
Ope_Exp_to_Loan_Portfolio	GIMFB	5	.113866	.0287302	.0128485	.078192	.149539	.0759	.1544
	PIMFB	5	.095925	.0282173	.0126192	.060889	.130961	.0572	.1249
	FINGOs	5	.106907	.0271453	.0121397	.073201	.140612	.0701	.1414
	SACCOs	5	.033759	.0242765	.0108568	.003616	.063903	.0067	.0574
	Total	20	.087614	.0410039	.0091688	.068424	.106805	.0067	.1544
Per_Exp_to_Loa	GIMFB	5	.092434	.0284378	.0127178	.057124	.127745	.0567	.1346

	PIMFB	5	.065044	.0231506	.0103533	.036298	.093789	.0352	.0902
	FINGOs	5	.049714	.0152847	.0068355	.030735	.068692	.0318	.0702
	SACCOs	5	.009621	.0138531	.0061953	-.007580	.026822	.0004	.0341
	Total	20	.054203	.0362848	.0081135	.037221	.071185	.0004	.1346

ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
Tot_Exp_to_Assets	Between Groups	.008	3	.003	1.432	.270
	Within Groups	.029	16	.002		
	Total	.037	19			
Fin_Exp_to_Assets	Between Groups	.000	3	.000	.067	.976
	Within Groups	.014	16	.001		
	Total	.014	19			
Prov_for_Loan_Imap_to_Assets	Between Groups	.000	3	.000	1.945	.163
	Within Groups	.000	16	.000		
	Total	.001	19			
Ope_Exp_to_Assets	Between Groups	.008	3	.003	9.337	.001
	Within Groups	.005	16	.000		
	Total	.013	19			
Adm_Exp_to_Assets	Between Groups	.001	3	.000	4.343	.020
	Within Groups	.001	16	.000		
	Total	.002	19			
Ope_Exp_to_Loan_Portfolio	Between Groups	.020	3	.007	9.116	.001
	Within Groups	.012	16	.001		
	Total	.032	19			
Per_Exp_to_Loan_Portfolio	Between Groups	.018	3	.006	13.508	.000
	Within Groups	.007	16	.000		
	Total	.025	19			

6. Efficiency and Productivity

Descriptives

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		

Cost_per_Borrower	GIMFB	5	21.3380	7.99184	3.57406	11.4148	31.2612	12.23	29.88
	PIMFB	5	15.7900	3.20257	1.43223	11.8135	19.7665	11.41	20.23
	FINGOs	5	10.2720	1.83108	.81889	7.9984	12.5456	8.48	12.68
	SACCOs	5	25.0900	24.09564	10.77590	-4.8287	55.0087	2.18	59.25
	Total	20	18.1225	13.10303	2.92993	11.9901	24.2549	2.18	59.25
Cost_per_Loan	GIMFB	5	17.7660	7.10079	3.17557	8.9492	26.5828	10.14	25.93
	PIMFB	5	10.2840	6.11968	2.73680	2.6854	17.8826	2.12	18.08
	FINGOs	5	5.3600	2.63426	1.17808	2.0891	8.6309	1.68	8.53
	SACCOs	2	3.0800	3.11127	2.20000	-24.8737	31.0337	.88	5.28
	Total	17	10.1888	7.47369	1.81264	6.3462	14.0314	.88	25.93
Borrowers_per_Staffmem	GIMFB	5	143.8860	33.48409	14.97454	102.3100	185.4620	106.58	181.86
	PIMFB	5	221.5300	35.05658	15.67778	178.0015	265.0585	165.56	248.85
	FINGOs	5	209.2620	39.05446	17.46568	160.7695	257.7545	171.18	274.86
	SACCOs	5	115.4260	111.56217	49.89212	-23.0967	253.9487	10.80	285.17
	Total	20	172.5260	74.14211	16.57868	137.8264	207.2256	10.80	285.17
Loans_per_Staffmemb	GIMFB	5	138.5760	34.24234	15.31364	96.0585	181.0935	104.14	181.86
	PIMFB	5	241.2060	36.89770	16.50115	195.3915	287.0205	183.59	284.07
	FINGOs	5	232.6420	88.89049	39.75303	122.2699	343.0141	130.03	375.27
	SACCOs	5	74.6960	97.25026	43.49164	-46.0562	195.4482	1.56	238.72
	Total	20	171.7800	95.92548	21.44959	126.8855	216.6745	1.56	375.27
Borrowers_per_Loan_Officer	GIMFB	5	496.4020	575.93202	257.56463	-218.7121	1211.5161	195.74	1522.09
	PIMFB	5	325.5680	42.92118	19.19493	272.2743	378.8617	281.04	375.38
	FINGOs	5	202.9880	61.47089	27.49062	126.6618	279.3142	124.87	266.91
	SACCOs	5	192.5460	165.16924	73.86593	-12.5387	397.6307	24.92	387.86
	Total	20	304.3760	304.26276	68.03522	161.9766	446.7754	24.92	1522.09
Loans_per_Loan_Officer	GIMFB	5	505.3960	579.59018	259.20061	-214.2603	1225.0523	209.13	1538.32
	PIMFB	5	370.8880	49.70644	22.22939	309.1693	432.6067	297.25	419.02
	FINGOs	5	298.3960	122.18081	54.64092	146.6885	450.1035	163.99	490.41
	SACCOs	5	220.2680	230.86353	103.24531	-66.3869	506.9229	24.92	588.50
	Total	20	348.7370	311.77274	69.71450	202.8229	494.6511	24.92	1538.32
Depositors_per_Staffmemb	GIMFB	5	154.0360	21.30990	9.53008	127.5763	180.4957	134.96	187.67
	PIMFB	5	307.7600	91.44182	40.89403	194.2200	421.3000	166.02	413.13
	FINGOs	5	258.9860	46.88524	20.96772	200.7703	317.2017	219.14	337.35
	SACCOs	5	191.5020	184.68950	82.59566	-37.8203	420.8243	30.25	483.92
	Total	20	228.0710	114.96438	25.70682	174.2660	281.8760	30.25	483.92

ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
Cost_per_Borrower	Between Groups	629.782	3	209.927	1.276	.316
	Within Groups	2632.314	16	164.520		
	Total	3262.096	19			
Cost_per_Loan	Between Groups	504.772	3	168.257	5.624	.011
	Within Groups	388.924	13	29.917		
	Total	893.696	16			
Borrowers_per_Staffmem	Between Groups	39157.927	3	13052.642	3.199	.052
	Within Groups	65286.069	16	4080.379		
	Total	104443.995	19			
Loans_per_Staffmemb	Between Groups	95259.806	3	31753.269	6.385	.005
	Within Groups	79572.440	16	4973.278		
	Total	174832.246	19			
Borrowers_per_Loan_Officer	Between Groups	300542.805	3	100180.935	1.099	.378
	Within Groups	1458397.874	16	91149.867		
	Total	1758940.679	19			
Loans_per_Loan_Officer	Between Groups	220356.047	3	73452.016	.723	.553
	Within Groups	1626486.514	16	101655.407		
	Total	1846842.561	19			
Depositors_per_Staffmemb	Between Groups	70622.735	3	23540.912	2.087	.142
	Within Groups	180496.629	16	11281.039		
	Total	251119.363	19			

6. Risk Management

Descriptives

		N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
						Lower Bound	Upper Bound		
Portfolio_at_Risk_GD_30days	GIMFB	5	.136560	.0593858	.0265581	.062823	.210297	.0808	.2301
	PIMFB	4	.031814	.0177045	.0088522	.003642	.059986	.0120	.0542
	FINGOs	5	.007006	.0100193	.0044808	-.005435	.019446	.0000	.0240
	SACCOs	3	.010686	.0137579	.0079431	-.023490	.044863	.0008	.0264
	Total	17	.051597	.0654070	.0158635	.017968	.085226	.0000	.2301

Portfolio_at_risk_GD_90days	GIMFB	5	.131811	.0610304	.0272936	.056032	.207591	.0808	.2301
	PIMFB	4	.022493	.0161543	.0080772	-.003212	.048198	.0076	.0450
	FINGOs	5	.006068	.0096894	.0043332	-.005963	.018099	.0000	.0231
	SACCOs	2	.002348	.0023718	.0016771	-.018961	.023657	.0007	.0040
	Total	16	.049004	.0666987	.0166747	.013463	.084545	.0000	.2301
Write0ff_ratio	GIMFB	4	.004375	.0035031	.0017515	-.001199	.009949	.0013	.0084
	PIMFB	4	.001075	.0017906	.0008953	-.001774	.003924	.0001	.0038
	FINGOs	3	.000102	.0000648	.0000374	-.000059	.000263	.0000	.0002
	SACCOs	1	.011924	.	.	.	.	.0119	.0119
	Total	12	.002836	.0039695	.0011459	.000314	.005358	.0000	.0119

ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
Portfolio_at_Risk_GD_30days	Between Groups	.053	3	.018	14.407	.000
	Within Groups	.016	13	.001		
	Total	.068	16			
Portfolio_at_risk_GD_90days	Between Groups	.051	3	.017	12.617	.001
	Within Groups	.016	12	.001		
	Total	.067	15			
Write0ff_ratio	Between Groups	.000	3	.000	7.286	.011
	Within Groups	.000	8	.000		
	Total	.000	11			

Annex-4: Exchange Rate

1. Exchange Rate between United States Dollar (USD) and Nepalese Rupees (NPR)

Fiscal Year	Mid-July	USD	NPR
2004/2005	2005	1	72.1
2005/2006	2006	1	72.3
2006/2007	2007	1	70.5
2007/2008	2008	1	65.0
2008/2009	2009	1	76.9
2009/2010	2010	1	74.5
2010/2011	2011	1	72.3
2011/2012	2012	1	79.4

Note: Annual Average of buying and selling rates, 10 months average for the current fiscal year.

Source: Government of Nepal, Ministry of Finance (2012). Economic Survey 2011/12

2. Exchange Rate between United States Dollar (USD) and Chinese Yuan (RMB)

Year	USD	RMB
2003	1	8.2784
2004	1	8.277
2005	1	8.1917
2006	1	7.9718
2007	1	7.604
2008	1	6.948
2009	1	6.832
2010	1	6.7695
2011	1	6.3133
2012	1	6.3125

Source: International Monetary Fund and Baidu website
http://wenku.baidu.com/view/a54b64205901020207409c8f.html

Acknowledgement

This thesis is for the partial fulfillment of doctoral dissertation (Ph.D. in Finance) at the College of Economics in Jilin University, China。

This thesis is an outcome of a long rigorous research, marked by guidance, criticism, observation, participation, and help from many quarters. Guidance, appreciation and consistent supervision for my research was persistently and duly provided by respected supervisor Professor **Dr. Sun Shaoyan** (Jilin University, Research Center for China Public Sector Economy), who made this task possible. I express my heartfelt appreciation and gratitude to him. Apart from an academic advisor, he emerged as my mentor, filling this period with joyous moments of social relations.

I sincerely thank Asst. Prof. Dr. Syed Hasnat (Jilin University, Institute of International studies); from whom I learnt a great deal about research method and his frequent inspiration and motivation led me to complete my research work. Similary, my heartfelt thanks also go to Araya Kebede Araya from Ethiopia and Dr. Kad Oudum Khamvilay from Laos who offered valuable ideas and suggestions for me in the preparation of this thesis. Indeed, their guidance was instrumental in shaping the structure of this thesis.

I would like to thank my classmates Mu Yutang, Wei Lan, Wang Jiang for their tireless help, advice and friendship during the study period. Likewise, I would like to express my gratitude to juniors of department mainly Li Mengjia, Wu Junji and friend Li Fengjuan. Their extensive help in improving and correction of my Chinese writing in precious moment is highly acknowledgeable and makes me moved.

My due thanks goes to Nepali friends and juniors in Jilin University who assisted me in the data collection and processing, and also encouraged and helped me to complete my thesis on time, specially Ayash Joshi for assisting me in refining and publishing the thesis in the present form. I would like to thank Deepak Khadka for helping me to edit English written thoroughly. During the field work in Nepal, numerous persons bestowed help and support me. I can’t forget, those friends who helped me in collecting data and necessary information in Nepal.

I cannot remain without expressing my heartily respect for friend Rajendra Chawal, who recommended the Jilin University, helped me to understand China and support me during China's life.

I also sincerely thank the Department of Economics and Office of International Students, for their support and help during the university life. My gratitude also goes to China Scholarship Council and Jilin University giving me this ample opportunity and financial assistance.

I am thankful to the staff of Central Library, Foreign Language Section of Jilin University and staff of National Library, Beijing who provided me with required material on a simple request.

I also sincerely thank the members of the experts' adjudication committee for their valuable criticism and suggestion.

Finally, this thesis could not have been completed without patient understanding and support of my beloved family. In this regards, I cannot remain without expressing my respect for my entire family member and specially my honourable father and mother for their endless blessing and encouragement in excelling in life until this point, their endless guidance will always remain with me.

Bal Ram Duwal