Working Paper No. 6

A Decade of Pro Poor Institution Building in Nepal – Innovations and Lessons Learned from the Small Farmer Cooperatives Ltd. (SFCLs)

Kathmandu, October 2004

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It took a full decade for Small Farmer Cooperatives Ltd. (SFCLs) to emerge not only as one of the leading microfinance models in Nepal but to become a recognized holistic model for rural development. The purpose of Working Paper No. 6 is thus to present in a precise form the most significant innovations that emerged from the SFCL system. The paper also attempts to outline the most important lessons learnt from a decade of institution building efforts in rural Nepal. While the experiences, insights and lessons learned are from Nepal, the overall conclusions might be of interest to readers in other countries, too.
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List of Abbreviations

ADB  Asian Development Bank
ADBN  Agriculture Development Bank of Nepal
APRACA  Asia Pacific Rural and Agricultural Credit Association
CGAP  Consultative Group to assist the Poorest
CICTAB  Centre for International Cooperation and Training in Agricultural Banking
GTZ  German Technical Cooperation
IDP  Institutional Development Process
IFAD  International Fund for Agricultural Development
IG  Inter-Group
MC  Main Committee
MF  Microfinance
MFI  Microfinance institution
MPC  Multi Purpose Cooperative
NGO  Non Government Organization
NRB  Nepal Rastra Bank
RUFIN  Rural Finance Nepal
SFCL  Small Farmer Cooperative Limited
SFDP  Small Farmer Development Project
SKBB  Sana Kisan Bikas Bank
SPO  Sub-Project Office
VDC  Village Development Committee

1 USD = 74 Nrs (October 2004)
1 EUR = 90 Nrs (October 2004)
Foreword

The RUFIN Working Paper series started in early 2001 with the objective of making existing microfinance efforts more visible. Throughout the last three and a half years RUFIN and its partners managed to publish six Working Papers covering various aspects of the Small Farmer Cooperatives Ltd. (SFCLs):

- Are Small Farmer Cooperatives Ltd. viable microfinance organizations? (January 2001)
- Financial technology of Small Farmer Cooperatives (January 2001)
- Microfinance and armed conflict in Nepal (January 2003)
- Reforming an agricultural development bank (August 2003)
- Poverty alleviation, governance improvement and conflict transformation in rural Nepal (September 2004)

This last Working Paper entitled “A decade of pro-poor institution building in Nepal” is a brief document summarizing innovations and the lessons learnt that emerged from the SFCL system over the last years.

We would like to thank all those persons who played a significant role in contributing to the RUFIN Working Papers, particularly Bihari Krishna Shrestha, Devendra Pratap Shah, Eckart Koch, Jalan Kumar Sharma, Radha Acharya, Roshan Shakya, Stefan Staschen, and Sylvia Wisniswski.

We do hope that the nine years long armed conflict in Nepal will find soon a peaceful solution allowing the long suffering Nepali people and institutions to recover and to regain the strength that guided the country in the early 1990ies.

Ram Chandra Maharjan
General Manager
ADBN
Kathmandu,
October 2004

Ulrich Wehnert
Team Leader
GTZ/Rural Finance Nepal
1. Introduction

The Small Farmer Cooperatives Ltd. (SFCLs) are next to the Grameen Banks the largest provider of microfinance services in Nepal. SFCLs are reaching out to 90,000 poor rural households with an estimated total outreach of half a million people. Despite the adverse effects of the present armed conflict in Nepal, the number of SFCLs is still growing. By the year 2007 the SFCLs will hopefully reach out to a total population close to one million. The Consultative Group to assist the Poorest (CGAP) together with the International Fund for Agricultural Development (IFAD) awarded in early 2003 the Rural Pro-Poor Innovation Challenge to the SFCL model.

It took a full decade for SFCLs to emerge not only as one of the leading microfinance models but to become a recognized holistic model for rural development. The purpose of this paper is thus to present in a precise form the most significant innovations that emerged from the SFCL system. The paper also attempts to outline the most important lessons learnt from a decade of institution building efforts in rural Nepal. While the experiences, insights and lessons learned are from Nepal, the overall conclusions might be of interest to readers in other countries, too.

At this point, it seems appropriate to clarify what is meant by “innovation”. The term innovation, in general, and in the world of microfinance (MF), in particular, has entered into our day-to-day vocabulary. Many MF scholars and practitioners use the term without much thinking about the real meaning. This Working Paper will adopt the definition of Greve and Taylor (2000) who define innovation as “activities that differ significantly from current or recent practice”.

This paper will give in chapter two a brief introduction into the history of the SFCL system. Readers, already familiar with the SFCLs in Nepal can directly enter into chapter three that presents the three prerequisites of a successful MF programme: a systems approach, vision and ownership. Chapter four outlines four major innovations that emerged over time from the SFCL system. Chapter five attempts to identify some of the lessons learned from the SFCL model for MF practitioners and scholars beyond Nepal. The next to last chapter deals with the visible impact of the SFCLs on the village level and addresses the adverse effects of the armed conflict on the ongoing operations of the cooperatives. Finally, chapter seven concludes with a brief summary of the main points to be remembered.
2. History, development, situation - facts and figures

In 1975, the Agricultural Development Bank of Nepal (ADBN) started to form joint liability groups of small farmers through its Sub-Project Offices (SPOs). In line with the prevailing development thinking of that time, “cheap” money, meant for productive purposes, was channeled to group members. The high overheads and low collection rates of the SPOs, however, led experts to question the sustainability of this approach (ADB, 1989 and NRB, 1993).

In 1987, the ADBN introduced an action research Institutional Development Programme (IDP) with the support of GTZ. The objective of the new direction was to transfer the ADBN-run SPOs into fully self-administered and managed cooperatives of small farmers (Lamsal, Sejuwal & Shakya, 2001). In 1993, as a result of the IDP, the first four SPOs were transformed into Small Farmer Cooperatives Ltd. (SFCLs). Since then, 164 SFCLs have been established in 36 districts of the country. Currently, the Small Farmer Cooperatives Ltd. in Nepal comprise almost 90,000 rural households with outstanding loans of USD 17.9 million and internally generated resources of USD 3.9 million. Female membership stands at 40% and is increasing. Box No. 1 provides an overview about the major milestones of the program while Table No. 1 shows the expansion of the SFCL system.

<table>
<thead>
<tr>
<th>Year</th>
<th>Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>Pilot Test of SFDP</td>
</tr>
<tr>
<td>1981</td>
<td>Expansion with support of IFAD</td>
</tr>
<tr>
<td>1985</td>
<td>Further expansion with support of the Asian Development Bank</td>
</tr>
<tr>
<td>1987</td>
<td>Institutional Development Program introduced in SFDP with support of GTZ</td>
</tr>
<tr>
<td>1993</td>
<td>First four SPOs transformed into SFCLs in Dhading district</td>
</tr>
<tr>
<td>1996</td>
<td>The first district level SFCL federation was established in Dhading district</td>
</tr>
<tr>
<td>1998</td>
<td>Conceptual work on an apex level bank for SFCL refinancing activities started</td>
</tr>
<tr>
<td>2002</td>
<td>The first SFCL was attacked by the so called Maoists</td>
</tr>
<tr>
<td>2003</td>
<td>The Sana Kisan Bikas Bank was registered and started operation</td>
</tr>
<tr>
<td>2003</td>
<td>A local level and central level SFCL federation concept has been introduced</td>
</tr>
<tr>
<td>2003</td>
<td>The SFCLs received the CGAP/IFAD pro-poor innovation challenge award</td>
</tr>
<tr>
<td>2004</td>
<td>161 SFCLs with 90,000 household members are serving 0.5 million rural people</td>
</tr>
</tbody>
</table>

The transformation from SPOs into SFCLs proved to be very cost effective for ADBN and paved the way to cut operating costs significantly without compromising outreach and quality of services¹.

In brief terms a Small Farmer Cooperative Ltd. can be defined as a multi-service cooperative designed to deliver primarily financial, but also non-financial services to its members in rural areas. SFCLs are civil society organizations that pool their joint resources to meet basic

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¹ Until July 2002, the total estimated savings of ADBN in operating costs due to the transformation of SPOs into SFCLs are estimated to be around USD 1.2 million (Juenemann, Sharma, & Wehnert, 2003).
needs and to defend their members' interests. They are member-owned and controlled and have an open membership policy towards "poor" farmers.

Table 1: The expansion of the SFCL system from 1994 to 2004

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of SFCLs</td>
<td>4</td>
<td>85</td>
<td>101</td>
<td>107</td>
<td>128</td>
<td>161</td>
</tr>
<tr>
<td>No. of VDCs with replication</td>
<td>1</td>
<td>6</td>
<td>6</td>
<td>11</td>
<td>11</td>
<td></td>
</tr>
<tr>
<td>No. of groups</td>
<td>372</td>
<td>7,550</td>
<td>8,888</td>
<td>9,255</td>
<td>11,383</td>
<td>13,351</td>
</tr>
<tr>
<td>No. of female groups</td>
<td>91</td>
<td>2,662</td>
<td>3,279</td>
<td>3,427</td>
<td>4,516</td>
<td>5,501</td>
</tr>
<tr>
<td>No. of members</td>
<td>2,624</td>
<td>51,340</td>
<td>60,551</td>
<td>61,934</td>
<td>75,430</td>
<td>88,064</td>
</tr>
<tr>
<td>No. of female members</td>
<td>610</td>
<td>18,205</td>
<td>22,276</td>
<td>23,041</td>
<td>30,139</td>
<td>36,486</td>
</tr>
<tr>
<td>Internal resources (USD)</td>
<td>23,600</td>
<td>1,580,000</td>
<td>2,254,000</td>
<td>2,381,000</td>
<td>3,862,000</td>
<td>3,909,000</td>
</tr>
<tr>
<td>Outstanding loan balance (USD)</td>
<td>156,000</td>
<td>8,124,000</td>
<td>10,454,000</td>
<td>12,156,000</td>
<td>14,945,000</td>
<td>17,792,000</td>
</tr>
<tr>
<td>No. of covered districts</td>
<td>1</td>
<td>31</td>
<td>31</td>
<td>32</td>
<td>32</td>
<td>36</td>
</tr>
</tbody>
</table>

Source: ADBN
3. Three prerequisites of a successful programme

What does it need to make a programme successful? This chapter suggests the systems approach, vision and people's ownership as necessary preconditions of any programme.

3.1 A systems approach as a guiding principle

There are numerous examples of failed efforts in promoting microfinance institutions (MFIs) if the stakeholders focus on the institution building part only. MFIs are part of the financial system that needs to be fully taken into account for the design and implementation of a sound strategy. Identifying and promoting linkages to financial and non-financial support institutions as well as the regulatory environment is a necessity that often is underestimated by promoting organizations. Even worse, sometimes, with good intentions in mind, parallel structures are created next to the banking system just to provide services to the poor. This, of course, will not have long lasting effects but might work in the short term.

The SFCL system approach is based on three strong foundations:
1. The local SFCLs at the grassroots level
2. The Sana Kisan Bikas Bank (Small Farmer Development Bank) and ADBN at national level to provide refinance facilities, and
3. Federations/networks of SFCLs to provide non-financial i.e. technical support services.

These elements will be further explained later on in chapter four. In addition, the regulatory and supervisory framework for rural finance in general and SFCLs in particular needs to be taken into account, too. ADBN, SKBB and GTZ thus, have formed close working relations with the Nepal Rastra Bank (NRB) and more recently with the Cooperative Department to deal with these important issues.

3.2 Vision and people’s ownership as the two underlying success factors

Two underlying principles have been of particular importance to the emergence of the SFCL system: vision and people’s ownership. To many readers, the two aspects may first sound like platitudes that do not add real value to existing MF knowledge. Let’s take a close look at these aspects.

A vision can be seen as a powerful inspiring long-term perspective, which gives a direction, creates a strong identity and leads to appropriate actions. The SFCL vision can be described as "creating a system of self-sustained institutions for financial and non-financial intermediation to successfully fight poverty". The importance of a vision is to develop it at an early stage and to stick to it. It is the glue that holds all stakeholders together, in good and bad times.
In more detail, the vision of the SFCL stakeholders implied:

- to achieve a significant outreach with cooperative microfinance institutions
- to establish a member-based and member-owned system, which is run and controlled by the members themselves
- to ensure financial sustainability as sine qua non for institutional sustainability
- to encourage village cooperatives in overcoming cast, ethnic and other socially rooted development constraints
- to apply a systems approach including interventions at micro-, meso- and macro-level, and finally
- to create a system, which is rooted in the villages, but at the same time is complemented by a vertical structure at district and national level and is embedded into a sound regulatory and supervisory framework.

The second aspect, people’s ownership, is a well-acknowledged principle in MF. However, successful and less successful MF programmes can be distinguished by the degree to which they have implemented the ownership principle. Too often, people’s ownership is easily taken for granted by MF promoters. The SFCL innovations that will be presented in the next chapter are truly based on the people’s participation. In fact, as we will see, the people have become the actors and promoters of the programme at the same time.
4. Innovations that emerged from the SFCL system

Keeping in mind our definition of innovation as “activities that differ significantly from current or recent practice”, this chapter describes in more detail four innovations that emerged over time from the SFCL system.

4.1 Three tiered structure: Reaching out effectively to members

Small Farmer Cooperatives Ltd. in Nepal have been comprehensively researched (e.g., Acharya, Shrestha, & Shakya, 2002; Lamsal, Sejuwal, & Shakya, 2001; Staschen, 2001). One of the interesting features that distinguishes SFCLs from other MFIs in Nepal and beyond is their unique three-tiered structure with small farmer groups, inter-groups and the main-committee as the three pillars.

Small farmer groups are formed as joint liability groups at the village level, usually consisting of 5 to 12 members. These bodies allow members to start and operate financial and non-financial services required by the group and/or group members. From each small farmer group within a defined area, one representative joins the so-called inter-group. The inter-group further validates specific group requests and gives approval recommendations to the main committee. It also functions as an intermediary between the groups and the main committee. One representative of each inter-group joins the so-called main committee at the Village Development Committee (VDC)² level. The nine member main committee approves the programme of the SFCL and decides on the implementation of any other projects such as office building construction, livestock insurance schemes, consumer stores, etc. To handle the daily operations of the organisation, a chief manager, an assistant manager and a helper are employed by the SFCL. Either the chief manager or the assistant manager should be female.

SFCLs deliver various financial and non-financial services. Financial services include various forms of voluntary and compulsory savings products, a variety of loan products as well as a livestock insurance scheme. Non-financial services include the construction of irrigation channels, establishment of milk collection centers, nursery programmes or women empowerment programmes. New products are continuously added. A prominent example is the design of a savings product addressed to children and their parents.

Through this unique organizational set-up, SFCLs deliver their services to the members. Important messages from the main committee can be effectively delivered through the inter-group representatives without calling in an assembly. Particularly for hill and remote areas, the three-tiered structure appears to be appropriate

² A VDC is the smallest administrative unit in Nepal.
since the small farmers will be able to do the majority of their activities within their groups on the local level.

4.2 Replication: Creating new MF institutions at a discount rate

The process of institution building in microfinance is generally considered as very costly. The lack of capacity building measures for MFIs is probably the single most important factor that many MFIs in Asia and elsewhere are still struggling for survival. Against this background, SFCLs have initiated a farmer-to-farmer replication with support of ADBN and SKBB. The core idea of replication is to minimize the institution building costs of a community based organization through the exclusive involvement of mature and highly experienced SFCLs. Being the real practitioners, the small farmers appear to be more knowledgeable than staff from public banks or NGOs. This approach leads to a significant reduction in the institution building costs of up to 50%.

The process of replication takes about three to four years. In this process the replicators provide microfinance services and training (social mobilization, capacity building, financial and accounting management) to the rural poor (mostly women) in order to establish a sustainable MFI to be registered in the form of a SFCL. SFCL Chatredeurali, for example, started a replication initiative in 1998. It took 3.5 years to form the SFCL Kewalpur with about 350 members, with USD 38,000 outstanding loans. USD 13,500 mobilized internal resources and a 93% financial self-sufficiency ratio until July 2002.

The following table 2 shows the completed and ongoing replication initiatives. The prime promoters of replication next to the SFCLs themselves are ADBN and SKBB with technical and financial support from GTZ and CGAP. It is hoped that replication becomes the prime tool to support the establishment of new SFCLs all over the country and thus, to boost the outreach of the SFCL system.
Table 2: Status of the SFCL replication process

<table>
<thead>
<tr>
<th>Name of new SFCL (and district)</th>
<th>Start of replication</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kewalpur (Dhading)</td>
<td>January 1998</td>
<td>Completed in June 2002</td>
</tr>
<tr>
<td>Karaiya (Rupandehi)</td>
<td>December 2000</td>
<td>Completed in July 2004</td>
</tr>
<tr>
<td>Baluwadi (Jhapa)</td>
<td>December 2000</td>
<td>Completed in June 2004</td>
</tr>
<tr>
<td>Kumarwati (Nawalparashi)</td>
<td>September 2002</td>
<td>Completed in October 2004</td>
</tr>
<tr>
<td>Kathar (Chitwan)</td>
<td>December 2000</td>
<td>To be completed in November 2004</td>
</tr>
<tr>
<td>Geta (Kailali)</td>
<td>December 2000</td>
<td>To be completed in November 2004</td>
</tr>
<tr>
<td>Khairahani VDC (Chitwan)</td>
<td>January 2004</td>
<td>Replication is in progress</td>
</tr>
<tr>
<td>Inaharwashira (Bara)</td>
<td>January 2004</td>
<td>Replication is in progress</td>
</tr>
<tr>
<td>Jabda (Rupandehi)</td>
<td>January 2004</td>
<td>Replication is in progress</td>
</tr>
<tr>
<td>Khaduwabanagai (Rupandehi)</td>
<td>January 2004</td>
<td>Replication is in progress</td>
</tr>
<tr>
<td>Pashupatinagar (Illam)</td>
<td>January 2004</td>
<td>Replication is in progress</td>
</tr>
</tbody>
</table>

4.3 Sana Kisan Bikas Bank: A bank for and by the poor

The Sana Kisan Bikas Bank (SKBB) was registered in July 2001 with the company registrar office. The bank received its operating license from the Nepal Rastra Bank in March 2002 and started its lending operations from three area offices in November 2002.

The objectives of the Sana Kisan Bikas Bank (SKBB) are:
- to act as a specialized, professional and lean rural finance institution to refinance SFCLs and similar institutions in rural and remote areas
- to encourage SFCLs to become majority shareholders of this bank in a 5-10 year time frame.

Given the high transaction costs in MF, SKBB is acting as a wholesaling institute to SFCLs and similar organizations. While ADBN continues to serve the standard retail customers in rural areas, SKBB will be able to serve through its delivery mechanisms the segment of poor and very poor clients. Thus, the two organizations clearly address two different segments of the rural finance market by using different methodologies, i.e. retailing and wholesaling.

The vision of SKBB is “to become one of the leading financially viable wholesale banks for the microfinance sector, owned by SFCLs and similar grassroots-level MFIs, to substantially improve the life of the rural poor. Thus, another distinguished feature of the bank is not to create merely a subsidiary of ADBN, but to establish a refinance institution which should be driven and guided in the long run through its members, i.e. SFCLs and similar organizations. However, in the start-up phase, ADBN assumed the role of a strong promoter and main shareholder.”
The total paid-up capital of SKBB at present is almost NRs 105 million (USD 1.4 million). The biggest shareholder is ADBN with NRs 70 million (USD 959,000), followed by the Ministry of Finance with NRs 20 million (USD 274,000) and two commercial banks with a total shareholding of NRs 7 million (USD 96,000). All together 99 SFCLs have already invested NRs 8.1 million (USD 111,000). This amount is expected to increase significantly over the coming years. Despite being the second smallest shareholder, SFCLs are represented on the seven-member board with two representatives. The remaining seats are shared by ADBN with three representatives and by the Ministry of Finance and the Nabil Bank with one representative each. Box No. 2 shows the major developments of SKBB over the last years.

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>Start of the conceptual work</td>
</tr>
<tr>
<td>1999</td>
<td>Feasibility study was carried out</td>
</tr>
<tr>
<td>2000</td>
<td>Legal framework was designed</td>
</tr>
<tr>
<td>2001</td>
<td>Establishment under the Company Registration Act; the Nepal Rastra Bank (Central Bank) provided a banking operation license</td>
</tr>
<tr>
<td>2002</td>
<td>The first two regional offices were established</td>
</tr>
<tr>
<td>2003</td>
<td>The bank becomes the single largest provider of microfinance wholesale services in Nepal</td>
</tr>
<tr>
<td>2004</td>
<td>The bank has now seven regional offices</td>
</tr>
<tr>
<td>2004</td>
<td>SKBB receives membership of APRACA and CICTAB</td>
</tr>
</tbody>
</table>

### 4.4 Federations: The future pillar of non-financial support services

Besides the refinance facilities provided through the SKBB, SFCLs will still need technical assistance and guidance in the future. In order to achieve full autonomy from external support, SFCL federations will provide non-financial services to their members such as training, consultancy, supervision and auditing.

From the start, a guiding principle was to separate financial and non-financial services at the apex level. While SKBB was established to meet the financial requirements of the SFCLs, a federation system was to be set up for the non-banking services. In addition, as more and more SFCLs are emerging, a well functioning vertical structure is needed to provide those non-financial services to SFCLs, which ADBN was no longer in a position to deliver.

The federations at the district level will be business and services oriented. Income generating services, such as stationary management, cooperative audit, management consultancy and marketing support are to be launched. Business plans have already been prepared. Since the present cooperative act does not yet allow the registration of SFCL federations, the SFCLs have established ad-hoc committees to be operational. These ad-hoc committees operate in the same areas as the Sana Kisan Bikas Bank.
While the first three innovations, the three-tiered SFCL structure, the farmer-to-farmer replication, and the Sana Kisan Bikas Bank have been in operation now for many years, the federation concept is fairly new and still awaits full implementation.
5. Breaking with some "traditional" views

Having presented the four innovations in chapter four that emerged from the SFCL system in Nepal over the years, are there any lessons to be learned for both MF practitioners and scholars beyond Nepal? In this chapter a number of lessons learned will be presented that break with traditional MF thinking.

5.1 Multipurpose can work - many services, many customers

The present cooperative ideology is largely in favor of single-purpose cooperatives, simply because this type of cooperative has a long and successful track record. In contrast, multi-purpose cooperatives (MPCs) appear to have encountered many failures. MPCs are more complex to manage - they require a sound management and good market knowledge. In the past, MPCs were a prime target of supply-oriented government programmes. This did not only make them unmanageable, but spoiled their character and made the representatives easy to be affected by corruption and selfish behavior (Koch, 1986).

As the SFCL model in Nepal demonstrates, there might be specific rural conditions that could justify a multipurpose approach (see chapter 5.2). This approach will require the absence of government interference, the establishment of a profitable core business (such as financial services), a sound and experienced management and a demand oriented approach. Under these circumstances, MPCs will be attractive for their members and will have a fair chance to be successful and to prosper.

SFCLs represent premier self-help poverty reduction initiatives in that they provide savings opportunities and credit access to poor farmers. In addition, they promote a range of other financial and non-financial services. Other services offered are dairying, livestock insurance, veterinary services, various income generating skill training as well as social development activities such as literacy and awareness about family planning. They all directly contribute to the enhancing of income opportunities and quality of life of the member farmers. Thus, one may argue that SFCLs are successful because they offer not only credit (at market and above-market interest rates), but also provide other advantages for the members.

5.2 Big is beautiful - one village, one cooperative

In building MFIs, promoters often forget to think a priori about certain minimum criteria to ensure an institution’s future economic viability. In the case of the SFCLs, the promoters developed at the beginning some minimum standards such as number of members (around 350) and minimum loan portfolio size (around USD 40,000). These minimum standards should ensure that an organization is in a position to derive a margin from its loan portfolio to pay for administrative and financial costs.
To achieve these minimum standards, SFCLs need to include many households into their membership drive. Typically, an SFCL would reach between 30 to 70% of all households of a VDC in Nepal.

Particularly in the hill and remote areas of Nepal, there is less room for a variety of service providers that could compete for clients. Thus, the concept of establishing one service provider that offers a variety of services in a professional manner to a rather large number of members has proved to be viable.

5.3 Cold money vs. hot money – the magic of the AND

Cold money destroys the spirit of savings and self-help. This statement is well-accepted knowledge in microfinance since the end of the supply led rural credit paradigm in the 1980s. Yet, the experience gained from the SFCL network building shows that low savings can be effectively complemented with high external loans.

The major advantage of accessing external loans is a faster take-off of the institution. Shrestha (2004) has argued that in the SFCL case the bulk lending facilities of ADBN has been of great importance to the poor in making larger investments in their income generating activities. This did not only help the poor but also the SFCLs in building up their portfolio and transactions, and thus, to cover their operational and financial costs at an early stage.

The benefits of an early access to external refinance through the banking sector may outnumber the negative effects, which are usually associated in the MF literature with the provision of cold money such as low repayment rates. In the case of the SFCLs the right blend between cold and hot money proved to be a success factor.

The case of the SFCL Anandaban in Rupandehi District shows that with the right vision in place, cold money (external bank refinance) can be gradually replaced with hot money (local savings). Table 3 shows that it took the SFCL Anandaban eight years to become fully self reliant from external finance sources.
Table 3: SFCL Anandaban: Substituting "cold" money with "hot" money in eight years

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Pre-SFCL Position</th>
<th>I Year</th>
<th>II Year</th>
<th>III Year</th>
<th>IV Year</th>
<th>V Year</th>
<th>VI Year</th>
<th>VII Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowed Fund (including programme subsidies) / Total Asset</td>
<td>95%</td>
<td>86%</td>
<td>70%</td>
<td>50%</td>
<td>29%</td>
<td>19%</td>
<td>13%</td>
<td>2%</td>
</tr>
<tr>
<td>Total Deposits / Total Asset</td>
<td>5%</td>
<td>9%</td>
<td>19%</td>
<td>33%</td>
<td>52%</td>
<td>64%</td>
<td>71%</td>
<td>76%</td>
</tr>
<tr>
<td>Total Capital Fund / Total Asset</td>
<td>0%</td>
<td>0.4%</td>
<td>7%</td>
<td>16%</td>
<td>18%</td>
<td>16%</td>
<td>14%</td>
<td>15%</td>
</tr>
<tr>
<td>Net Outstanding Loan / Total Asset</td>
<td>95%</td>
<td>98%</td>
<td>89%</td>
<td>97%</td>
<td>98%</td>
<td>90%</td>
<td>87%</td>
<td>85%</td>
</tr>
<tr>
<td>Past due Loan</td>
<td>5%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Operational Self-sufficiency Ratio</td>
<td>N.A.</td>
<td>96%</td>
<td>160%</td>
<td>209%</td>
<td>144%</td>
<td>149%</td>
<td>120%</td>
<td>111%</td>
</tr>
<tr>
<td>Financial Self-sufficiency Ratio</td>
<td>N.A.</td>
<td>93%</td>
<td>155%</td>
<td>199%</td>
<td>133%</td>
<td>134%</td>
<td>112%</td>
<td>104%</td>
</tr>
</tbody>
</table>

5.4 NGOs only – Government can be effective, too

There has been a strong movement in the last decade to generally rely on NGOs for the provision of financial and technical services to the MF sector, particularly in Latin America. That Government could also be a reliable development partner has been almost forgotten. The SFCL case shows that successful institution building in the rural finance sector requires powerful, capable and professional institutions with a good political standing and backing, while the cooperation between the partners (i.e. ADBN, SKBB, SFCLs and GTZ) has to be built on trust.

The emergence of the SFCL system had not been possible without the leadership and determination of a public bank that is capable of reaching out to even the most remote areas of the country. Thus, it is not a question of either or, rather, it will always require a careful evaluation of each case to see whether the competitive advantages of NGOs or a government institution would best serve the purpose of a microfinance project.
6. More than just finance – reaching out to the poor

This next to last chapter tries to show the ultimate impact of the SFCL system on the village level and addresses the present difficult conflict situation in which the SFCLs have to operate.

6.1 The SFCL impact on the household level

A few impact studies have been conducted in the past. They consent that SFCLs have a substantial positive impact on the socio-economic situation of their members (ADBN, 2002; Sharma, Bhattachan & Shrestha, 2001). Living conditions have improved for a large majority (above 80%) of SFCL members, largely due to the access to credit. Independence from moneylenders was mentioned as an important change after joining the cooperative. Many cooperative members diversified their economic activities after joining the cooperative, in many cases including non-agriculture income opportunities. Most cooperative members make productive and rational use of the additional income they gained. Literacy levels, food consumption habits, sanitation and health conditions as well as social cooperation have improved. The mortality rate of children decreased while access to safe drinking water increased. Savings habits also increased, thus insuring the families against risks. Furthermore, the use of modern agricultural inputs increased. Even ecological aspects are better than before with the installation of biogas plants, construction of low cost latrines, more scientific use of organic manures and multi-service tree planting / maintenance. The Human Development of South Asia report (1997) concludes that "the human development indicators of families covered by the programme have shown a dramatic improvement".

Changes to the role of women have been observed as well. The results of a participatory assessment (Sharma, Bhattachan, & Shrestha, 2001) show increased awareness of the importance of equal treatment of girl children; increased cooperation between husband and wife; increased respect for women; decrease in prevalence of child marriages; better access to education for male and female children; women participation in income generation. Women started to become active even in the cooperative federations and local politics. However, women are still under-represented in the leadership and as office-bearers, but their numbers are increasing.

The number of women groups and female cooperative members is increasing much faster than the number of overall groups and membership. The major reason may be that cooperative decision-makers have realized that female members are more reliable credit clients and better co-operators than males. The women's group has been an immense instrument for lending them a sense of power both in the household and in the community. Since they engage in income generating activities on behalf of the households, there are now instances in which the men take care of the household chores while the women folk go about attending group meetings. Most SFCLs have
recognized women as the more responsible representative of the household and more reliable as the member of their cooperative. There is an enhanced emphasis on acquiring literacy and numerous skills by the otherwise illiterate women members. In the case of one 5-member woman group, four of them said they would like to be born as women again in the next life.

The SFCL approach is obviously highly effective, especially for poor small-farmers of the higher castes, which are over-represented in the cooperative leadership. Empirical evidence suggests that mature cooperatives do not generally exclude the landless nor low and non-castes, but they thoroughly select those that "fit in". This is a perfect rational behavior in order to not jeopardize the financial self-sufficiency of the cooperative. In fact, the cooperatives also exclude higher caste members and rich farmers if they have a bad reputation. In other words, the cooperatives act like any good banker would do.

6.2 If there only was no armed conflict…

Unfortunately, the country's social and economic development has taken a down turn due to the nine years old conflict between the Government and the Maoists. Until five years ago, the SFCLs could impress with double-digit growth rates in all major financial areas. Particularly over the last couple of years the quality of the loan portfolio has deteriorated. Maoists openly threaten the management of SFCLs to decrease interest rates on loans and encourage SFCL members not to repay any loans.

The Maoists have attacked out of 164 SFCLs, around 50. The most common form is the burning of SFCL documents and the looting of the land certificates of members that serve as the cooperative's collateral for the ADBN refinanced loans. It also appears that the Maoists are looking for the sympathy of those SFCL members, which have past due loans and which presumably would benefit most from destruction of an SFCL office. It is surprising, however, that obviously almost all of the attacked SFCLs were able to soon reopen their offices. This shows the great sense of ownership amongst the cooperative members.

While the crisis without doubt has an adverse effect on the overall development of the SFCLs, the situation needs to be analyzed very carefully. It appears that particularly in the times of crisis, "leadership" has become the single most important factor that relates to the success or failure of a SFCL. Despite the crisis there are still SFCLs that enjoy a good financial performance over the last years as can be seen from Table 2. This performance is mostly due to the good leadership provided by the chairman and the executive members of the Main Committee. These people serve as role models for the members of the cooperative by providing guidance and encouragement to overcome the current difficult situation.
In sharp contrast, there are cases in conflict-affected districts in which chairmen and executive members did not manage to agree on a joint policy on how to deal with the effects of the crises. Even worse, executive members started arguing about politics and became divided along the lines of the major political parties of the country. This behavior subsequently blocked major decisions within the committee. On top, some of the executive members started to delay the repayment of loans, which, of course, immediately translated into a further deterioration of the overall repayment of the ordinary members.

A good example of what happens if the factors of crisis and lack of leadership meet are the SFCLs in the Dhading district. Table 4 shows a decline in the performance of these institutions until July 2003. Only recently, so-called conflict workshops organized by ADBN, SKBB and GTZ, and involving executive members, ordinary members and the Dhading Federation, have started to address the issue of local leadership in the times of crisis. The initial results are very encouraging and indicate a reversal in the financial performance of the affected institutions. Thus, even in a difficult socio-economic and security environment, the performance of organizations can be improved under good local leadership.

Table 4: Leadership as a determinant of organizational performance

<table>
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</thead>
<tbody>
<tr>
<td>FS of conflict affected but performing SFCLs(^3)</td>
<td>86%</td>
<td>88%</td>
<td>142%</td>
<td>126%</td>
<td>110%</td>
<td>120%</td>
<td>122%</td>
</tr>
<tr>
<td>FS of conflict affected former non-performing SFCLs(^4)</td>
<td>72%</td>
<td>80%</td>
<td>92%</td>
<td>71%</td>
<td>75%</td>
<td>76%</td>
<td>112%</td>
</tr>
</tbody>
</table>

*FS = Financial Self Sufficiency Ratio*

The Dhading federation of SFCLs has shown how important apex structures can be in general and in times of crisis in particular. The intervention of the Federation into the management of a number of SFCLs in the Dhading district prevented a further deterioration of the performance of these institutions. The Federation held a series of workshops with conflict affected SFCLs in close cooperation with SKBB, ADBN and RUFIN, and facilitated a dialogue with the local Maoist leaders.

\(^3\) Sample includes SFCL Madhubaliya, SFCL Anandaban, SFCL Kerwani, SFCL Semail, SFCL Shankarnagar from Rupandehi District; SFCL Dumarwana from Bara District; SFCL Taratal from Bardiya District, SFCL Sakhawa from Dhanusa District; and SFCL Panchanagar from Nawalparasi District.

\(^4\) Sample includes SFCL Sunaulabazar, SFCL Salyantar, SFCL Salang, SFCL Madi, SFCL Dhola, SFCL Goganpani, and SFCL Kumpur all from Dhading District.
7. Conclusion – ten points worth remembering

The purpose of this paper was to outline in a precise manner some of the innovations and lessons learned that emerged from the SFCL system in Nepal.

A systems approach, vision and people's ownership have been identified and reconfirmed as important prerequisites of a successful programme approach.

With the understanding that innovations are "activities that differ significantly from current or recent practice", the following four innovations were proposed: (1) The unique three-tiered structure of the SFCLs that ensures good communication and accessibility to members, (2) The Sana Kisan Bikas Bank as an emerging apex bank to be owned by its clients, (3) The farmer-to-farmer replication approach that cuts institution building costs into half, and (4) The business oriented SFCL federations that provide non-financial support services only.

Other lessons learned from the SFCL system suggest that (1) multi-service cooperatives can work under certain conditions, (2) larger cooperatives have advantages over several smaller ones, (3) cold money can serve to quickly scale-up MF programmes, and (4) that government institutions can be effective and efficient partners, too.

Finally, let us remember ten points that summarize our experiences:

(1) Building sustainable, pro poor institutions, particularly in the field of rural finance, is an excellent vehicle to fight poverty.
(2) The process of institution building has to be guided by a vision to be shared by all the stakeholders and should be truly based on the ownership of the people.
(3) Views and insights gathered elsewhere are not to be treated as "holy cows". They can be overrun by own experiences based on a special situational context.
(4) Multipurpose cooperatives might have competitive advantages over single purpose cooperatives, depending on the environment they are operating in.
(5) Early refinancing of self-help organizations may work, provided the self-help spirit is intact and the motivation and interest in keeping up the institution is there.
(6) Cooperation with a strong government partner works, provided the long-term partnership is really built on trust.
(7) Successful institution building programmes will trigger social and economic changes in the villages, which will go far beyond providing, advanced financial services only.
(8) Building vertical or apex structures is a prerequisite for long lasting success, but only if these structures provide appropriate and economically sound services and if they are firmly supported
by the primary institutions.

(9) In times of crisis and armed conflict, good local leadership and management are of particular importance to the survival of grassroots organizations.

(10) Building sustainable grassroots institutions needs time and is an ongoing process. Results will not come overnight. Donors wishing to support institutions should have at least a medium-term perspective of 5 years.
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