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Transforming an Unsustainable Project into Sustainable Rural Financial Institutions: The Case of the Small Farmer Co-operatives Ltd. (SFCLs) in Nepal

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Transforming an Unsustainable Project into Sustainable Rural Financial Institutions

The Case of the Small Farmer Co-operatives Ltd. (SFCLs) in Nepal

by

Ulrich Wehnert & Roshan Shakya

January 2001

Note:
This paper was prepared for Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH. The project was based on a proposal by Hans Dieter Seibel, 1995.

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Abbreviations

ADB	Asian Development Bank
ADBN	Agricultural Development Bank of Nepal
GTZ	German Technical Co-operation
IDP	Institutional Development Process
IFAD	International Fund for Agricultural Development
IG	Inter-Group
MC	Main Committee
NGO	Non Governmental Organisation
NR	Nepalese Rupee, 1 US$ = 74 NR (December 2000)
NRB	Nepal Rastra Bank
PEARLS	Protection, Effective financial structure, Asset quality, Rate of return and cost, Liquidity and Sign of growth
SFCL	Small Farmer Co-operative Ltd.
SFDP	Small Farmer Development Project
SPO	Sub Project Office
USD	United States Dollar

Preface

Over the last decade, Nepal has turned into a microfinance laboratory, exploring various approaches to provide financial services to the rural poor, both in the hill and plain areas of the country. The list of institutions and programs engaged in rural finance is long and includes informal credit and savings associations, savings and credit co-operatives, multi service co-operatives, Grameen Banks, village banks, government and privately owned development banks as well as microfinance NGOs.

Rural Finance Nepal (RUFIN) is a joint Nepali-German project, implemented by the Agricultural Development Bank of Nepal (ADBN), with technical assistance from the German Agency for Technical Co-operation (GTZ). RUFIN aims at bringing sustainable financial services to the rural poor.

The largest provider of rural credit is the Agricultural Development Bank of Nepal (ADBN). In 1975 it started the Small Farmer Development Program (SFDP), the "mother" of all microfinance activities in Nepal, by introducing the joint liability concept to the country. IFAD was the first major donor, followed by Asian Development Bank. For a long time, the SFDP was considered an unsustainable credit program with low recovery rates and high overhead costs. Responding to this challenge, the ADBN started in the early 90's to transfer this program into autonomous and member-owned financial institutions, as part of its overall reform program.

This paper, through a comprehensive financial analysis, reviews the financial sustainability of these co-operative microfinance institutions, which are known in Nepal as Small Farmer Co-operatives Ltd. (SFCLs). The results of this viability check are very encouraging, and demonstrate that profitable microfinance business and outreach to the poor are not merely fantasy, but can be reality.

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Acknowledgements

This document was made possible due to the initiative, contributions and support of various people.

Special thanks go to Sylvia Wisniwski, who developed the methodology of the first financial viability study of 1999, which we largely applied to this study as well.

Rohsan Shakya took the initiative for a second test of the financial viability of Small Farmer Co-operatives Ltd. (SFCLs). He contributed significantly to this study. Special thanks go to Kishor Bachracharya and Kedar Lal Shrestha who also supported the study team.

Further appreciation goes to Stefan Staschen who carefully reviewed and commented on the first draft.

I would like to thank the SFCLs participating in this study for providing balance sheets and income and loss statements for our analysis.

Finally, much of the credit has to go to the persons responsible at the Agricultural Development Bank of Nepal, i.e. Devendra Pratap Shah, Jalan Kumar Sharma, Radha Acharya and Punya Prasad Lamsal. Under their leadership formerly government-owned bank branches have been transformed into what now appear to be increasingly sustainable grassroots organisations in the form of Small Farmer Co-operatives Ltd.

Ulrich Wehnert
Rural Finance Nepal

1. Introduction

1.1 Purpose of the Study

Small Farmer Co-operatives Ltd. are emerging in Nepal as effective tools for poverty alleviation. However, to claim that such tools are a sustainable approach, SFCLs have to demonstrate both, the capacity to reach the poor (outreach) and to cover their costs by internally generated revenues (viability).

In the past, many targeted credit programs in Nepal have failed due to their supply-led character and a resulting poor repayment performance. Interestingly, the Small Farmer Development Program was initially also a subsidised credit program. However, it recognised the shortcomings of this approach and succeeded in adopting a major policy shift towards an institution-building and more demand-driven approach of Small Farmer Co-operatives Ltd. (SFCLs). Today, microfinance organisations all over the world are struggling to serve poor clients in a sustainable manner. The case of the government-run Grameen Bank Replicators in Nepal demonstrates the big challenges experienced in this undertaking.

A first report on the financial viability of Small Farmer Co-operatives Ltd. (SFCLs) was already produced during the second half of 1999[1]. Some of the key findings of this study were:

- SFCLs show a strong trend towards reaching financial self-sufficiency;
- the best single performers are SFCLs with a predominantly female membership;
- the equity capital of many SFCLs is insufficient to cover their risks.

This report is a follow-up of the first financial viability study. This study intends to challenge and respectively validate earlier findings and to follow-up on the overall development path of SFCLs after completion of another fiscal year, i.e. 1999/2000. The number of samples discussed in this study has increased from 20 to 33 SFCLs[2]. The regional distribution of SFCLs in our sample is now more even. SFCLs with predominantly female membership have also been added to our discussion, which now brings their total number to four.

1.2 Methodology

To assess the financial viability of SFCLs, the study team followed a very similar methodology, which was successfully tested and used in the first viability study. We referred to the commonly accepted financial and operational self-sufficiency ratios, as well as some other well-known financial indicators.

With regard to the operational self-sufficiency ratio, the team decided this time to include financial costs in the calculation formula. The reason behind this was to allow better comparisons with other microfinance organisations and programs, which tend to prefer this kind of formula. Another difference

[1] Small Farmer Development Project Technical Assistance Team (GTZ): *Institutional Sustainability of and Impact on Small Farmer Co-operatives Limited,* Kathmandu, June 2000.

[2] The detailed financial ratios of individual SFCLs participating in this study can be obtained from rufin@gtz.org.np.

between this and the first study is the adoption of the PEARLS rating system with regard to loan provisioning of overdue loans.[3]

In order to come up with sound and meaningful results regarding the financial viability of SFCLs, the study team applied the following steps:

1. Selection of a sample of 33 SFCLs
In the selection process, the study team gave high priority to including all 29 districts in which SFCLs are operating. However, due to lack of proper financial statements SFCLs in the districts of Gorkha, Sanja and Pyuthan could not be included in the sample. Thus, altogether 33 SFCLs from 26 districts were selected for the study. Prior to the selection of SFCLs, the study team agreed on specific criteria for determining the number of SFCLs to be selected from a particular district. The following modus was applied: In districts with less than five SFCLs, one SFCL was included in our sample; in districts with five to ten SFCLs, two; with eleven to fifteen, three; and with more than fifteen, four organisations were included in our sample. In addition, one SFCL from Chitwan (Piple) and one from Illam (Smalbung) were included.

To participate in this study, the SFCLs had to provide consistent and complete data from balance sheets and income statements. The study is composed of 29 SFCLs having predominantly male members and 4 SFCLs with predominantly female members. Similarly, 15 SFCLs are situated in the hill areas, while 18 SFCLs are located in the terai of Nepal. In our study, 6 SFCLs with limited banking license from Nepal Rastra Bank were included. For a complete list of SFCLs participating in the study please refer to Annex 1.

TEXTBOX 1 Brief background on the Small Farmer Development Program

The SFDP was one of the first poverty alleviation efforts in Nepal, initiated by the Agricultural Development Bank of Nepal (ADBN) in 1975. After initial success and rapid expansion with the financial support of the ADB and the IFAD, the program experienced some setbacks due to high overhead costs and deteriorating recovery rates. In 1987, the ADBN introduced an action research Institutional Development Program (IDP) with the support of the German Agency for Technical Cooperation (GTZ). The objective of the new direction was to transfer the ADBN-run Sub Project Offices (SPOs) into fully self-administered and -managed co-operatives of small farmers.

A Small Farmer Co-operative Ltd. is a multi-service co-operative designed to deliver primarily financial, but also non-financial services to its members in rural areas. SFCLs are civil society organisations which pool their joint resources to meet basic needs and to defend their members' interests. They are member-owned and controlled and have an open membership policy towards "poor" farmers. An SFCL is a three-tiered organization with small farmer groups, inter-groups and a central committee as the main pillars.

In 1993, as a result of the IDP, the first four SPOs were transferred into SFCLs. Since then, 101 SFCLs have been established. Currently, the Small Farmer Co-operatives Ltd. in Nepal comprise a total of 56,000 members with outstanding loans of USD 9.2 million and internally generated resources of USD 1.5 million. Female membership stands at 33% and is increasing.

[3] PEARLS stands for **P**rotection, **E**ffective financial structure, **A**sset quality, **R**ates of return and cost, **L**iquidity and **S**igns of growth. Cf. David C. Richardson, *PEARLS Monitoring System*, World Council of Credit Unions Toolkit, Series No. 4, Madison 2000.

2. Adjustments to balance sheet and income statements

The present Co-operative Act in Nepal does not yet meet international accounting standards. Co-operatives, in our case SFCLs, are not obliged to do loan loss provisioning. Only SFCLs with a limited banking license from the Nepal Rastra Bank are obliged to do so. Furthermore, SFCLs receive an interest free revolving fund for a two years period and other small subsidies to build up business volume and to implement other income generating activities. These factors have to be considered when we try to assess the financial viability of these institutions. Thus, the following adjustments were made in the submitted balance sheets and income statements of SFCLs:

a) Regular provisioning for overdue loans

The PEARLS rating system is widely used to evaluate the financial health of co-operatives. This system is an analytical tool that helps co-operative management in its day to day decision making and planning. According to the PEARLS rating system, there are two types of loan loss provisioning. The first category is provisioning for loans less than one-year overdue. For this category it is suggested to assert provisioning of 35%. For overdue loan of more than one-year it is suggested to assert provisioning of 100%. In this study, a loan classification system of overdue loans in the form of an aging report was not available. Thus, the study team made provisions of 35% on overdue loans. A loan is considered to be overdue when payment is not made by the due date. In addition, “overdue loan” can be taken to mean only the installments due, and does not include the remaining balance of the overdue loan.

TEXTBOX 2 Key findings from a recent impact study on SFCLs

In early 2000, GTZ’s Impact Monitoring Unit (IMU) for Nepal conducted a study on the “Institutional Sustainability of and Impact on Small Farmer Co-operatives Ltd.”. The objectives were to assess whether SFCLs are *institutionally* viable grassroots organizations and to examine the impact of the program in terms of its ability to promote economic and social well-being of its members. The study assessed a sample of 11 SFCLs from hill and terai areas of Nepal with regard to their organizational sustainability in terms of management capacities, decision-making processes, member participation, resource mobilization and communication. The assessment was based on the perceptions of small farmers at various tiers of their respective organizations. The study showed that both economic and social living conditions of members had further improved after joining the cooperative organization. In particular, dependency on money-lenders had decreased significantly. More than 50% of the farmers reported that their children now have easier access to schools due to improved income levels. The study concluded, "The SFCLs are clearly emerging as viable grassroots organizations of Small Farmers". Nevertheless, there is also scope for improvement, particularly in the area of communication within the SFCLs. The study suggests relying more on Inter Group meetings as the key medium for communicating decisions of the main committee to the small farmer groups.

For more information please refer to "Small Farmer Development Project, ADBN/GTZ*, Institutional Sustainability of and Impact on Small Farmer Cooperatives Ltd.*, Kathmandu, June 2000".

b) Imputed cost of capital

The opportunity costs on equity and on concessional loans are often neglected when analysing microfinance institutions. In this study, a 10% opportunity cost rate has been applied to equity capital, reserve funds and undistributed profits. An 8% opportunity cost rate has been applied to the interest free revolving fund available to SFCLs in the first two years of operations.

c) Other income, expenses and subsidies

Some SFCLs have various income sources derived from activities, such as milk collection, telephone services, etc., which are not directly linked with banking business. These types of income and expenses have been excluded from this analysis. In addition, some SFCLs show donations or subsidies in their income statements. Where possible, these donations/subsidies have been excluded from the income statements.

3) Calculating financial ratios and other indicators for each SFCL

Once the above mentioned adjustments were made in the balance sheets and income statements, financial ratios and other indicators were calculated. The following table gives an overview on indicators and ratios used in the study:

TABLE 1 Definitions of indicators and financial ratios used in the study

Financial Ratios	Definition
Past Due Ratio	Last past due installments / outstanding loans
Total Capital Fund/ Overdue Loans	(Paid-up capital + reserve funds + undistributed profits)/ over due loans
Operational Self-sufficiency	Total income - (subsidies + other income) / (total operational expenses + total provisions total financial costs - other expenses)
Financial Self-sufficiency	Total income - (subsidies + other income) / (total operational expenses + total provisions total financial costs + imputed cost of capital – other expenses)
Internal Source to Loan Ratio	(Total deposits + paid-up capital + reserve funds + undistributed profits) / outstanding loans
Liquidity Ratio	Cash and bank account / deposits
Growth Rates	(Value for year 2 – value for year 1) / value year 1
Yield on Average Loans	(Total interest and commission income) / (previous outstd. Loans + current outstd. loans)/2
Interest Expenses and Commissions on avg. Loans	(Total interest and commission expenses) / (previous outstd. loans + current outstd. loans)/2
Fixed Costs on avg. Loans	(Total operational costs) / (previous outstd. loans + current outstd. loans)/2

1.3 Limitations of the Study

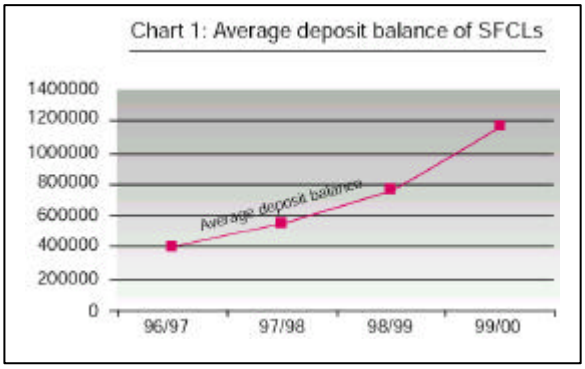
Although the study team followed a sound methodology for the assessment of the financial viability of SFCLs, a number of limitations do remain:

a) The study is based on primary (unaudited) financial statements of participating SFCLs. Therefore, there is no guarantee that the provided data and figures are 100% correct and subsequently, that the assessment based on these figures is without error.
b) The available data does not allow establishing a detailed aging report on those loans that are overdue. Thus, a “portfolio at risk figure”, which would include the entire outstanding principal of a loan which is overdue could not be calculated. This study, therefore, relies upon the “Past Due Rate”, which only considers the installments of a loan which have fallen past due. This procedure tends to underestimate the real risk of past due loans in a given loan portfolio.
c) SFCL staff has undergone training in accounting procedures. However, there remains the risk that figures have been recorded in improper budget lines due to a lack of management skills. In such cases, the study team used its own interpretation.
d) Not all direct subsidies paid to SFCLs could be identified. There might have been some smaller contributions/donations from Village District Committees or NGOs that are still registered as regular income.
e) In special cases, SFCLs are restructuring past due loans. This factor could also not be considered by the study team due to lack of available data.

2. Findings

Despite the above mentioned limitations, the findings of this comprehensive study will allow us to draw further conclusions on the financial viability of the Small Farmer Co-operatives Ltd. in Nepal.

a) Strong savings drive of SFCLs continues; average total deposits increased by 50% during the last fiscal year 1999/2000



In 1996/1997, each SFCL had average total deposits of NR 398,000 (USD 5,380).[4] This figure dramatically increased by 191% over a four year period to NR 1,159,000 (USD 15,660). As the chart on the left indicates, the upward trend is characterised by a gradual increase, which gained momentum during the last fiscal year (1999/2000), when the average total deposits more than doubled within that period.

When considering the development of the average deposit amount per member, the trend is quite similar to the above graph. The average deposit amounts of individual members increased by 276%, from NR 554 (USD 7.7) to NR 1,950 (USD 27) within a four year period (1996/97-1999/00). The increase in the average deposit amount per member is much more dynamic than the increase in the average loan amount per member. At the end of the fiscal year 1996/97, the average loan amount per member stood at NR 8,870 (USD 123); it increased by 47% over a four year period to NR 12,245 (USD 170) by the end of the fiscal year 1999/2000.

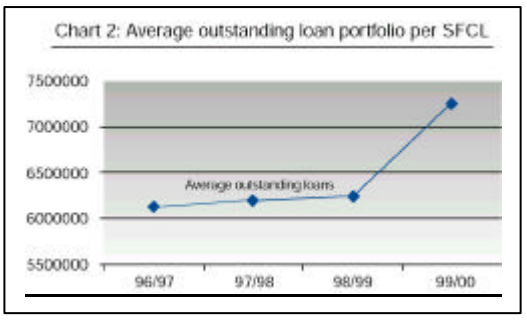
In our study, the upward trend in average loan and deposit amounts was topped by SFCLs with a strong female membership. The average loan amount for this group in 1996/97 was NR 7,044 (USD 98) with an average deposit amount per SFCL member of NR 621 (USD 8.6). Within a four year period, the average loan amount more than doubled to NR 14,167 (USD 196); the average deposit amount per SFCL member increased by more than 450% to NR 2,820 (USD 39).

Looking at individual cases, the highest average deposit amount per SFCL member was observed in the SFCL Anandavan, with NR 4,757 (USD 66) in 1999/2000. The largest average loan amount per SFCL member was reported from the SFCL Smalbung, Ilam district with NR 20,000 (USD 270).

b) Loan business picked up during last financial year 1999/2000

The development of the loan business of SFCLs over the last years can be best described as modest. The outstanding average loan portfolio in 1996/97 stood at NR 6.1 million (USD 82,400) and increased by 19% to NR 7.2 million

[4] In this study, all figures have been converted from NR into US Dollars at a rate of 1 USD = 74 NR.



(USD 98,000) in the fiscal year 1999/2000. Most of this increase, however, can be attributed to the last fiscal year as the included chart indicates (see chart 2: Average outstanding loan portfolio per SFCL). What are the reasons for the sudden increase in loan activities of SFCLs? The study team, after discussion with various involved parties, offers the following explanations:

- SFCLs increased their maximum loan amount for individual borrowers from NR 30,000 to NR 50,000 (USD 405 to USD 675);
- The ADBN conducted a series of "Problem Solving Workshops" with SFCLs in order to help remove bottlenecks in the refinancing process from the ADBN to SFCLs;
- Some SFCLs shifted from long term loans to loans with shorter maturity; this trend led to a higher turnover of loans;
- Climatic conditions for farming were very conducive during the last two years.

c) Improvement of loan portfolio quality continues

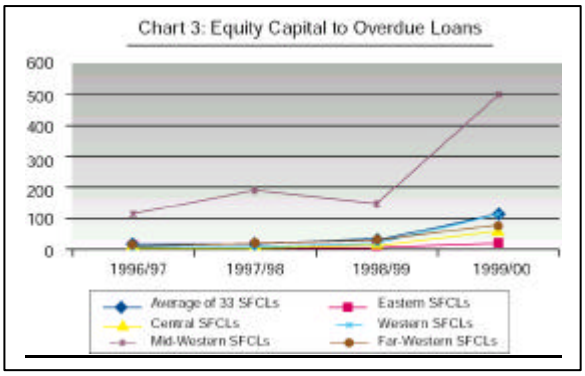
One way to look at the portfolio quality of a microfinance institution is to analyse the installments not paid on time by its members, and to relate it to the overall outstanding loans. The past due ratio for all SFCLs in our study stood at 18.5% in 1996/97, and gradually decreased to 14.1% in the fiscal year 1999/2000.

Surprisingly, the past due ratio of 16% for terai based SFCLs is clearly higher compared to that of hill based SFCLs at 11.9%. In addition, such SFCLs with more than 50% female membership generally did not manage to sustain such high performance as previous years. The past due ratio climbed from 2% in 1996/97 to 8.4% in 1999/2000. These figures are, however, still ahead of the figures calculated for the total average of participating SFCLs in the study.

d) Equity capital improved remarkably from very low levels during the last fiscal year

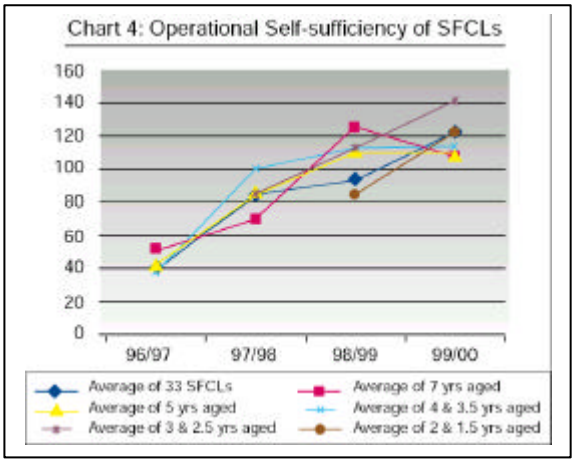
The first viability study on SFCLs raised strong concerns about the SFCLs' weak capital bases, which were considered to be too low to adequately cover risks associated with the loan business. Equity capital is defined in this context as total paid-up capital by members plus reserve funds and undistributed profits. The equity capital to overdue loan ratio shows the capacity of an institution to cover risks associated with a loan through its equity.

The data shows slight average improvements from 18.4% in 96/97, to 24% in 97/98 and to 32.8% in 98/99. However, in the last year (1990/00), the SFCLs managed to increase their equity capital to overdue loan ratio to 113.8%. The reason behind this very favorable development is that in the fiscal year 1999/2000 many SFCLs' operations became profitable. The equity capital, thus, increased due to growing undistributed profits.



The chart on the left reveals some fundamental regional differences with regard to the progress made by SFCLs towards building up a stronger equity base. SFCLs from the Central, Eastern, Western and Far-Western region experienced gradual and steady improvements over time. The SFCLs from the Eastern region are at the low-end with a 2.5% equity capital to overdue loan ratio in 1996/97, which improved to 17.3% in 1999/2000. In the Mid-Western region the equity capital to overdue loan ratio stood at more than 100% in 1996/97; the SFCLs in this region managed to bring this ratio up to an astonishing 500% in the fiscal year 1999/2000. They are thus clearly outperforming their fellow SFCLs in other regions of the country.

e) Operational Self-sufficiency has been achieved during the last fiscal year 1999/2000



Over the last four years, the SFCLs participating in our study managed to improve their operational self-sufficiency from an average of 40.3% in 1996/97 to 122.2% in 1999/2000. They are thus able to fully cover costs related to personnel and administration, loan provisioning and financing by internally generated revenues. This further supports and validates the findings from the first viability study, suggesting that SFCLs are efficient financial intermediaries with very low operating costs.

Interestingly, newly transferred SFCLs seem to more quickly achieve operational self-sufficiency than SFCLs, which were registered some five or seven years ago. This finding is substantiated by the chart above, which shows the operational self-sufficiency achieved by SFCLs after different years of operation. The chart indicates that SFCLs, which have been transferred very recently, manage to achieve operational self-sufficiency after only two years of operation.

The four SFCLs participating in our study with a female membership above 50% were again outperforming their fellow male dominated SFCLs. The operational self-sufficiency ratio of these four SFCLs jumped from 93.8% in 1996/97 to 132.4% in the fiscal year 1999/2000.

Do SFCLs from the terai region of Nepal achieve faster operational self-sufficiency than SFCLs from the hill areas? The data of our study does not support this view. SFCLs from the hill areas started with an operational self-sufficiency rate of 51.6% in 1996/97, which increased to 79.9% in 1997/98 and to 93.7% in 1998/99. It reached 122.6% in 1999/2000. In the terai region, SFCLs' operational self-sufficiency ratio was 32.7% in 96/97. It jumped to

85.2% in 1997/98 and further increased to 92.6% in 1998/99. It finally reached 121.8% in the last fiscal year. The data, thus, suggests that the SFCL model is in concordance with both the terai as well as hill regions of Nepal.

TEXTBOX 3 SFCL Anandavan, one of the best performing co-operatives

The Small Farmer Co-operative Limited (SFCL) Anandavan is situated in the terai region of the Rupandehi district. The Agricultural Development Bank of Nepal (ADBN) implemented the Small Farmer Development Program in 1977. At that time, the VDC did not have infrastructure facilities like today. Most of the people were migrants from the hill areas. In the meantime, through the program, the people built community roads, irrigation, and water supply schemes.

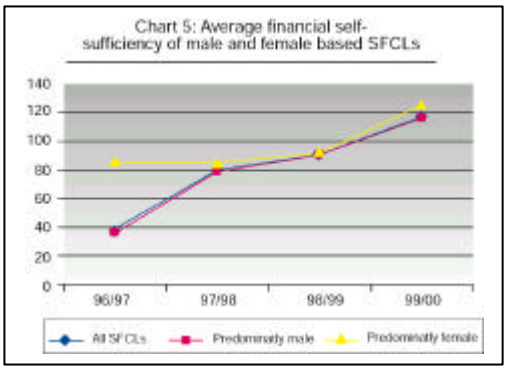
The ADBN introduced the Institutional Development Program (IDP) in this VDC in the mid-nineties. The main objective of the IDP, to transfer the government owned Sub-Project Office (SPO) into a small farmer owned and managed SFCL, was achieved in 1997 with the establishment of SFCL Anandavan, the second SFCL in this district.

By October 2000 the SFCL Anandavan had altogether 754 members, 654 of them female. This is the highest female participation ratio among the 101 SFCLs. The total outstanding loan amount was NR 8.5 million (USD 115,000) and collected deposits from members totaled around NR 3.3 million (USD 45,000). The equity share capital increased by 194% during the last fiscal year to NR 76,000 (USD 1,025) and undistributed profit amounted to NR 1.3 million (USD 17,500).

Over the last three years this SFCL has made tremendous progress, demonstrating that an SFCL can break even only after the second year since transformation. The financial self-sufficiency ratio stands at an impressive 196% for 1999/2000. Savings mobilization has been very dynamic with growth rates of 152% and 131% for the last two fiscal years. Due to this strong savings drive and the above mentioned increase in share capital, SFCL Anandavan managed to finance more than 50% of the loan portfolio through internal resources. Considering these results SFCL Anandavan was rated as the best performing SFCL in the last couple of years according to ADBN evaluation criteria.

Apart from this, SFCL Anandavan also provides other innovative financial services to its members, such as Pewa savings for old age and a livestock insurance scheme. Non-financial services include milk collection, irrigation programs and a rickshaw lending product for landless members.

f) SFCLs become fully financially sustainable with an average financial self-sufficiency ratio of 117.2% in the last fiscal year 1999/2000



The last financial viability study of February 2000 revealed a strong trend of SFCLs towards achieving financial-self sufficiency, resulting in an average figure of 92% for the year 1998/99.[5] By adding more SFCLs to our study, the results could be confirmed and even further improved by crossing the 100% line during the last fiscal year 1999/2000.

The chart above (Chart 5: Average financial self-sufficiency of male and female based SFCLs) shows the continuation of the positive upward trend during the last years. The 33 SFCLs' average financial self-sufficiency ratio for the year 1996/97 was

[5] The first viability study followed the Nepal Rastra Bank's deprived sector loan provisioning standards, which suggest making provisions of 0.25% on non-overdue and 15% on overdue loans. This is significantly lower than the PEARLS system used in this study, with its recommended 35% provisioning for overdue loans. However, the first study took into account extra write-offs for handed over loan portfolios from the ADBN to SFCLs at the day of transformation. This time, our present study neglects these extra write-offs, since the ADBN took steps with regard to this matter during the last fiscal year.

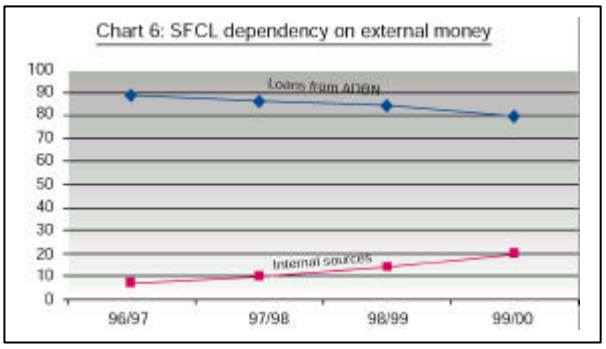
38.8%, doubled in 1997/98 to 79.2% and further increased in 1998/99 to 90.2%; in the last financial year 1999/2000 it crossed the 100% level to reach 117.6%. Except for the newly transferred SFCLs with only one year of operational experience, all SFCLs managed to achieve the 100% level.

While there was a huge gap in the fiscal year 1996/97 with regard to financial self-sufficiency ratios between female and male dominated SFCLs, the gap has narrowed over the last few years. The average financial self-sufficiency rate of predominantly female SFCLs was 85.4% in 1996/97, slightly declining to 84.3% in 1997/98, increasing to 92.2% in 1998/99 and finally jumping to 124.3% in the last fiscal year 1999/2000. The predominantly male SFCLs experienced gradual annual increases. In 1996/97 the ratio was at 35.5%, it doubled to 78.4% in 1997/98, continued to increase in 1998/99 to 89.9% and arrived at 116.5% in the last fiscal year.

The study also compared the average financial self-sufficiency ratios of SFCLs located in the hills with SFCLs located in the terai region of Nepal. Similar to the results obtained from the analysis of the average operational self-sufficiency ratios, there were no major differences found between SFCLs in the terai and those of hill areas with regard to the pace of achieving financial self-sufficiency.

Looking at individual cases in our sample of 33 SFCLs, the SFCL Anandavan emerged as one of the best-performing SFCLs in the last few years. Its Financial Self-sufficiency ratio improved from 92.7% in 1997/98 to 196.4% in the fiscal year 1999/2000. There are virtually no overdue loans attributed to SFCL Anandavan. This is a remarkable and truly exceptional result.

g) Increasing internal resources help SFCLs to become less dependent on external funds



The Internal sources of SFCLs are defined as total deposits plus paid-up share capital plus reserve funds and undistributed profits. By relating the internal sources to the outstanding loan amount, some clues regarding the dependency of SFCLs on external fund providers such as the ADBN can be ascertained. The chart above indicates that the SFCLs successfully managed to decrease their dependency by building up their own internal resources. Over the last few years, a steady increase of the Internal Source to Loan Ratio can be observed. From 1996/97 to 1999/2000 the ratio increased from 7.4% to 20.4%. Similarly, the ADBN refinance volume decreased from almost 88% in 1996/97 to 76.8% in 1999/2000. Nevertheless, the ADBN still plays a key role in the refinancing of SFCLs.

Looking at some sub-groups in our study, the highest internal source to loan ratio was observed in predominantly female SFCLs with 30.8% in the fiscal year 1999/2000. Our data does not suggest any differences in this ratio between hill and terai based SFCLs. On an individual level, the SFCLs Utterganga and Anandavan are top performers with an internal source to outstanding loan ratio of 51%.

3. Conclusion

The second financial viability study confirms the encouraging findings of the first study. The Small Farmer Co-operatives Ltd. in our sample have managed to achieve full financial self-sufficiency during the year 1999/2000. The results show that SFCLs are efficient financial intermediaries with very low operating costs. They are capable of covering these operating costs and of maintaining the value of capital with internally generated income.

For the SFCLs included in our sample, the financial year 1999/2000 was an unprecedented year with a very strong performance. All major financial figures and ratios improved substantially. For example:

- total savings mobilisation increased by 50%;
- loan business activities started to pick up with an increase of 16% after years of only modest increments;
- the past due ratio further declined to 14.1%;
- SFCLs crossed the 100% financial self-sufficiency mark and arrived at an average figure of 117%;
- the weak equity capital basis substantially improved by a 90% increase.

Looking closer at the financial self-sufficiency ratio (FSR) of SFCLs a few observations could be made:

- Female-dominated SFCLs with an average FSR of 124.3% are still doing a better job than male-dominated SFCLs with an average FSR of 116.5%. This is due to higher growth rates in deposit mobilisation and outstanding loans, while overdue loans in female-dominated SFCLs have become insignificant.
- SFCLs from the terai area of Nepal do not achieve faster financial self-sufficiency than SFCLs from the hill areas. In both areas the average FSR arrives at 117%. This observation is especially important when comparing the SFCL-model with the Grameen Bank Replicators in Nepal, which do struggle to break-even on an operating basis.
- Newly transferred SFCLs seem to more quickly achieve operational and financial self-sufficiency than older SFCLs. More recently transformed SFCLs could thus benefit from previous experiences by avoiding mistakes made by fellow SFCLs on their way towards sustainability.

The great challenge ahead will be to further build on these achievements. Another 75 Sub Project Offices of the ADBN are to be transformed into SFCLs within the next three years. The Small Farmers Development Bank is to be registered within the coming months. The establishment of a national federation of SFCLs is under consideration. All of these projects, however, will only succeed if the present trend towards sustainability continues.

Annex 1: List of participating SFCLs in the study

S.N.	Name of SFCL	Age	District	Region
1	Jeetpur	1 year	Ilam	Eastern
2	Prithvinagar	5 years	Jhapa	Eastern
3	Bahundngi	3.5 years	Jhapa	Eastern
4	Sundharpur	3.5 years	Morang	Eastern
5	Jhorahat	2.5 years	Morang	Eastern
6	PanchaKanya	2.5 years	Sunsari	Eastern
7	Basaha	5 years	Udaypur	Eastern
8	Hariharpur	2 years	Saptari	Eastern
9	Bhisnupur	4 Years	Siraha	Eastern
10	Jabdi	4 Years	Sarlahi	Central
11	Sakhuwa	2 years	Dhanusha	Central
12	Manahari	2 years	Makawanpur	Central
13	Dumarvana	3 years	Bara	Central
14	Kumroj	4 Years	Chitwan	Central
15	Bhumisthan	7 Years	Dhading	Central
16	Maidi	7 Years	Dhading	Central
17	Goganpani	4 Years	Dhading	Central
18	Salang	2 years	Dhading	Central
19	Sundharbazar	2.5 years	Lamjung	Western
20	Dhorphirdi	4 Years	Tanahu	Western
21	Makar Daunnedevi	1.5 Years	Navalparasi	Western
22	Anandvan	3 Years	Rupandehi	Western
23	Valkarpur	2 Years	Kapilbastu	Western
24	Narpani	3 Years	Arghakhachi	Western
25	Narayansthan	3 Years	Baglung	Western
26	Laxmipur	2 Years	Dang	Mid-western
27	Naubasta	4 Years	Banke	Mid-western
28	Tara tal	2 Years	Bardiya	Mid-western
29	Utterganga	4 Years	Surkhet	Mid-western
30	Attariya (Malakheti)	4 Years	Kailali	Far-western
31	Suda	2 Years	Kanchanpur	Far-western
32	Piple	4 Years	Chitwan	Central
33	Smalbung	1.5 Years	Ilam	Eastern

Annex 2: Summary sheets of SFCLs
Average Figure of all 33 SFCLs

	Mid-July 96 to Mid-July 97	Mid-July 97 to Mid-July 98	Mid-July 98 to Mid-July 99	Mid-July 99 to Mid-July 00
1. PAST DUE RATIO	18.5%	16.5%	14.8%	14.1%
2. TOTAL CAPITAL FUND / OVERDUE LOANS	18.4%	24.0%	32.8%	113.8%
3a. OPERATIONAL SELF-SUFFICIENCY (PEARLS)	40.3%	82.8%	93.1%	122.2%
3b. OPERATIONAL SELF-SUFFICIENCY (without provision)	60.0%	94.9%	101.3%	124.8%
4. FINANCIAL SELF-SUFFICIENCY (PEARLS)	38.8%	79.2%	90.2%	117.6%
5. INTERNAL SOURCE TO LOAN RATIO	7.4%	10.3%	14.3%	20.4%
6. DEPOSITS / INTERNAL SOURCE	87.4%	88.6%	89.4%	82.8%
7. LIQUIDITY RATIO (cash + bank account / deposits)	106.2%	68.6%	55.3%	26.2%
8. TOTAL CAPITAL FUND/INTERNAL SOURCE	12.6%	11.4%	10.6%	17.2%
9. GROWTH RATES				
Outstanding loans		9.0%	7.7%	16.9%
Overdue loans		19.0%	6.0%	6.0%
Deposits		59.8%	49.3%	54.2%
Livestock insurance		84.4%	14.8%	18.7%
Paid-up share capital		27.5%	12.3%	89.8%
Total members		3.7%	3.0%	6.8%
Female members		8.6%	6.4%	14.5%
10. AVERAGE SIZE				
Loan size per member	8,870	10,438	11,008	12,245
Deposits per member	554	901	1,352	1,950
Paid-up capital per member	54	73	73	133
Members per group	7	7	7	7
Loan amount per staff	1,732,947	1,726,691	1,881,695	2,012,081
Co-operative members per staff	193	167	174	169
Outstanding loan amount	6,124,886	6,195,132	6,242,001	7,258,146
Deposit balance	398,137	552,570	761,857	1,159,692
11. FINANCIAL MARGIN ANALYSIS				
Yield on average loan portfolio	7.8%	13.4%	13.7%	17.3%
Variable cost ratios:				
Interest expenses & Commission on average loan portfolio	11.8%	12.9%	12.5%	12.0%
Provisions over average loan portfolio	6.5%	2.7%	1.6%	0.4%
Contribution margin for fixed costs	-10.5%	2.2%	-0.4%	4.8%
Fixed costs on average loan portfolio	2.0%	2.4%	2.3%	2.6%
Net position	-12.5%	-3.7%	-2.7%	2.2%
12. TOTAL LOANS TO TOTAL ASSETS	75.1%	77.1%	77.5%	80.4%
13. LOANS FROM THE ADBN TO TOTAL OUTSTANDING LOANS	87.9%	86.3%	84.1%	77.5%
14. FEMALE MEMBERS TO TOTAL MEMBERS	31.6%	34.5%	35.7%	37.2%
Number of SFCLs covered	15	22	32	33

Average of Male Dominated SFCLs

	Mid-July 96 to Mid-July 97	Mid-July 97 to Mid-July 98	Mid-July 98 to Mid-July 99	Mid-July 99 to Mid-July 00
1. PAST DUE RATIO	19.7%	18.3%	15.7%	14.9%
2. TOTAL CAPITAL FUND / OVERDUE LOANS	3.9%	6.8%	16.4%	60.7%
3a. OPERATIONAL SELF-SUFFICIENCY (PEARLS)	36.4%	81.7%	92.6%	120.8%
3b. OPERATIONAL SELF-SUFFICIENCY (without provision)	57.2%	94.7%	100.1%	123.5%
4. FINANCIAL SELF-SUFFICIENCY (PEARLS)	35.5%	78.4%	89.9%	116.5%
5. INTERNAL SOURCE TO LOAN RATIO	7.0%	10.0%	13.5%	18.9%
6. DEPOSITS / INTERNAL SOURCE	88.9%	89.3%	90.4%	82.7%
7. LIQUIDITY RATIO (cash + bank account / deposits)	111.6%	72.0%	53.9%	26.0%
8. TOTAL CAPITAL FUND/INTERNAL SOURCE	11.1%	10.7%	9.7%	17.3%
9. GROWTH RATES				
Outstanding loans		10.1%	8.0%	15.8%
Overdue loans		21.5%	2.0%	11.4%
Deposits		65.8%	45.7%	51.0%
Livestock insurance		97.7%	14.3%	17.1%
Paid-up share capital		31.2%	11.3%	92.7%
Total members		4.0%	2.5%	3.9%
Female members		9.6%	6.0%	10.7%
10. AVERAGE SIZE				
Loan size per member	9,000	9,939	10,565	11,980
Deposits per member	549	860	1,248	1,830
Paid-up capital per member	56	75	75	140
Members per group	7	7	7	7
Loan amount per staff	1,790,482	1,680,509	1,878,689	2,030,260
Co-operative members per staff	197	169	179	173
Outstanding loan amount	6,363,637	6,347,820	6,372,751	7,356,980
Deposit balance	409,061	576,020	767,123	1,128,224
11. FINANCIAL MARGIN ANALYSIS				
Yield on average loan portfolio	7.5%	13.6%	13.7%	17.2%
Variable cost ratios:				
Interest expenses & Commission on average loan portfolio	11.9%	13.1%	12.8%	12.0%
Provisions over average loan portfolio	6.9%	2.9%	1.6%	0.4%
Contribution margin for fixed costs	-11.2%	2.8%	-0.7%	4.7%
Fixed costs on average loan portfolio	2.0%	2.4%	2.3%	2.6%
Net position	-13.2%	-3.8%	-3.1%	2.1%
12. TOTAL LOANS TO TOTAL ASSETS	74.1%	75.8%	76.9%	79.6%
13. LOANS FROM THE ADBN TO TOTAL OUTSTANDING LOANS	89.1%	86.5%	84.4%	78.7%
14. FEMALE MEMBERS TO TOTAL MEMBERS	28.2%	29.5%	31.7%	32.8%
Number of SFCLs covered	14	19	28	29

Average of Female Dominated SFCLs

	Mid-July 96 to Mid-July 97	Mid-July 97 to Mid-July 98	Mid-July 98 to Mid-July 99	Mid-July 99 to Mid-July 00
1. PAST DUE RATIO	2.0%	5.1%	8.4%	8.4%
2. TOTAL CAPITAL FUND / OVERDUE LOANS	220.9%	188.4%	185.8%	627.5%
3a. OPERATIONAL SELF-SUFFICIENCY (PEARLS)	93.8%	89.8%	97.0%	132.4%
3b. OPERATIONAL SELF-SUFFICIENCY (without provision)	99.6%	95.8%	109.9%	134.5%
4. FINANCIAL SELF-SUFFICIENCY (PEARLS)	85.4%	84.3%	92.2%	124.9%
5. INTERNAL SOURCE TO LOAN RATIO	13.1%	12.0%	20.6%	30.8%
6. DEPOSITS / INTERNAL SOURCE	67.1%	83.8%	82.7%	83.1%
7. LIQUIDITY RATIO (cash + bank account / deposits)	31.0%	47.3%	64.6%	27.4%
8. TOTAL CAPITAL FUND/INTERNAL SOURCE	32.9%	16.2%	17.3%	16.9%
9. GROWTH RATES				
Outstanding loans		1.9%	6.0%	25.5%
Overdue loans		3.3%	34.2%	-33.0%
Deposits		21.3%	74.4%	77.4%
Livestock insurance		0.0%	18.3%	30.1%
Paid-up share capital		4.4%	19.2%	68.5%
Total members		2.1%	6.9%	27.8%
Female members		2.2%	8.9%	42.1%
10. AVERAGE SIZE				
Loan size per member	7,044	13,600	14,112	14,167
Deposits per member	621	1,161	2,083	2,820
Paid-up capital per member	39	60	64	83
Members per group	6	7	7	7
Loan amount per staff	927,462	2,019,182	1,902,738	1,880,289
Co-operative members per staff	132	152	136	141
Outstanding loan amount	2,782,385	5,228,111	5,326,754	6,541,603
Deposit balance	245,197	404,054	724,994	1,387,834
11. FINANCIAL MARGIN ANALYSIS				
Yield on average loan portfolio	11.1%	12.2%	13.8%	17.9%
Variable cost ratios:				
Interest expenses & Commission on average loan portfolio	10.3%	12.2%	10.3%	12.2%
Provisions over average loan portfolio	0.7%	1.6%	1.8%	0.2%
Contribution margin for fixed costs	0.2%	-1.6%	1.8%	5.4%
Fixed costs on average loan portfolio	2.1%	1.9%	2.0%	2.7%
Net position	-1.9%	-3.3%	-0.2%	2.8%
12. TOTAL LOANS TO TOTAL ASSETS	88.7%	85.5%	81.5%	85.9%
13. LOANS FROM THE ADBN TO TOTAL OUTSTANDING LOANS	70.6%	84.9%	82.1%	68.8%
14. FEMALE MEMBERS TO TOTAL MEMBERS	80.3%	66.2%	63.8%	68.8%
Number of SFCLs covered	1	3	4	4

Average of Hill Based SFCLs

	Mid-July 96 to Mid-July 97	Mid-July 97 to Mid-July 98	Mid-July 98 to Mid-July 99	Mid-July 99 to Mid-July 00
1. PAST DUE RATIO	16.2%	17.0%	14.5%	11.9%
2. TOTAL CAPITAL FUND / OVERDUE LOANS	40.0%	44.2%	57.4%	188.4%
3a. OPERATIONAL SELF-SUFFICIENCY (PEARLS)	51.6%	79.9%	93.7%	122.6%
3b. OPERATIONAL SELF-SUFFICIENCY (without provision)	68.9%	99.1%	102.6%	123.5%
4. FINANCIAL SELF-SUFFICIENCY (PEARLS)	49.4%	75.7%	90.2%	117.3%
5. INTERNAL SOURCE TO LOAN RATIO	9.1%	12.2%	15.7%	20.8%
6. DEPOSITS / INTERNAL SOURCE	86.5%	88.0%	90.2%	85.2%
7. LIQUIDITY RATIO (cash + bank account / deposits)	82.9%	72.6%	57.7%	29.4%
8. TOTAL CAPITAL FUND/INTERNAL SOURCE	13.5%	12.0%	9.8%	14.8%
9. GROWTH RATES				
Outstanding loans		4.0%	8.9%	16.0%
Overdue loans		15.5%	17.2%	-19.5%
Deposits		37.3%	51.1%	43.0%
Livestock insurance		9.3%	11.4%	14.8%
Paid-up share capital		14.5%	16.3%	26.9%
Total members		2.7%	3.2%	2.3%
Female members		4.6%	7.7%	4.6%
10. AVERAGE SIZE				
Loan size per member	8,482	9,326	10,478	12,151
Deposits per member	633	896	1,360	1,984
Paid-up capital per member	54	68	76	111
Members per group	6	7	7	6
Loan amount per staff	1,368,822	1,354,463	1,595,550	1,790,236
Co-operative members per staff	164	148	157	154
Outstanding loan amount	4,725,802	4,540,373	5,035,115	5,844,215
Deposit balance	379,664	473,833	687,032	1,002,884
11. FINANCIAL MARGIN ANALYSIS				
Yield on average loan portfolio	9.8%	14.1%	14.7%	17.1%
Variable cost ratios:				
Interest expenses & Commission on average loan portfolio	12.8%	13.3%	13.8%	12.0%
Provisions over average loan portfolio	5.7%	4.7%	1.3%	-0.1%
Contribution margin for fixed costs	-8.7%	-1.9%	-0.4%	5.2%
Fixed costs on average loan portfolio	2.6%	2.8%	2.6%	2.8%
Net position	-11.3%	-4.6%	-3.1%	2.4%
12. TOTAL LOANS TO TOTAL ASSETS	77.2%	76.0%	78.1%	80.6%
13. LOANS FROM THE ADBN TO TOTAL OUTSTANDING LOANS	82.6%	84.1%	82.4%	75.9%
14. FEMALE MEMBERS TO TOTAL MEMBERS	38.6%	35.7%	38.6%	38.2%
Number of SFCLs covered	6	10	14	15

Average of Terai Based SFCLs

	Mid-July 96 to Mid-July 97	Mid-July 97 to Mid-July 98	Mid-July 98 to Mid-July 99	Mid-July 99 to Mid-July 00
1. PAST DUE RATIO	20.0%	16.0%	15.1%	16.0%
2. TOTAL CAPITAL FUND / OVERDUE LOANS	4.0%	5.8%	12.5%	48.0%
3a. OPERATIONAL SELF-SUFFICIENCY (PEARLS)	32.7%	85.2%	92.6%	121.8%
3b. OPERATIONAL SELF-SUFFICIENCY (without provision)	54.1%	91.3%	100.2%	125.9%
4. FINANCIAL SELF-SUFFICIENCY (PEARLS)	31.7%	82.1%	90.2%	117.7%
5. INTERNAL SOURCE TO LOAN RATIO	6.3%	8.7%	13.3%	20.0%
6. DEPOSITS / INTERNAL SOURCE	88.0%	89.1%	88.8%	80.7%
7. LIQUIDITY RATIO (cash + bank account / deposits)	121.7%	65.3%	53.4%	23.5%
8. TOTAL CAPITAL FUND/INTERNAL SOURCE	12.0%	10.9%	11.2%	19.3%
9. GROWTH RATES				
Outstanding loans		13.2%	6.8%	17.7%
Overdue loans		22.0%	-2.6%	27.2%
Deposits		78.5%	47.8%	63.6%
Livestock insurance		147.0%	17.4%	21.9%
Paid-up share capital		38.4%	9.2%	142.2%
Total members		4.5%	2.9%	10.5%
Female members		12.0%	5.4%	22.7%
10. AVERAGE SIZE				
Loan size per member	9,128	11,365	11,421	12,324
Deposits per member	502	904	1,346	1,921
Paid-up capital per member	55	78	71	151
Members per group	7	7	7	7
Loan amount per staff	1,975,698	2,036,882	2,104,252	2,196,953
Co-operative members per staff	212	182	188	181
Outstanding loan amount	7,057,610	7,574,098	7,180,690	8,436,422
Deposit balance	410,452	618,185	820,053	1,290,365
11. FINANCIAL MARGIN ANALYSIS				
Yield on average loan portfolio	6.4%	12.8%	13.0%	17.4%
Variable cost ratios:				
Interest expenses & Commission on average loan portfolio	11.1%	12.7%	11.5%	12.1%
Provisions over average loan portfolio	7.0%	1.1%	1.9%	0.8%
Contribution margin for fixed costs	-11.6%	5.6%	-0.4%	4.5%
Fixed costs on average loan portfolio	1.6%	2.0%	2.0%	2.5%
Net position	-13.3%	-3.0%	-2.4%	2.0%
12. TOTAL LOANS TO TOTAL ASSETS	73.7%	78.1%	77.1%	80.2%
13. LOANS FROM THE ADBN TO TOTAL OUTSTANDING LOANS	91.4%	88.1%	85.4%	78.9%
14. FEMALE MEMBERS TO TOTAL MEMBERS	27.0%	33.5%	33.5%	36.3%
Number of SFCLs covered	9	12	18	18