PERFORMANCE OF REGIONAL RURAL DEVELOPMENT BANKS OF NEPAL

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Certification

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ABSTRACT

This paper tests the performance of Regional Rural Development Banks (RRDBs) adopting 'institutional studies' approaches, using indicators that reflect outreach; operational and financial performance; sustainable interest rate and subsidy dependence index (SDI) and assessment on various management aspects governing their operation. The information used in this paper is the published progress report as well as audited income statement and balance sheet of these banks obtained from Nepal Rastra Bank, the centre bank of Nepal and discussion on their management.

The result indicates that despite almost identical operating conditions and policies on governance and institutional linkages; operational strategy; products and delivery; MIS, internal control; financial management and accounting policies; and human resource management, there exist considerable variations on performance of five RRDBs due to differences on practices and micro level differences. While RRDBs in western and eastern region are relatively well performing, the one in central region has mixed performance and the performance of RRDBs in mid and far western region is below standard. The outreach performance of RRDBs is low compared to their potential demand mainly due to their ownership with de-facto political interferences, lending methodology, targeting to rural areas, diversification of loan product, portfolio size, loan size, reporting standard and reporting accuracies.

The results show that RRDBs are not viable and self-sustainable at present. The RRDBs in western, eastern and centre region have prospects for attaining viability and self-sustainability, while viability and sustainability of the RRDBs in mid and far western region is doubtful. The interest rate charged by RRDBs are kept low and do not allow them to cover all costs. In addition, there is significant inefficiencies on realising interest income as evident by momentous differences between effective interest rate charged and return on average performing asset (APA) realised.

The results indicate that RRDBs are dependent on subsidies. Consistent to their viability level, RRDBs in eastern, centre and western region have the lowest SDI in contrast to RRDBs in mid and far western region.

Based on analytical findings, the paper suggest that more attention should be placed on ownership structure of RRDBs, improving operating efficiency, introducing efficient management information system and some work on setting standard on (i) return on APA, (ii) ratios such as financial cost and operating cost to APA, number of loans to motivator, outstanding portfolio to motivator, and loan size and (iii) amount of transactions to be carried out at a given level of expenditures. The paper stresses that the sustainable RRDBs can not be developed without long term efforts, some patience, and outside support. The outside supports are particularly essential for institution building (training, information, sensitizing, etc.) and for establishing new branches and developing innovative products.

TABLE OF CONTENT

ABSTRACT ..... **I**

TABLE OF CONTENT ..... **III**

LIST OF TABLES ..... **IV**

LIST OF FIGURES ..... **IV**

ACRONYMS AND ABBREVIATION ..... **IV**

1. INTRODUCTION **1**

1.1 BACKGROUND 1
1.2 OBJECTIVES 5
1.3 METHODOLOGY 5
1.4 ORGANISATION OF THE PAPER 6

2. THEORETICAL AND ANALYTICAL FRAMEWORK **6**

2.1 THEORETICAL FRAMEWORK 6
2.2 ANALYTICAL FRAMEWORK 8
2.2.1. Outreach *8*
2.2.2. Operational and Financial Performance *10*
2.2.3. Sustainable Interest Rate *13*
2.2.4. Subsidy Dependence Index *14*

3. ANALYSIS OF PERFORMANCE OF RRDBS **14**

3.1 ESTABLISHMENT AND GEOGRAPHICAL COVERAGE 14
3.2 GOVERNANCE SYSTEM 15
3.3 OPERATIONAL STRATEGY 17
3.3.1. Client development and expansion *17*
3.3.2. Competitive response *18*
3.3.3. Organisation structure *19*
3.4 PRODUCTS AND DELIVERY 20
3.4.1. Client coverage *20*
3.4.2. Savings Products *21*
3.4.3. Loan Products *22*
3.5 MANAGEMENT INFORMATION SYSTEM 23
3.6 INTERNAL CONTROL FOR RISK MANAGEMENT 24
3.6.1. Loan Products *25*
3.6.2. Internal Audit *25*
3.6.3. Portfolio Quality *26*
3.7 ACCOUNTING POLICIES AND FINANCIAL MANAGEMENT 27
3.8 HUMAN RESOURCE MANAGEMENT 28
3.8.1. Recruitment, Orientation and Training *28*
3.8.2. Staff Performance Evaluation *29*
3.9 ISSUES IN SUSTAINABILITY 31
3.9.1. Financial Performance *32*

3.9.2. Sustainable Interest Rates *34*
3.9.3. Subsidy Dependence Index *35*
3.10 COMPARATIVE ASSESSMENT OF RRDBS 35
3.11 PROBLEMS OF RRDBS 37
4. CONCLUSION AND RECOMMEDNATIONS 39
4.1 CONCLUSION 39
4.2 RECOMMENDATIONS 40
ANNEXES 42
ANNEX A: OUTREACH, OPERATIONAL AND FINANCIAL ASPECTS OF THE RRDBS 43
ANNEX B: ANALYSIS OF THE RRDBS RELATED INFORMATION 48
ANNEX C: FRAMEWORK FOR COMPARATIVE ASSESSMENT OF THE RRDBS 53
REFERENCE 56

LIST OF TABLES

TABLE 1: CHARACTERISTICS OF RRDBS 15
TABLE 2: RRDBS' RESPONSE TO COMPETITION IN THE 'FIVE FORCES' FRAMEWORK 19
TABLE 3: TOTAL CLIENTS AND LOAN CLIENTS OF RRDBS 21
TABLE 4: VALUE OF PERSONAL SAVINGS (RS. '000) 21
TABLE 5: VALUE OF GROUP FUND BALANCE (RS. '000) 22
TABLE 6: VALUE OF OUTSTANDING LOAN BALANCE (RS. '000) 23
TABLE 7: PORTFOLIO QUALITY OF THE RRDBS IN 2003 27
TABLE 8: ADMINISTRATIVE EXPENSES ANALYSIS OF RRDBS AS OF JULY 2003 30
TABLE 9: STAFF EFFICIENCY ANALYSIS OF RRDBS AS OF JULY 2003 31
TABLE 10: FINANCIAL PERFORMANCE OF THE RRDBS AS OF JULY 2003 33
TABLE 11: INTEREST RATE (%) IN 2003 34
TABLE 12: SUBSIDY DEPENDENCE INDEX IN 2003 35
TABLE 13: INDICATORS SHOWING COMPARATIVE STATUS OF THE RRDBS 36

LIST OF FIGURES

FIGURE 1: DETERMINANTS OF MFI'S PERFORMANCE 9
FIGURE 2: ORGANISATIONAL STRUCTURE OF RRDBS 20

ACRONYMS AND ABBREVIATION

ADBN	Agriculture Development Bank Nepal
APA	Average Performing Asset
AsDB	Asian Development Bank
CEO	Chief Executive Officer
CGAP	Consultative Group to Assist the Poorest
CRRDB	Central Regional Rural Development Bank
DWD	Department of Women Development

ERRDB	Eastern Regional Rural Development Bank
FI	Financial Intermediary
FSS	Financial Self-Sufficiency
FWRRDB	Far Western Regional Rural Development Bank
IBP	Intensive Banking Programme
IDP	Institution Development Programme
MCPW	Microcredit Project for Women
MDB	Microfinance Development Bank
MFI	Microfinance Institution
MWRRDB	Mid Western Regional Rural Development Bank
NABIL	Nepal Arab Bank Limited
NBL	Nepal Bank Limited
NGO	Non Government Organisation
NRB	Nepal Rastra Bank
OSS	Operating Self Sufficiency
PCRW	Production Credit for Rural Women
RBB	Rastriya Banijya Bank
RMDC	Rural Microfinance Development Centre
RRDB	Regional Rural Development Bank
RSRF	Rural Self Reliance Fund
SBB	Swabalamban Bikas Bank
SCC	Savings and Credit Cooperatives
SCOs	Savings and Credit Organisations
SDI	Subsidy Dependence Index
SFCL	Small Farmer Cooperative Limited
SFDB	Small Farmer Development Bank
SFDP	Small Farmer Development Programme
UNICEF	United Nations Children Fund
VDC	Village Development Committee
WCCU	World Council of Credit Unions
WRRDB	Western Regional Rural Development Bank

1. INTRODUCTION

1.1 Background

The lack of access to formal financial services in rural and semi-urban areas and the inability of the informal sector to provide sustainable financial services to the poor led to the emergence of innovative financial institutions in Nepal. These innovative financial institutions, usually labelled under the term "Microfinance Institutions (MFIs)" have emerged with the support of government, civil institutions and donor organizations.

Over the last few years, two broader consensuses are reached among Nepalese planners and policy makers for the growth and development of microfinance sector. First, the financial needs of the poor populations are structural needs and institutions that target at the poor have to be sustainable. Second, MFIs can not be successful without appropriate legal and regulatory framework. Backed by these two consensuses, over the last 5-7 years greater focus has been provided on setting a legal and regulatory framework, adopting policy to gradually withdraw subsidy, and providing greater attention on MFIs sustainability.

Within existing legal and regulatory provisions of Nepal, MFIs are those institutions established and operated under Cooperative Act 1992, Development Bank Act 1996, and Act for Non Government Organisation involving in Financial Intermediation 1999. Thus, legally Nepalese MFIs are: Regional Rural Development Banks (RRDBs), Microfinance Development Bank (MDB), Financial Intermediary Non Government Organisations (FI-NGOs), Savings and Credit Cooperatives (SCCs); Small Farmers' Cooperative Limited (SFCLs) and apex institutions providing wholesale loan to MFIs for retail lending. The number of MFIs has been growing since implementation of financial reforms and creation of the legal and regulatory framework. As of May 2004, there are five RRDBs, four MDBs, 44 FI-NGOs, over 2300 SCCs and 144 SFCLs in Nepalese microfinance sector. There are three apex institutions: Rural Microfinance Development Centre (RMDC), Small Farmer Development Bank (SFDB) and Rural Self Reliance Fund (RSRF) in Nepal.

The history of formal microfinance services in Nepal is temporally short but eventful. The chain of events seems to be marked by a costly process of trial and error rather than by

institutional dynamism. The landmark was set by cooperative societies instituted under the Rapti Valley Development Scheme in early 1950s which were primarily intended to provide credit to agricultural sector. Initially these institutions evolved under an executive order as the country lacked legal basis for the purpose. The cooperative Department was established in 1954 with the objective of promoting and assisting the operations of these cooperative societies. Realising that this arrangement undermined financing needs of these societies led to the establishment of Cooperative Bank in 1963. Further, Agriculture Development Bank on Nepal (ADBN) emerged in cognizance to the shortfall in the supply of funds for agricultural loans experienced by these credit cooperatives (Sinha, 2000). A well-structured and specialised programme to cater to the financial needs of the poor was provided further impetus with the launching of the Small Farmer Development Programme (SFDP) in 1975 within ADBN. This programme, which covered the entire country at times, aims at organising farmers into small groups and providing credit on a group guarantee basis.

Over the past few years, a process of institutionalising the small farmer groups formed under SFDO into the SFCL has been under way. This process is being undertaken with the purpose of creating locally owned and managed MFIs that can take over the activities of SFDP on a self sustaining basis. ADBN has, so far, been able to convert its 144 sub-project offices into registered SFCLs. However, the overall coverage of SFDP is still relatively low (Shrestha, G. K. 1999).

In 1974, one year before launching of SFDP, Nepal Rastra Bank (NRB) directed commercial banks to invest 5% of their total deposits in the "small sector" to promote rural finance (AsDB, Manila and NRB 1994). This scheme is collectively renamed the "priority sector" that divert credit to cover agriculture, cottage industry and service sectors. The lending requirement for commercial banks to priority sector was increased to 7% in 1976 and further to 12% in 1990. NRB directed that 25% of these priority sector loans or 3% of the total portfolio to the hardcore poor under the "deprived sector credit" programme.

In 1981, to strengthen the priority sector programme, NRB introduced the Intensive Banking Programme (IBP) which was intended to do away with collateral requirements and to get the banks to engage in group-based lending (DEPROSC, Nepal and J. Ledgerwood, 1997). The programme was undertaken by two large commercial banks [Nepal Bank Limited

(NBL) and Rastriya Banijya Bank (RBB)] and latter by the first joint venture bank in Nepal, the Nepal Arab Bank Ltd. (NABIL). Unfortunately, in practice, neither of the objectives of the programme was achieved; rather it largely bypassed the poorer segments of population, reaching instead non-poor small sector.

The next main step in development of Nepalese microfinance came in the form of the first gender-focussed programme, Production Credit for Rural Women (PCRW), in 1982 by Ministry of Local Development (MLD) in collaboration with the United Nations Children Fund (UNICEF) and NRB. This involved organising women groups and training them to undertake group-based borrowing from NBL, RBB, and ADBN. Encouraged by the results and learning from the experience of this initiative, the same department in 1994 started the Microcredit Project for Women (MCPW). This was more innovative since, for the first time in a government-sponsored programme, it involved NGOs as intermediaries in financial service delivery (DEPROSC, Nepal and J. Ledgerwood, 1997).

NGOs and cooperatives have also had an increasing role to play in the delivery of microfinance in Nepal. While the proportion of the over 30,000 NGOs[1] engaged in microfinance is not known, the number with limited banking licenses provided by NRB under Financial Intermediary Act 1999, has grown to 44 in a period of four years of introduction of the act and policy. FI-NGOs acquire loanable fund from two apex institutions namely RMDC and RSRF.

As discussed already, the first credit cooperatives were established by executive order in Rapti valley of Chitwan district in 1956, which is often described as the beginning of institutional credit in the rural sector (Sharma, S. R. and V. Nepal. 1997). Initially the cooperatives were provided financial support from the Government through the Cooperative Development Fund. The growth of these credit cooperatives received a significant impetus with the establishment of the Cooperative Bank in 1963 which was later converted into ADBN. Subsequently, the management of the cooperatives was handed over to the Department of Cooperatives in 1979. In 1992, to stem the growing political interference and to institutionalise cooperatives as people's institutions, a new cooperative act (Cooperative Act 1992) was enacted. This Act helped promote the growth of cooperatives

[1]Registered under the Society Registration Act, 1978.

and by 2003/04 over 6,000 000 cooperatives registered under this act. These included over 2300 SCCs (Sharma 2004) which are savings and credit focused, as opposed to multipurpose cooperatives. SCCs are viewed as a feasible alternative model to provide microfinance services, especially in remote hills and mountains of Nepal.

In 1992, in an important initiative to augment the supply of microfinance, the first two RRDBs (one in the eastern and other in the far western region) were established with government and NRB funds as replications of the Grameen Bank of Bangladesh. By mid-July 1997, five RRDBs were established, one for each region. While initially four of the RRDBs were established under the Commercial Banks Act 1984, the fifth was registered under the Development Banks Act 1996 (Sharma and Nepal, 1999). As of May 2004, Grameen Model has been replicated through five RRDB, four MDBs, one cooperative and three FI-NGOs[2] in Nepal. The rational for the establishment of RRDBs was to offer a proven model of low cost, sustainable credit delivery system to poor women by-passed by other programmes. Since the replication of the Grameen Model, there has been a number of research articles, published and unpublished reports on RRDBs, most of them written on poverty alleviation, loan supervision approach, women empowerment, and institutional set up rather than on assessing their performance (Dhakal 2001 and 2002).

Although the 'apparent' success of RRDB has widely been accepted, much consideration has also been given to comparing RRDBs' performance with other lending agencies working in Nepal which were created a long time ago by the public sector, also targeting the poor. Since RRDBs has always been claiming that 'RRDBs is a bank, not a charity', despite charging higher interest rates than other MFIs, they have good recovery rates and relatively rapid expansionary trends. RRDBs have achieved some social goals for the betterment of the poor in terms of empowering women to be self-reliant; it is also desirable that they should be self-reliant. But with over 7-12 years' of operation, RRDBs still depend on government grant to meet the need of their clients. The question on 'whether RRDBs are sustainable or not' seems justified and in-depth assessment of the performance of the RRDBs is obviously desirable.

RRDBs are essentially public sector institutions with majority NRB and government ownership, and it has been often cited that it is for that reason, more than any other, that

[2] The three FI-NGOs are NRDSC, NERUDO and TRWS.

they have developed a culture of low staff productivity and political interference. In spite of apparently negligible loan losses, these banks are often blamed to be poorly performing. Further, many claim that there is significant variation on performance of these RRDBs, with the one in eastern, central and western regions performing fairly better than those in mid and far western region, which are rather ad-hoc, derived without systematic assessment of their performance. The feasibility of providing credit to the poor has been widely examined by various researchers so far. As a result, RRDBs' accomplishment has also been studied but there still remains a gap to be filled through a systematic study of their performance.

1.2 Objectives

This paper aims at assessing whether RRDBs are sustainable or not through a systematic evaluation of their performance. The specific objectives of this paper are to:

- analyse the outreach and sustainability of the RRDBs;
- make comparative assessment in terms of their outreach and sustainability;
- identify the problems (if any), of RRDBs in terms of their outreach and sustainability; and suggest remedies to the problems encountered;

1.3 Methodology

The information used in this paper were collected through a review of literature such as books, journals, discussion papers, published and unpublished reports and RRDBs' outreach report, audited balance sheet and income statement. A theoretical and analytical framework of studying performance of MFIs in general and RRDBs in particular was developed through a review of the works done elsewhere on assessing MFIs' performance. This framework has been used for assessing RRDBs' performance.

Ratios showing outreach, operating and financial performance, portfolio, efficiency and productivity have been used to make assessment on the financial health and overall performance of RRDBs. Personal observations of the author's involvement both as a promoter and practitioners in the Nepalese microfinance sector over last 20 years have been used as appropriate while analysing various dimensions of RRDBs performance.

1.4 Organisation of the paper

This paper includes four sections. Section one provide context, objectives and methodology of the study, followed by the theoretical and analytical framework for MFIs performance assessment in section two. Section three provides assessment on performance of the RRDBs while section four provides a summary of conclusions and recommendations that emerged from the analysis in this paper.

2. THEORETICAL AND ANALYTICAL FRAMEWORK

2.1 Theoretical Framework

The lack of access to savings, credit and insurance services is among the main constraints facing low-income households and the poorest in the developing countries that contributes on limiting the ability of the poor to finance their activities, improve their incomes, and access to basic services such as food, education, medical services, clothing, etc. (Zeller and Sharma 1998). Because commercial banks neglect to provide savings and credit services to them, the poor, at least until the 1950's, almost exclusively borrowed from informal sources (Adams and Vogel 1986). In order to mitigate imperfections in financial markets, microcredit projects were established after the Second World War under governments' and donors' support with the objective to reach the greatest number of poor people and to provide them with financial services at a low cost. In view of wide believe that the key determinant of the poor demand for credit was its costs, these programmes were largely subsidized and the approach known as "welfarist approach" or "directed credit approach". Based on logic of subsidization, this approach led to high unpaid rates and transaction costs, resulting in failure of these programmes (Von Pischke *et al*. 1983; Yaron 1994).

Economists such as Adams, Graham and Von Pischke were among the first to show that most of directed credit programmes launched in developing countries have failed owing to the faulty conceptions such as (i) the poor are neither creditworthy nor able to save; (ii) credit should be cheap in order to allow small farms and urban micro-activities to be profitable enough; (iii) subsidized microcredit may decrease the role of informal lenders which charge high interest rates; (iv) financial transactions on informal financial markets

would not be significant, and (v) commercial banks would not operate in rural areas because transaction costs are higher (Congo 2002). Most rural finance experts claim that each of these assumptions led to 'worst practices' resulting inefficient and costly policies: (i) low interest rates had often led to gross distortions and mis-targeting in services; (ii) subsidized credit constantly encouraged borrowers to engage in less productive activities, and contributed to significantly increased loan losses; (iii) cheap formal credit benefited only rich households, i.e. a tiny proportion of the population; (iv) finally, low interest rates prevented full recovery of transaction costs, and severely affected the performance of financial institutions. These findings led to a new approach characterized by the will to liberalize financial markets.

This new approach, commonly known as an "institutionalist approach" or "financial market approach" strongly influenced financial reforms implemented in developing countries emphasize that subsidies led to a worse allocation of financial resources, and to unsustainable institutions. The defenders of this approach (Gurgand *et al.* 1994, Graham 1986, etc.) seek to establish institutions offering microfinance services on sustainable and commercial bases. Such MFIs emphasize financial self-reliance and viability, and charge high interest rates because of high lending costs. The objective is to reach large numbers of poor in a sustainable manner (Gurgand *et al.* 1996; Yaron and Charitonenko 1998; etc.).

These two approaches (welfarist approach and institutional approach) still co-exist. Many MFIs are caught into twin challenges of finding new sources of external funding to increase their loan portfolio in order ensure their financial viability; and providing services to low-income and poor people to reconcile their economic and social objectives. This contrasted opposition between two trends of thought commonly known as "microfinance schism" characterized by methods to evaluate performance of MFIs. The 'welfarists' measure the performance of MFIs on the basis of 'welfare studies' or 'household studies' focusing on MFIs' impact on living conditions of its beneficiaries. Welfare studies are strongly criticized by the 'institutionalists' because of their subjectivity, their cost and methodological difficulties. They would rather deal with "institutionalist studies" and are interested in market variables, such as the repayment rate, transaction costs and degree of financial self-reliance. The welfarists, in turn, object to the institutionalists because of their failure to take into account the outreach performance including MFIs effects on poor. Therefore, they propose other performance criteria: the number of savings accounts or the number of loans,

the improvements in productivity, incomes, capital accumulation, food expenditures, and social services (education, health, etc.). Thus, today, there is neither an agreed upon nor a widespread definition of a well-performing MFI. The performance criteria and indicators[3] used vary significantly from one author to the next or from one organization to another, since they depend on methodological approach, which, in turn, depends on determination to give priority to the supply and demand side of financial intermediation.

2.2 Analytical Framework

The word "performance" possesses broad notion, which covers social, economic, institutional, ecological and financial dimensions. MFI's sustainability is commonly considered as the proxy for their performance in undertaking micro-lending effectively and efficiently and is the function of different constituents affecting their operations such as governance and institutional linkages; operational strategy; product and delivery; management information system; internal control for risk management, accounting policies and financial management; and human resource management. Practices adopted by MFIs on these factors enable them to tailor their service delivery that suits local conditions and attain sustainability. Within this framework, analytical technique adopted in this study encompasses the performance criteria introduced by Yaron (1992b, 1997) and those instituted by CGAP (1996). Yaron and CGAP suggest four key criteria such as outreach, operational and financial performance, sustainable interest, and subsidy dependence index (SDI) to evaluate the performance of MFIs. Great majority of studies are based on these criteria (Gurgand *et al.* 1996; Larrivière and Martin 1998) and the analytical approach adopted in this paper is centered on these four key criteria.

2.2.1. Outreach

Outreach is defined as MFI's ability to provide high quality financial services to a large number of clients and this concept addresses fundamental difference between MFIs and normal commercial finance institutions - most MFIs are established to accomplish a mission

[3]Many authors and organizations have published evaluation methods such as PEARLS by World Council of Credit Unions, Micro-Rate by Private Sector Initiative Corporation and by UNCTAD, CAMELS developed by ACCION International, performance criteria designed by CGAP/World Bank, USAID's Microenterprise Innovation Project, etc.

that is partly or wholly socially motivated and not simply to maximize investors' return. Although these missions differ, most MFIs include extending financial services to the poor and excluded and the commonly used outreach indicators[4] are focused on capturing combination of quality, cost, depth, breadth, length and variety of services that MFI offers in the form of scale of savings services, scale of lending services and services to women.

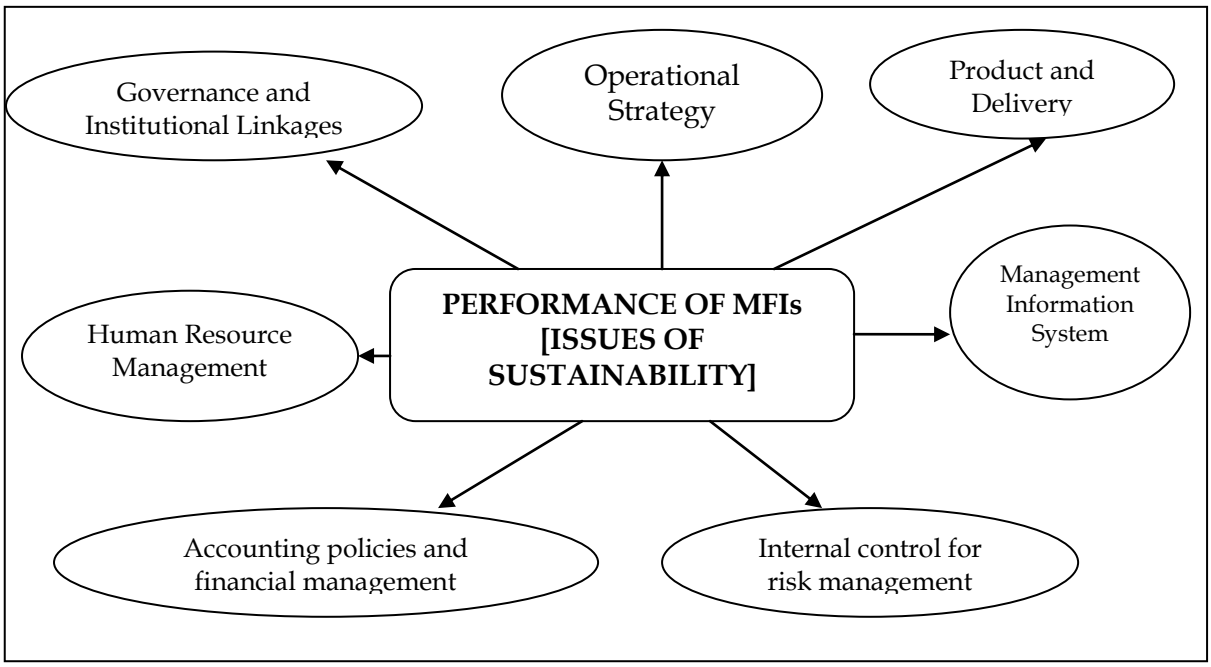

Figure 1: Determinants of MFI's Performance

Indicators such as number of savings accounts and average savings balance measure scale of saving services. The former indicator measures the extent of saving services and appropriate targets vary according to location and size of MFI's investments, while later is computed dividing total saving by total individual savings accounts. Where savings are voluntary, a positive trend would be an increase in average savings balance. Given same clients group and voluntary saving policies, a higher average savings balance indicates a program's greater comparative success at mobilizing savings.

Number of active loan clients, outstanding portfolio, average outstanding loan balance and average loan size to average per capita GNP are indicators measuring scale of lending services. Active loan clients refer to clients who currently hold loan. Number of active clients measures scale of lending services and for efficiency at least 95% of MFIs clients must be

[4]These are the indicators recommended by CGAP for assessing MFIs' performance.

active loan client. Outstanding portfolio refers to a total current value of loans not paid at specific date. It is a standard measure of size of lending services. In general, an increasing portfolio is a positive trend if it is caused by a growth in a number of active clients and growth in loan size of existing clients. Average loan size is computed dividing outstanding loan balance with active loan clients that measures depth of outreach with small average loan size signifying that loan has been extended to more poor. Average per capita Gross National Product (GNP) is estimated value of per capita annual productivity and provides a measure of average per capita national annual wealth. Average loan size can be compared to this figure to provide cross-national comparison of MFIs' relative outreach to lower income population. Lower figure for this ratio indicates that a MFI is reaching a relatively lower income segment of the population.

Number of women clients and total savings and outstanding loan balance with women clients are the commonly used indicators to measure outreach to women. Most MFIs aim to achieve at least 50% outreach to women. RRDBs have identified women as an underserved and disadvantaged group who are particularly likely to channel additional income to children's needs, hence, exclusively targeted their services to them. Hence, all the services provided by RRDBs relates essentially the services provided to women.

2.2.2. Operational and Financial Performance

Close scrutiny of operational and financial performance is instrumental to assess MFIs sustainability. Conceptually, sustainability requires that MFIs must cover all transaction costs (loan losses, financial costs, administrative costs, etc.) with return on equity (net of any subsidy), and consequently function without subsidies. Typical financial and operational performance indicators are financial performance ratios, operational performance ratios and portfolio quality ratios that provide extent at which MFIs are making best use of resources and providing services at least cost.

2.2.2.1. Financial Performance Ratios

Financial performance is assessed analyzing income, expenses and self-sufficiency level of the MFIs. Performing assets constitute most important asset used by the MFI for generating

income. In view of the stock (asset) and flow concept (income and expenses) prevailing on MFI's financial statement, concept of average performing asset (APA) has been used which can be calculated taking sum of bank deposits, investments, and performing portfolio (exclusive of reserve) of two periods and dividing by two to obtain an average. Return on performing assets ratio, the main indicator to analyse MFI's income which measures financial productivity of credit services and investment activities, computed dividing financial income by APA. An increasing return on this ratio is a positive trend. Analysis of this ratio is useful for determining the impact of lending policy changes that might affect MFI's return and commissions.

Ratios such as financial cost, operating cost, loan loss provision, and imputed cost of capital are commonly used for analyzing expenses. Financial cost ratio shows the average cost of funding MFI's assets with debts, and derived by dividing financial cost by the APA. It is sensitive to a number of factors such as changes in mix between debt and net worth, between commercial and concessional loans, and in size of the loan portfolio being financed; hence, interpretation of the trend for this indicator depends on the situation. Operating cost ratio is measured by dividing operating by the APA. As a key indicator of financial efficiency, the operating cost ratio shows how much an institution must spend on operating cost to keep a unit of money loaned out for one year. This ratio decreases if MFI reduced its costs while increasing its portfolio. Loan loss provision ratio is computed dividing loan loss provision for a given period by the APA and indicates provisioning requirements on the loan portfolio for the current period. Imputed cost of capital ratio relates to the cost of maintaining purchasing power of organization's net worth and calculated dividing imputed cost by the APP. Inflation erodes value of an organization's equity and quasi-equity (concessionary loans); it is therefore necessary for the organisation to earn a surplus to keep pace with inflation. The imputed cost of capital qualifies the impact of inflation on an institution's net worth. Decreasing trend on all the costs discussed indicates organization's increasing efficiency over time.

Operating and financial self-sufficiency ratios are measured for analyzing current state of MFI's self-sufficiency. Operating self-sufficiency (OSS) ratio is computed by dividing financial income by the sum of financial cost, operating costs and loan loss provision and indicates whether MFI is earning enough revenue to cover its transaction costs. On the other

hand, financial self-sufficiency (FSS) ratio is calculated by dividing financial income by the sum of financial and operational costs, loan loss provision, and imputed cost of capital and indicates the degree to which an organization is earning enough revenue to cover all its transaction cost while maintaining value of its equity and quasi-equity relative to inflation. One hundred percent FSS is necessary for institution to provide credit services over long run without being reliant on donor funds. An increasing trend in OSS and FSS is considered a positive development.

2.2.2.2. Operating Performance Ratios

Operating performance is measured analysing relative performance on minimising the transaction cost on MFI operation. Some of the operating performance indicators are ratios such as administrative cost to transaction cost, average client per credit officer and outstanding portfolio and credit officer. Administrative cost to transaction cost ratio is the simple division of administrative cost by total transaction cost and indicates transaction efficiency of MFI. According to Christen (1997), the norms of 'optimal practices' assume that well-managed MFIs should be able to maintain the ratio of administrative expenses to transaction costs between 15 % and 25 %. Active clients per credit office ratio are obtained by dividing number of active clients by number of credit officers (motivators in case of RRDBs) and signify the productivity of key MFI's staff. Productive MFI may have active clients per credit officer ratio of 300-400. A positive trend would be an increase in this ratio, if it were not accompanied by an increase in the portfolio in arrears and loan loss ratio. Finally, outstanding portfolio per credit officer ratio is obtained by dividing outstanding portfolio by number of credit officers and indicates credit officer's productivity. In combination with lower staff costs, this ratio is a key indicator for financial viability. The portfolio per credit officer ratio monitors financial productivity of credit officers, which is an important determination of loan revenues.

2.2.2.3. Portfolio Quality Ratios

MFIs are essentially credit-driven. Loan portfolio is by far the largest asset managed by them and if it is not managed well, un-recovered loans may well become an institution’s largest expense. Good portfolio management is the basic feature of a sustainable institution. Bad

portfolio quality saps energy of an institution as staff attention need to divert to loan recovery that lead to escalate cost with additional effort, while income begins to fall as a result of missed interest payments. Commonly used portfolio quality indicators are ratios such as portfolio in arrears, portfolio at risk, loan loss and reserve. Portfolio in arrears ratio is defined as the payments in arrears divided by the outstanding loan balance. As such, it indicates the proportion of loan payment past due. It considers only those payments of a loan that are currently past due. Portfolio at risk ratio is defined as the value of outstanding balance of loan arrears divided by outstanding portfolio. It measures the amount of default risk in portfolio. This ratio is better reflection of risk of a delinquency problem because it considers the value of the loans to be at risk when it is arrears. An aging analysis of portfolio at risk is a key element of a portfolio report. This ratio is critical to a careful monitoring of portfolio quality, and to evaluate policies implemented to control delinquency. A portfolio at risk ratio of more than 10% is considered to be an indicator of low quality portfolio. Loan loss ratio is defined as the amount written off this period divided by the average loan outstanding. It indicates the extent of un-collectable loans over the previous period. A decreasing trend in both these ratios is a positive development. Finally, reserve ratio is defined as the loan loss reserve divided by loan outstanding. This indicates what percentage of the loans outstanding is expected to be unrecoverable. As a safety net, reserve ratio should be equal to loan loss ratio.

2.2.3. Sustainable Interest Rate

Sustainable interest rate is rate that MFI need to realize on mobilizing its APA, if it wants to fund its growth primarily with commercial funds at some point in the future. In this paper, sustainable interest rate of RRDBs is estimated using the methodology suggested by CGAP (1996) as under.

$$R = [(AE + LL + CF + K)/(1 - LL)] - II$$

Where;

R	=	Annualized effective (or viable) interest rate
AE	=	Administrative costs
LL	=	Loan losses
CF	=	Financial costs
K	=	Desired capitalization rate
II	=	Investment income.

Each variable in this equation is divided by average outstanding loans, and is therefore expressed as a decimal fraction.

2.2.4. Subsidy Dependence Index

The subsidy dependence index (SDI) is defined as the ratio which measures the percentage increase in the average on-lending interest rate required to compensate an MFI for the elimination of subsidies in a given year while keeping the return on equity equal to approximate non-concessional borrowing cost (Yaron 1997). In this paper RRDBs dependence to subsidies is measured by using SDI developed by Yaron (1992, 1997) using following formula and parameters there-off.

$$\mathbf{SDI} = \frac{\mathbf{S}}{\mathbf{LP} * \mathbf{i}} = \frac{\mathbf{A(m-c)+[(E*m)-P]+K}}{\mathbf{LP} * \mathbf{i}}$$

Where;
SDI = Subsidy Dependence Index;
S = Total subsidy;
A = Subsidy on concessional rate borrowing;
m = Market (reference) interest rate;
c = Concessional interest rate;
E = Annual average equity;
P = Profit (losses);
K = Miscellaneous grants and benefits;
LP = Annual average loan portfolio and
i = Lending interest rate.

3. ANALYSIS OF PERFORMANCE OF RRDBS

3.1 Establishment and Geographical Coverage

There are five RRDBs, one each in the far western, mid-western, western, central and eastern development regions of Nepal. The Far Western RRDB (FWRRDB) and Eastern RRDB (ERRDB) were established towards the end of 1992 while the Mid Western RRDB (MWRRDB) and Western RRDB (WRRDB) were established in the beginning of 1995. The latest Central RRDB (CRRDB) was established in June 1996. Establishment of these banks is another effort of government to fulfil its commitment towards poverty reduction. RRDBs

represent an innovative outreach model patterned on the Grameen Bank Bangladesh to cater the financial needs of the deprived sections of the society, especially in rural areas. The rational behind their establishment lies at providing institutional outreach of microfinance services to those sections of the society which still remained outside the targeted credit programme such as IBP, SFDP and PCRW.

Table 1: Characteristics of RRDBs

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	Establishment (year)	1992	1996	1995	1995	1992	
2	District covered (No)	9	12	13	4	5	43
3	VDC covered (No)	262	246	273	102	83	966
4	Branch offices (No)	44	38	41	22	20	165
5	Centres (No)	1375	1172	1111	551	583	4792
6	Groups (No)	11274	7712	8038	3897	3419	34340

Source: NRB, 2004

The RRDBs are capitalised by HMGN and NRB up to 75 % of the paid-up capital of Rs. 60 million each, the balance being subscribed by other banks and financial institutions. The rational behind their establishment lies at providing institutional outreach of microfinance services to those sections of the society which still remained outside the targeted credit programme such as IBP, SFDP and PCRW. As of July 2003, RRDBs had organised 34,340 groups and 4,792 centres from 966 VDCs of 43 (20 terai and 23 accessible hill) districts - *See Table 1*. WRRDB has the maximum and FWRRDB has the minimum geographical coverage.

3.2 Governance System

RRDBs were formed under the promotion of NRB. In aggregate, NRB hold two thirds of their share capital, the government 9.95%, commercial banks 22.1% and other financial institutions 1.27%. The paid-up capital is Rs. 60 million each. In the past RRDBs are managed by NRB-appointed staff seconded to each RRDB for 2-3 year term, while lately NRB has started a system to recruiting professional managers under performance-related contracts. There are 5-8 directors in the board. There is government dominance on ownership and management of RRDB and suffer from frequent change of top management.

The impact of government ownership on the management of the RRDBs has manifested itself in several ways. First, the success of certain RRDBs, particularly those associated with the large numbers of borrowers they have reached has led the political parties to begin to see

the banks as "vote banks". Political parties like to claim the credit for the accomplishments of the RRDBs and mobilise members to support their parties. Second, the board of directors, including the Executive Director and its Chairperson, are supposed to elect for a term of four years, however, each of the changes of the government in the past has been usually followed by the replacement of the Executive Director and Chairperson of the GBBs, and often Board members as well. Third, several of the other top positions in the banks have been awarded to political party workers on the basis of their affiliation rather their banking competence. This has led to serious instability of management, and has made more difficulties for the banks to focus on their mission - reaching on a sustainable basis a maximum number of poor women borrowers. Forth, even the decision for locations of some branch offices and headquarters also appear to have been based on political rather than financial criteria. Fifth, in all the RRDBs, staff have organised themselves into trade union. RRDBs' workers are frequently demanding higher benefits and allowances, more job security, specific postings, etc. While all the workers have the rights to organise and to join the unions, the attitude of the workers and their expectations about their employment conditions are far more consistent with the civil service than for a poverty focused organisation. This is making impossible for the RRDBs' to reach financial viability. For instance, in Grameen Bank of Bangladesh, workers' pay raised are directly linked to productivity increases, within the context of providing secure and sustainable credit to the poor. Sixth, salaries of the RRDBs' workers are considerably higher than private GBRs. The implications are clear: movement toward financial self-sufficiency will be lower, and the orientation has not been toward increases of borrowers under each staff. Seventh, in the past most RRDBs does not follow the proper recruitment procedures, including placement of advertisements and conducting of examinations, thereby having on efficient operation of these banks.

The weak governance and the lack of professionalism and accountability among top management of RRDBs have deteriorated financial positions of RRDBs. Dominance in their ownership and management, a lack of Grameen-type culture although they follow Grameen operating principles, a lack of staff commitment towards their work typified by civil-servant behaviour and low staff productivity, insufficient attention paid to obtaining full cost recovery of services, frequent change of top management and instances of member groups being formed through government intervention have been the characteristic features of these banks. The RMDC, an apex institution to provide wholesale loan to RRDBs, found

them ineligible for borrowing due to their poor financial performance. Every year, RRDBs are recurring additional losses, which have caused to negative net-worth position in the two oldest RRDBs (EGBB and FWGBB). The RRDBs can not work as envisaged and meet their mission on poverty reduction unless NRB and the Government should not initiate immediate steps to improve their governance system and top management and lay off unproductive and excess staff.

3.3 Operational Strategy

Operational strategy critical to RRDBs operation have three aspects: client development and expansion, competitive response and organisational structure. Client development and expansion strategy impacts the type of clients of the RRDB, the retention rate, portfolio quality and organisation's cost structure and efficiency. RRDBs' response to competition is keys to ensuring its long-term survival in markets that are becoming more crowded by suppliers of financial services. Organisation structure is important as it affects their ability to take decision and run operations effectively.

3.3.1. Client development and expansion

RRDBs' client promotion and expansion strategies are well defined and interlinked. Client development process includes stages such as VDC selection, cluster selection, introduction of the bank, member selection, pre-group training, group formation and group recognition test. Each stage in client development process is carefully structured. After member selection considerable emphasis has been provided on communicating rules that govern organisational practices including those related to group behaviour and products. Credit discipline is emphasised at all stages as is the organisation's background and philosophy. Client development and expansion policy of ERRDB, CRDB and WRRDB is fairly established than RRDBs in mid and far west regions.

RRDBs have a *well defined target group.* Any poor rural women, as defined by women from households of less than 0.6 hectares of land in the Terai region, or less than 0.5 hectares of land in the hills, is eligible to join a group. They adopt *an area approach* whereby the staff concentrate their lending and outreach activities in a VDC area. RRDB follow a *group lending approach*. A group consists of five members who elect a chairperson from among themselves.

A one-week compulsory training programme is organised for group members when they join in the group. The group is recognised when members pass group recognition test. During training period, group members are familiarised with Bank's philosophy, objectives, commandments and procedures. They are also explained about their duties, rights and obligations. Those who do not know how to sign their names are also taught to do so. If group members do not pass group recognition test in one-week time, training period is extended till each member pass the test.

Thus right from formative stages, RRDBs focus on clients getting a sense of its guiding principles of being a dynamic, responsive, trustworthy and disciplined MFI. Such strategic positioning has enhanced their ability to expand. While being comprehensive, the entire process of group formation is quite quick. This agility, apart from limiting cost of promotion has obvious benefits for potential to expand operations and penetrate markets. Applying the elements that define any strategy, it is clear that all RRDBs fared well during initial years and diluted after insurgency and civil war these year. RRDBs are still relatively young (years of work ranging between 8 and 12 years with an average of 10 years) and still in full expansion. They cover a small fraction of all target clientele.

3.3.2. Competitive response

RRDBs work in terai and most accessible hill areas where other MFIs (mainly MDBs and FI-NGOs) also work, with intense competitions with other MFIs in some areas and virtual monopoly in other areas, especially in the hills. All five RRDBs are not sensitive on competition. Competitive situation and RRDBs response to them using Porter's five forces framework indicates that competitive situation may change radically in future - see Table 2. The main threats to RRDBs are no barrier to entry, powers of suppliers, threats to substitutes and increased competitive rivalry. Management of all five RRDBs management is fully aware the fact, however, due to governance problems discussed above. The problems is further complicated due to on-going insurgency and conflict for RRDBs, unlike other member based MFIs such as SCCs, and SFCLs, are under close observation under Maoist cadre especially on their pro-poor features including service delivery mechanisms, interest rate, staff behaviors and perception on quality of the services by the poor.

Table 2: RRDBs' Response to Competition in the 'Five Forces' Framework

Forces	RRDBs' Response
Potential entrants	Low barriers to entry in the market - with comparatively small scale and low capital MFIs can enter despite RRDBs' established presence.
Power of buyers (clients)	There is no formal organisation of buyers but buyer bargaining power could increase in the medium term if competition increases.
Power of suppliers (lenders)	The power of suppliers is low as RRDBs is one of the few MFIs enjoying a high credit rating; moreover, there are several suppliers for such MFIs.
Threat of substitutes	High. There is high concentration of other category MFIs in their working area. Alternative financial service options from these MFIs are more likely.
Competitive rivalry	High. Low barriers to entry; possible price wars and possibility of developing new product or copy those of RRDBs may increase competitive environment.

3.3.3. Organisation structure

All five RRDBs have fairly decentralised organisational structure (Figure 1), divided into area and branch officers based on geographical areas. Banking transactions and all other activities take place at a centre located at the village level under each branch. A "**centre**" is a place where two to eight groups meet every week. Group members are required to participate at such weekly centre meetings. Failure to attend the meeting leads to a penalty. Activities such as group training, loan disbursement, collection of weekly instalments, savings and loan demands, group discussion on loan applications and group recommendations, and other social and community development take place at the centre. A branch/unit office is in place to administer 50 centres and an area office for every five unit offices. Head office defines strategy on fund mobilisation and expansion, defines operational policies on portfolio management, recruitment, staff training and compensation. These roles are not fulfilled through a master plan, but rather strategic control is built through business plans that are developed by the branch and area offices and agreed by head office.

Overall, RRDBs head office, and branch offices via area offices have a two-way relationship. In RRDBs branch offices are able to concentrate on the problems and opportunities in its business areas. These could vary vastly as RRDBs work in number of different districts and regions. ERRDB and WRRDB also encourage branch office to innovate to attract untapped potential market segments of clients. On the other hand, head office focuses on measuring unit performance; focus on strategy and policy issues. In some RRDBs, such decentralised structure has created confusion over the locus of responsibilities.

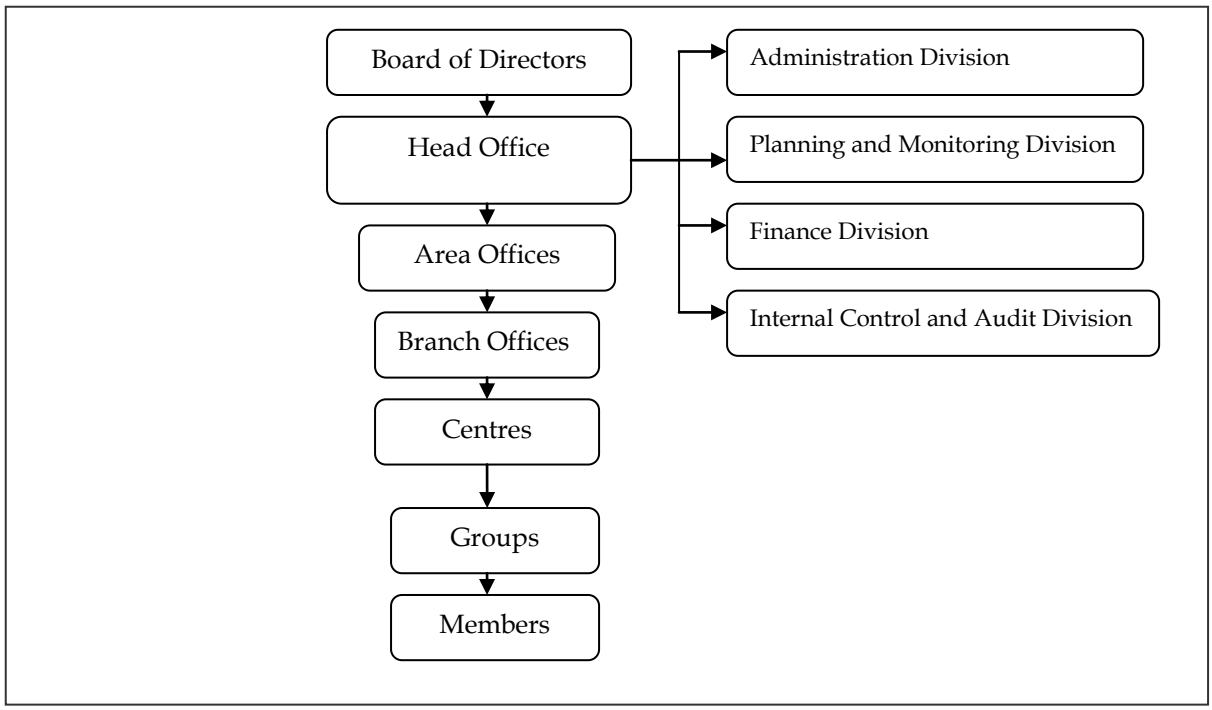

Figure 2: Organisational structure of RRDBs

3.4 Products and Delivery

Primary reason for the existence of RRDBs and their basis for generation of revenue lies at delivery of financial products extended to low income clients. RRDBs products include mainly savings and loans, and occasionally relief (insurance) scheme. Products have been designed to facilitate easy record keeping and tracking.

3.4.1. Client coverage

As of July 2003, RRDBs had 169,470 clients (women), of which 152719 were loan clients. Proportion of loan clients to total clients was 90%, highest (97%) in CRRDB and WRRDB and lowest (61%) in FWRRDB. RRDBs are characterised by significant growth (7%) in number of their clientele over the last four years (2000-2003) which varies across them (e.g. except in CRRDB, number of clients increased by less than 6.3%). ERRDB, the largest in term of client coverage, accounted for around 32% of all clients. MWRRDB and FWRRDB are the smallest each sharing a total of 11% clients. CRRDB (22%) and WRRDB (24%) is in between - *See Table 3*. RRDBs focus on providing easy access to financial services to women from rural poor households for undertaking income generating activities, and help them on reducing poverty. Savings and loans are the main financial services provided by RRDBs.

Table 3: Total Clients and Loan Clients of RRDBs

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	Clients (No)	53290	37357	40140	19485	19198	169470
2	Loan clients (No)	49233	36274	38942	16515	11755	152719
3	% of loan clients	92	97	97	85	61	90
4	Growth during last 4 years	4.23	18.66	6.21	4.13	3.13	7.04
5	Share on total clients	32	22	24	11	11	100

Source: NRB, 2004

3.4.2. Savings Products

RRDBs operate two type of saving accounts namely individual voluntary provision of saving for an amount of Rs.1 per week and a forced group fund savings account and all the RRDBs' clients receive savings services. RRDBs savings activity is strongly influenced by their philosophical approach and focus on mobilising local savings for on lending activity.

Personal savings balance: Each client of the RRDBs makes weekly deposit in her personal savings account and they pay 7-8% interest per annum in such saving deposits. As of July 2003, five RRDBs has mobilised combined personal savings of 37.7 million - *See Table 4*. Except in ERRDB, growth in personal savings balance is quite fluctuating partly that on-going insurgency and conflict forced these RRDBs to return back savings to their clients.

Table 4: Value of Personal Savings (Rs. '000)

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	Savings as of July 2003	18704	4198	11114	2278	1502	37796
2	Growth in savings over last 4 years (%)	63.4	10.4	8.3	-4.3	-4.8	20.3
3	Share on total savings (%)	49.5	11.1	29.4	6.0	4.0	100.0
4	Average personal savings balance (Rs)	351	112	277	117	78	223

Source: NRB, 2004

During the last four years, average growth in personal savings balance is 20.3%, highest in ERRDB (63.4%), followed by CRRDB (10.4%) and WRRDB (8.3%). There is negative growth in personal saving balance in MWRRDB and FWRRDB. In terms of volume of personal savings, ERRDB has highest share (50%), followed by WRRDB (29%), CRRDB (11%) and MWRRDB (6%). The FWRRDB (4%) has the lowest share. Average personal savings balance per member is Rs. 223/- and it is quite low.

Group fund balance: RRDBs lending policy requires that each loanee must contribute 5 % of loan amount to group fund, which will be refunded back after sometime. As of July 2003, savings generated in group fund of five RRDBs stood at 234.6 million - *See Table 5*.

Table 5: Value of Group Fund Balance (Rs. '000)

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	Balance as of July 2003	14904	22964	89872	58022	48921	234683
2	Growth in group fund balance over last 4 years (%)	-35.3	12.4	26.5	30.7	9.4	5.6
3	Share on total savings (%)	6.4	9.8	38.3	24.7	20.8	100.0
4	Average group fund balance per client (Rs)	280	615	2239	2978	2548	1385

Source: NRB, 2004

Except in ERRDB, growth in group fund balance is increasing at normal growth trends with an average growth of 5.6%, highest in MWRRDB (30.7%), followed by WRRDB (26.5%) and CRRDB (12.4%) and FWRRDB (9.4%). There is negative growth in group fund balance in ERRDB during last four years. As of July 2003, share on total group fund savings is the highest in WRRDB (38.3%), followed by MWRRDB (38.3), FWRRDB (20.9%) and CRRDB (9.8). The ERRDB (6.4) has the lowest share. Average group fund balance per member is Rs. 1385, [highest (Rs. 2978) in MWRRDB and lowest in ERRDB (Rs. 280) in ERRDB].

3.4.3. Loan Products

RRDB follow group lending approach and has a highly *organised delivery system* as banking activities take place in communities where women members live. All banking transactions take place openly and publicly at weekly centre meetings. The loan is disbursed adhering to *2+2+1 system* whereby initially only two members receive loans. After eight weeks, additional two members receive loans, provided that the first two are able to pay back their weekly instalments regularly. Finally, chairwoman receives a loan after sixteen weeks from the date of the first loan disbursement. The sources of lending fund are mainly equity capital, group fund and borrowing from NRB, commercial banks and RMDC.

The *size of the loans is small*. The first loan is a maximum of Rs. 8,000 (initially Rs. 5,000 and later increased). After full payment of the first loan after a one-year period of weekly payments, members can receive a second loan of up to Rs. 12,000. The initial loan size goes on increasing as member proceeds subsequent loan cycles. RRDBs do not require physical

collateral for acquiring loans. Loans are extended to individual group members under a group guarantee system that uses peer pressure, persuasion, and support from group to ensure loan repayment. Group savings are sometimes tapped to ensure high repayment rate. They follow a *weekly repayment system*, through which interest and principal payments are due on a weekly basis for 55 weeks.

Table 6: Value of Outstanding Loan Balance (Rs. '000)

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	Outstanding loan balance as of July 2003	474471	234681	348974	121392	107453	1286971
2	Growth in last 4 year	17.3	29.2	15.1	8.4	2.9	15.7
3	Average loan size (Rs)	9637	6470	8961	7350	9141	8427
4	Share on total outstaying loan balance (%)	36.9	18.2	27.1	9.4	8.3	100.0

Source: NRB, 2004

Average nominal growth of RRDBs outstanding loan balance was 15.7% per year, highest in CRRDB (29.2%), followed by ERRDB (17.3%), WRRDB (15.1%) and MWRRDB (8.4%). FWRDB (2.9%) has lowest growth in outstanding loan balance - *See Table 6*. As of July 2003, share on total outstanding loan balance is highest in ERRDB (36.9%), followed by WRRDB (27.1), CRRDB (18.2%) and MWRRDB (9.4%). The FWRRDB (8.3%) has the lowest share. Average outstanding loan balance per member is Rs. 8427 [highest (Rs. 9637) in MWRRDB and lowest in CRDB (Rs. 6470) in ERRDB]. RRDBs are characterised by high degree of flexibility *about economic activities undertaken with loan proceeds.* Borrowers, in consultation with their groups, are free to decide the type of economic activities they wish to undertake.

3.5 Management Information System

RRDBs have basic information system to ensure two way data flow from clients - branch office - area office - head office and back. The system is very simple, manual, not professionally designed and prone to errors. Recording at field level comprises of client passbooks and a loan register that are consolidated, generally with a significant time lag at head office. Accounting is very basic in nature and annual financial statements are prepared several months after the end of accounting period. Reports for use by staff are very few in numbers and tend to focus more on meeting NRB's requirements rather than corporate felt need. The portfolio system usually runs basic MS Excel spreadsheets. As computer-literate

personnel are scarce at the price RRDBs are willing to pay, they find it easier to maintain manual records and computerise only during consolidation and report preparation. MIS is not significantly different across RRDBs. They frequently modify their systems to minimize data redundancy and capture as much details as possible. While manual system is very cost effective and requires low operator's skills, it does not correct potential entry errors. Additionally in view of RRDBs expansion plans and considering potential situations of a very high and sudden increase in delinquency levels due to on-going insurgency and civil wars, the current MIS has been limiting in terms of providing accurate information on portfolio quality and efficiency of operations.

Despite these potential downsides, given that all five RRDBs are able to produce branch wise statements of financial and operational highlights every months and consolidated statement within a day or two every month end, it is evident that the manual system is not ineffective and inefficient at the present scale and quality of operations. Major shortcomings have been observed on existing MIS system of RRDBs as it does not generate information on portfolio quality and aging of delinquent portfolio. Due to almost a decade long insurgency and conflict, delinquent portfolio is at an increasing trend in all the RRDBs' and especially true among MWRRDB and FWRRDB. Since existing MIS of the RRDBs does not provide any information on delinquent portfolio and aging, accurate provisioning as per NRB's directives has not been made.

3.6 Internal Control for Risk Management

RRDBs have procedures built into their operations that act as control measures for frauds and mis-use of fund, however, these are quite informal and their relevance as risk mitigating elements is not recognized. These procedures are designed to facilitate proper targeting, credit appraisal, smooth flow of funds, mitigate credit risks and provide critical points for monitoring. In general, RRDBs acknowledged the need for a formal control mechanism only after a significant event of serious mis-appropriation of funds or if there is a serious malfunction in their operations. Internal control mechanisms adopted by all five RRDBs have three features such as loan products, internal audit and portfolio quality monitoring. Since RRDBs are mainly owned by NRB, mechanisms for internal control are almost identical with minor differences across them which is the function of vision, background and experiences of Executive Director.

3.6.1. Loan Products

Loan portfolio is the RRDBs' largest asset and tracking portfolio is the most basic preventive measures they have to adopt, however, all five RRDBs do not have systematic portfolio control and tracking systems. The present tracking system provide information on volume of loan portfolios and repayments, it is usually unable to provide accurate information on portfolio at risk, portfolio in arrears and aging information. Nevertheless, close scrutiny internal control system on loan products exhibit three features. First, prevention of the portfolio begins with the client appraisal process wherein efforts are made to include poor and needy women only after thorough preparation. Motivator appraises individual loan applications and corroborates data with other group members who act as guarantors with further discussion in the weekly centre meeting. Second, besides client appraisal, motivators follow on loan utilisation within a week of disbursement in centre meeting. They insist on immediate use of the loan as a delay would mean a loss of income resulting reduced clients' ability to pay the weekly instalment. Repayment is based on peer pressure of group. Third, overdue is detected immediately in the centre meeting and this is the first lien of defence against default risk. Motivators must complete pre-printed collection sheets which require them to simply cancel out any payments that has not been received. These stand out as anomalies and are immediately discussed during centre meeting. To discourage delinquency, members of the overdue clients group must pay in the same day. This has been rather loose in the recent years due to insurgency and conflict. This is almost identical across all five RRDBs.

3.6.2. Internal Audit

Each RRDB has internal control division to oversee extent to which their operations are conducted according to the operations manual, particularly with respect to financial management and internal control. Besides being a detective process, RRDBs' audit also functions as a corrective means. Internal control division prepares confidential visit and audit schedule. Duration of audit is about a week per branch during which the team stays at the branch itself and collect information through both formal and informal channels. In all the RRDBs, internal audit process is clearly laid out in the operational manual and incorporates checks for both process and financial compliance. Some of the aspects included

are: cash verification and cash handling process compliance; verification of fund transfers from Branch Office to Area Office including disbursement records, collection against disbursements, salary payouts, branch reconciliation and trail balance verification, sample centre audit with at least one centre per field worker (using during centre meetings in the form of surprise checks); process and financial compliance of fund management; and verification of branch assets and supplies. Audit report is prepared at the end of the auditing that includes three main sections: an executive summary giving an overview of findings; critical findings of audit team that need to be addressed immediately; and other findings and observations. The report is send to Executive Director with copies given to senior management and concerned branch manager. The report details findings and asks for specific changes to be made by specific dates and for Audit Compliance Report to be submitted to management within three months of receiving request. A short follow-up audit is also planned upon receipt of the Audit Compliance Report.

In RRDBs, internal audit is a secondary level of internal control, which builds on primary control activities that are part of their procedures. The purpose of audit is simply to check whether control procedure embedded in operations are actually functioning or not. As an additional indicator for management, a standardized report format priorities risk and allows for horizontal and longitudinal comparisons between branches.

3.6.3. Portfolio Quality

All five RRDBs are quite serious on maintaining portfolio quality. RRDBs try to maintain high repayment rates to manage the resultant risks. Failing to maintain loan portfolio quality affects their efficiency. In the past, RRDBs were characterised by zero bad debt possible through the mechanism of solidarity guarantee (or peer monitoring). With this mechanism, pressure within group can be high and constitutes an efficient means of encouraging loan repayment. Due to on-going insurgency and conflicts, portfolio quality of RRDBs has been deteriorated. Ass of July 2003, average portfolio in arrears ratio and portfolio at risk ratio is estimated respectively more than 8% and 16% (fairly better in ERRDB, CRRDB and WRRDB and deteriorating in MWRRDB and FWRRDB). Average loan loss ratio range between 0 and 16.2% with an average is 4.6%. Reserve ratio is quite low compared to loan loss ratio. In general reserve ratio range between 0 and 0.8% of APA with an average of 0.3%.

Table 7: Portfolio Quality of the RRDBs in 2003

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	Portfolio in arrears ratio	>2	>2	>2	>10	>13	>8
2	Portfolio at risk ratio	>5	>5	>5	>25	>30	>16
3	Loan loss ratio	2.1	0.0	2.0	15.3	16.2	4.6
4	Reserve ratio	0.0	0.2	0.5	0.8	0.1	0.3

Source: NRB, 2004

The tendency on loan loss ratio and corresponding provision as reserve ratio indicate threatening financial health of RRDBs. The existing MIS of RRDBs could not improve work of field staff, enabling them to better monitor their portfolios and provide better services to increasing number of clients nor enable supervisors to better monitor their areas of responsibility, pinpointing priority areas requiring immediate attention. Further, the system was not instrumental to senior management to better orchestrate work of entire organisation and make well-informed operational and strategic decisions through regular monitoring of their financial health with a set of well-chosen reports and indicators.

3.7 Accounting Policies and Financial Management

For recording and accounting treatment of its operation, RRDBs follow accounting policies laid down by the law. In all RRDBs, revenue recognition is based on cash while cost is recognized on accrual principle and double entry system of account has been followed. Annual statement of accounts are prepared that contains a comparative figure on asset, liability, capital, income and expenses along with narrative statement on the basis for preparing statements; revenue recognition; fixed asset costing and depreciation; and share capital. On the absence of systematic MIS system, provision for loan losses and asset quality monitoring is not accurate and usually not undertaken in all the five RRDBs. Financial statements are regularly audited from recognized external auditors.

RRDBs have merged financial management with other functional areas that are the responsibility of the senior management and this function is not separated from operational management. Mechanisms that enable good financial analysis are also, often, not in place. Instance of RRDB undertaking common size analysis or examining financial statements for decision making are rare because of lack of capacity to do so. Even when financial analysis is

undertaken, the focus is on generating reports for meeting NRB's requirements. All RDBs prepare some financial reports for internal purposes; bit these often have little significance from a financial management perspective. In these cases, the information is generally not used for analysis or any decision making but only on presenting financial information as a formality. This results in financial decisions that, while possibly being acceptable, may not be the most efficient in the particular circumstances of RRDBs.

The lack of appreciation on significance for financial management skills in RRDBs is a matter of concern. With increasing scales of operation and more complex financial products, RRDBs need to place greater emphasis on enhancing technical capabilities to undertake financial management. Ever increasing scale of transition to more debt-financed operations of RRDBs requires a parallel improvement in financial management techniques. With regard to the financing of their fast growing portfolio, RRDBs strategy incorporates several elements. First, they rely on commercial sources of funds as they believe that this is the only way to find the resources necessary to fuel its growth in the long-term,. Second, they diversify sources of funds to lower funding risks both from several commercial banks and RMDC. Third, they adopt simple spread-sheet based cash planning for debt servicing that consolidates information on loans from all lenders and provide quarter-by-quarter dis-aggregation of expected outflows. Forth, loans are linked with savings products to provide stability structure and reduce the liquidity pressure. Finally, careful monitoring of financial risks through basic ratio analysis to track leverage, capital adequacy and debt servicing position is undertaken branch-wise and then consolidated. These elements are quite innovative but insufficient.

3.8 Human Resource Management

3.8.1. Recruitment, Orientation and Training

Human resources take especially significant role in RRDBs as they undertake all the activities that generate income; and in cognizance to this all RRDBs have developed a detailed and well structured selection and recruitment process for human resources. Human resource policy of RRDBs specifies qualifications, set skill and experience required for the potential staff members. For instance, motivators should have at least intermediate level

education and should have knowledge of rural dynamics, activities and culture. Supervisory staff should be at least graduates in relevant subject and be willing to work for unit located in a small town. Vacancies should be published in national dailies and recruitment process is systematically laid out to assess candidates on all critical parameters and avoid subjective biases. Suitable applicants are identified based on predetermined criteria.

RRDBs recruit staff as per their need. Such new recruits are placed under one year probation, during which they are s posted in a branch/unit office and work there for a minimum of six months. The first six months of the probation period is a training period during which recruits are exposed to field level operations and learn Grameen bank philosophy, rules and procedures, targeting, credit discipline, financial management and accounting. Once the recruit is sufficiently trained and motivated s/he receives a recommendation letter indicating that the recruit is capable to perform her/his job independently and qualified to enter the second phase of probation period and from concerned branch/unit chief. Recruit who does not perform field work satisfactorily during training period, does not receive recommendation and either her/his training period is extended for three more months or her/his job is terminated.

RRDBs regard staff training as an ongoing process. They organise annual personal/professional learning process to identify personal and professional learning needs of an individual for performance improvement. They encourage their staff to identify suitable training sources and programme for themselves. Training programmes utilised are of two kinds - internal and external. While internal programmes are mainly on the job as well as class room based, the external training are coordinated with microfinance training providers such as RMDC and Centre for Microfinance (CMF). RRDBs use training as a staff retention mechanism to address human resource maintenance function.

3.8.2. Staff Performance Evaluation

RRDBs' performance appraisal is developed to maintain both productivity and quality. Performance assessment provides indication on RRDBs' ability to maintain their non-financial cost to a reasonable level. Administrative expenses and staff efficiency has been analysed to assess the RRDBs staff performance - *Table 8 and 9*.

Administrative efficiency

RRDBs must minimize transactions costs, especially administrative expenses to attain viability. Despite having almost similar human resource recruitment, orientation and training policy, there exists significant difference on administrative efficiency across these RRDBs. First, average ratio of administrative cost to total transaction cost is 41%, highest in ERRDB (54%) and lowest in FERRDB (26%) indicating that administrative cost constitute over two-fifth of the transaction cost of RRDBs. Second, personal cost to administrative cost ratio among RRDBs range between 68% (WRRDB) and 82% (FWRRDB) with an average of 77% implying that personal (salary cost) dominates greatly in administrative cost and signified its dominant role on their overall performance. Personal cost to transaction cost ratio ranges between 21% (FWRRDB) and 43% (ERRDB) with an average of 32%.

Table 8: Administrative Expenses Analysis of RRDBs as of July 2003

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	Admin. cost/transaction cost (%)	53.9	52.7	40.6	31.7	25.7	41.2
2	Personal cost /admin. cost (%)	79.7	78.2	68.1	81.5	82.2	77.3
3	Personal cost/ transaction cost (%)	42.9	41.2	27.6	25.8	21.1	31.8
4	Admin. cost to APA (%)	8.7	7.0	4.9	9.0	7.4	7.0

Source: Annex B

Third, administrative cost to APA ranges between 4.9% (WRRDB) and 9.0 (MWRRDB) with an average of 7.0%. This ratio indicates rupees that RRDB spend for managing Rs. 100 under their operation. In true sense, overall viability of MFI depends on extent at which it can manage fund at the lowest cost. Considering effective interest rate (19.6%) and corresponding realisation rate (12.6%), administrative cost to APA ratio is quite high.

Staff efficiency

The most important part of administrative cost in RRDBs is attributable to personal cost. They range between 50% and 70% of total amount of administrative expenses. Therefore it is essential that MFIs control their staff efficiency. Motivators are the crucial staff in RRDBs and their future depends on their performance. Clients and loan clients per motivator are highest in WRRDB (251 and 243) followed by ERRDB (248 and 229). It is lowest in FWRRDB (223 and 137). Client and loan clients per motivator ratio by and large depend on lending methodology. With their lending framework, clients and active loan clients per motivator

ratio is quite low in all the RRDBs. Clients are one of the most valuable agents in RRDBs operation. Income of RRDBs depends on clients' willingness to receive financial services on continuous basis. Loan client to total client ratio, therefore, has special significance in RRDBs operation. Loan client to total client ratio fluctuates widely across RRDBs, between 61% (FWRRDB) and 97% (CRRDB and WRRDB) and average 90%. Low loan client to total client ratio below 90% indicates inefficiency.

Table 9: Staff Efficiency Analysis of RRDBs as of July 2003

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	Clients/motivator (No)	248	218	251	244	223	238
2	Loan clients/motivator (No)	229	212	243	206	137	214
3	Loan clients/Total clients (%)	92	97	97	85	61	90
4	Outstanding loan portfolio per motivator (Rs. '000)	2207	1372	2181	1517	1249	1808
5	Salary cost to APA	6.9	5.5	3.4	7.3	6.1	5.4

Source: Annex B

Outstanding loan portfolio per motivator depends on lending methodology, level of clientele's poverty, economic environment, etc. and provides indication on motivator's financial productivity. This ratio is highest in ERRDB, followed by WRRDB, MWRRDB, CRRDB and FWRRDB. This ratio is the determinant of loan revenues of RRDBs and has implications for viability. Salary Cost to APA is high in FWRRDB (13.4%), followed by CRRDB (9.6%), MWRRDB (9.3%) and ERRDB (6.9%). It is lowest in WRRDB (5.1%). Higher salary cost to APA ratio is partly attributable to lack of ownership among staff and their lending methodology that insists on weekly repayment, demand weekly loan-monitoring visits and field staff's intensive involvement in every stage of operation. High salary cost to APA has significant relationship on RRDBs' performance and ability to attain OSS and FSS.

3.9 Issues in Sustainability

It is apparent from the forgoing discussions that the performance of RRDBs in terms of sustainability has been an emerging issue. Sustainability is the matter of great concern among regulators as well as promoters and practitioners of microfinance services. Issues of RRDBs have been assessed through an in-depth assessment in their operation and financial performance, pricing and subsidy status.

3.9.1. Financial Performance

Financial performance analysis relates to assessment of the extent to which they possess prospects to serve large number of clients over long term. Using the framework discussed in section two, an assessment on RRDBs' financial performance and their ability to maintain their primary assets, i.e. loan portfolio has been done. In general, financial performance measures MFI's ability to attain operating and financial self-sufficiency. This has been done through an analysis of their income, expenses and self-sufficiency level - *See Table 7.*

Income analysis

Interest income from mobilising the performing assets is the main income of RRDBs. Return on APA of RRDBs range between 7.7% (FWRRDB) and 16.7% (ERRDB) with an average of 12.6%. Return on APA is more in ERRDB, followed by CRRDB, WRRDB and MWRRDB and FWRRDB. The return on APA is significantly lower than effective interest rate charged (19.6%) by them. This is the serious problem and signifies prevalence of one or combination of following situation: borrowers' inability to repay loans on-time, misappropriation of loan recovered, reporting inaccuracy, low capital mobilization rate and use of APA on low yielding portfolio. Except ERRDB, the problem is quite serious in all the four RRDBs.

Expenses analysis

The financial cost ratio of RRDBs ranged between 4.0% and 6.3% with an average of 5.4%. It is more in CRRDB (6.3%) and lowest in MWRRDB (4.0%). This indicates a relative imperfection and inefficiency on accessing loanable fund by RRDBs from the financial market. MWGBB has opportunity to acquire financial capital for managing lending activities from cheap sources, mainly borrowing under deprived sector lending, while CRRDB is less efficient to use such opportunity. In a technical sense since all these RRDBs access capital from same financial market, financial cost ratio reveals relative inefficiency of some RRDBs on accessing loanable fund. Administrative cost ratio among RRDBs ranges between 4.9% (WRRDB) and 9.0% (MWRRDB) with an average of 7.0%. In general RRDBs are inefficient compared to other category MFIs in providing financial services due to high cost involved on social preparation and frequent supervision and follow-up requirements. Among RRDBs, WRRDB has made some innovations that have contributed to manage activities effectively. Administratively, WRRDB is most efficient, followed by CRRDB, FWRRDB and ERRDB. MWRRDB is most inefficient on lending operation.

Table 10: Financial Performance of the RRDBs as of July 2003

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	**Income analysis**						
	APA (Rs. '000)	477965	442386	615933	166702	258395	1961380
	Return on APA (%)	16.7	12.5	12.4	9.6	7.7	12.6
2	**Expenses analysis**						
	Financial cost ratio (%)	5.4	6.3	5.3	4.0	5.3	5.4
	Administrative cost ratio (%)	8.7	7.0	4.9	9.0	7.4	7.0
	Loan loss ratio (%)	2.1	0.0	2.0	15.3	16.2	4.6
	Imputed cost of capital ratio (%)	1.2	1.1	1.0	5.0	3.1	1.7
3	**Self-sufficiency analysis**						
	Operating self-sufficiency (%)	103.7	94.2	101.5	33.9	26.7	74.3
	Financial self-sufficiency (%)	92.2	81.9	87.2	31.7	25.0	66.5

Source: Annex B

In the past, RRDBs do not report overdue amount accurately and make loan loss provision adhering to loan loss provisioning directive of NRB. Lately, they started making loan loss provision. Loan loss ratio among RRDBs ranges between 0% (CRRDB) and 16.2% (FWRRDB) with an average of 4.6%. CRRDB has not made loan loss provision in 2003. Loan loss ratio of FWRRDB has crossed thresh-hold level. The imputed cost of capital has been estimated using prevailing inflation rate of 8% that indicate the implication of maintaining purchasing power of RRDBs' net-worth (capital). Imputed cost of capital ratio among RRDBs ranges between 1.0% (WRRDB) and 5.0% (MWRRDB) with an average of 1.7%.

Self-sufficiency analysis

The OSS of RRDBs ranges between 26.7% (FWRRDB) and 103.7% (ERRDB) with an average of 74.3%. Only ERRDB (103.7%) and WRRDB (101.5%) are operationally self-sufficient. On the other hand, MWRRDB and FWRRDB have very low OSS level (< 35%). CRRDB has potential of acquiring OSS. None of the RRDBs have acquired FSS. The FSS of these RRDBs range between 25.0% (FWRRDB) and 92.2% (ERRDB) with an average of 66.5%. The three RRDBs, ERRDB (92.2%), WRRDB (87.2%) and CRRDB (81.9) have potentials of acquiring FSS while attaining FSS will be a dream to MWRRDB and FWRRDB.

3.9.2. Sustainable Interest Rates

Viability of RRDBs, and consequently their sustainability, is closely linked to their financial spread. RRDBs' lending interest rates (10% flat and approximately 19.6% effective) are obviously higher than formal market rate (15%). In effect, RRDB mostly operate in rural and semi-urban areas, often in remote areas, where risks and transaction costs are very high.

Table 11: Interest Rate (%) in 2003

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	Interest rate type	Flat	Flat	Flat	Flat	Flat	-
2	Lending interest rate (%)	10	10	10	10	10	10
3	Effective interest rate (%)	19.6	19.6	19.6	19.6	19.6	19.6
4	Return on APA (%)	16.7	12.5	12.4	9.6	7.7	12.6
5	Inefficiencies (%)	-14.8	-36.2	-36.9	-50.9	-60.7	-35.7
6	Sustainable interest rate (%) - theoretical	18.5	15.3	14.5	35.9	36.8	19.9
7	Sustainable interest rate (%) - practical	21.2	20.8	19.8	54.2	59.1	27.0

Source: NRB, 2004

Table 11 indicates that RRDBs interest rate on loans, although usually higher than rate charged by commercial banks, is not viable. Coupled with prevailing inefficiencies (14.8% in ERRDB to 60.7% in FWRRDB), all these RRDBs require increase their lending rates to cover costs and attain self-sufficiency. The sustainable interest rate (adjusted to inefficiencies) that RRDBs should charge ranges between 20.8% (CRRDB) and 59.1% (FWRRDB) with an average of 27%. The difference between sustainable lending interest rate and present lending rate of MWRRDB and FWRRDB is quite high and less likely to fill the gaps.

Are low income and poorest people able to pay for financial services at high interest rate (21% to 60%)? A great number of empirical studies have shown that what is more valuable to the poor is the access to financial services. They are often willing to pay for services at full cost and not for inefficiencies. Besides, one knows that in Nepal, the poor borrow from informal lenders despite high interest rates. Lending interest rates on informal financial market can range between 36% and 60% or even more. This is to convey that ERRDB, CRRDB and WRRDB can continue lending charging sustainable interest rate while further existence of MWRRDB and FWRRDB is questionable on viability ground.

3.9.3. Subsidy Dependence Index

The analysis on SDI shows a high dependence on subsidy, even older ones such as RRDB and FWRRDB (see table 12). Subsidy dependence level of MWRRDB and FWRRDB is quite high and it is technically in-feasible for these institutions to raise current rate of interest at subsidy independence level. ERRDB, CRRDB and WRRDB have to raise their current interest rate respectively by 9.7%, 14.7% and 17.2% to continue their transaction at FSS level.

Table 12: Subsidy Dependence Index in 2003

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
1	2001	31.4	42.8	25.0	39.7	138.7	43.5
2	2002	13.8	40.7	16.9	64.8	140.1	35.1
3	2003	9.7	14.7	17.2	252.7	317.6	53.7

Source: Annex B

The results of SDI analysis are consistent with finding of sustainable interest rates analysis of RRDBs. It is necessary to raise lending interest rate in hopes of covering all transaction costs, and even more, to suppress subsidies. Further, it is evident that there is a correlation between SDI and other performance, including age of RRDBs. It supports the theory that MFIs must be allowed time to become self-sustainable in addition to consideration on other management aspects.

3.10 Comparative Assessment of RRDBs

Close scrutiny of the indicators showing comparative status of RRDBs reveals that they differ in terms of their outreach, financial and operational performance, sustainable interest rate and SDI - See Table 13. In order to come-up into a common and representing index reflecting overall performance of these institutions, rating technique was developed covering all relevant aspects discussed above to a maximum score of 100[5] - See **Annex C**. The RRDBs demonstrated uniform and logical recital in all these aspects converging to reflect their performance at par to reality. Based on the rating exercise, score acquired by the RRDB were: WRRDB (59), ERRDB (51), CRRDB (41), MWRRDB (34) and FWRRDB (28) which is consistent to the conventional notions of Nepalese microfinance professionals and

[5]While rating RRDBs, various aspects of outreach was weighted to a score of 21, financial performance on 45, operating performance on 28 and portfolio quality on 6.

practitioners on RRDBs reinforcing that WRRDB, ERRDB and CRRDB possess prospects for viability while viability of MWRRDB and FWRRDB is doubtful.

Table 13: Indicators Showing Comparative Status of the RRDBs

S.N.	Particulars	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB
A	**Outreach**					
1	Active loan clients /total clients (%)	92	97	97	85	61
2	Growth in client during last four years (%)	4.23	18.90	6.37	2.45	-0.30
3	Growth in loan client during last 4 years (%)	2.72	18.90	6.37	2.45	-0.30
4	Growth in personal savings (%)	63.4	10.4	8.3	-4.3	-4.8
5	Growth in group fund (%)	-35.3	12.4	26.5	30.7	9.4
6	Average group fund balance (Rs.)	280	615	2239	2978	2548
7	Average loan size (Rs.)	9637	6470	8961	7350	9141
2	**Financial performance**					
1	Return on APA (%)	16.7	12.5	12.4	9.6	7.7
2	Financial cost ratio (%)	5.4	6.3	5.3	4.0	5.3
3	Admin. cost ratio (%)	8.7	7.0	4.9	9.0	7.4
4	Loan loss ratio (%)	2.1	0.0	2.0	15.3	16.2
5	Imputed cost of capital (%)	2.0	2.0	2.0	2.0	2.0
6	OSS (%)	103.7	94.2	101.5	33.9	26.7
7	FSS (%)	92.2	81.9	87.2	31.7	25.0
3	**Operating performance**					
1	Admin. cost to transaction cost (%)	53.9	52.7	40.6	31.7	25.7
2	Personal cost to admin. cost (%)	79.7	78.2	68.1	81.5	82.2
3	Personal cost to transaction cost (%)	42.9	41.2	27.6	25.8	21.1
4	Client per motivator (No)	248	218	251	244	223
5	Loan client per motivator (No)	229	212	243	206	137
6	Outstanding loan portfolio per motivator (Rs. '000)	2207	1372	2181	1517	1249
7	Salary cost to APA (%)	6.9	5.5	3.4	7.3	6.1
4	**Portfolio quality**					
1	Reserve ratio (%)	0.0	0.2	0.5	0.8	0.1

Source: Various Tables presented in section 3 and 4.

The differences on performance of the RRDBs are primarily attributable to their outreach, operational and financial productivity. Difference on return on APA is the most crucial factor that contributed on the performance differences. Other factors to cite with are the differences on staff productivity mainly active clients and active loan clients to motivator as well as active loan clients to active client ratio. The active loan clients and active clients ratio

below 90% has been crucial for determining level of operation of RRDBs. The relatively poor performance in MWRRDB and FWRRDB is primarily attributable to low active loan clients and active client ratio.

3.11 Problems of RRDBs

RRDBs have opened new dimensions in Nepalese microfinance circumstances. They have expended outreach of the microfinance services to low income women significantly in the last one and half decade. Critical review of their performance revealed that there are problems on the operation of RRDBs. Government ownership is the one of the crucial factor affecting RRDBs' performance. Due to government corporate ownership structure, RRDB is confronted with many mis-guided policies thereby distorting markets through political interference. RRDBs operation is confined on providing financial services to poor rural women who have very limited skill in entrepreneurship, marketing, and distribution process. In contrast, the poor living in urban areas have more skill in marketing and distributing the products financed from resources thus borrowed. The excessive biases on rural women can not solve the real poverty problems. If the rural people have been proved bankable, the urban poor may also be proved so, even more. So an appropriate mix of the urban and rural poor women in the clientele base becomes more justifiable.

Lending methodology has implications on operating performance and efficiency. Social intermediation (social preparation, group formation and maintenance) is quite high. As far lending methodology, multiple factor contributes to efficiency thereby making generalizations difficult. RRDBs lose money in the absence of timely repayment and high operating cost prelude self-sustainability. The present tiny group-based lending of small size has been proved to be very costly. Of course, it is indeed necessary to reduce loan default costs, search costs, etc. for rural financial intermediation, the group formation can be easily extended without spending more money for the staff involved. The present loan size should also be considered to increase.

The present shift of RRDBs' attitudes in lending and recovering rather than focusing on increasing the absorbing power and income may be more costly in future. The poor can only be good borrowers if and only if they can generate money from what they have borrowed. If

RRDBs try to earn a satisfactory level of income for taking no subsidized funds, it should try to follow some other similar lending agencies. Individual loans for long time RRDB members who have good records can be applied easily. This will reduce the transaction costs of borrowing and administrative costs of lending.

Relying primarily on credit demand of poorly educated entrepreneurs appeared to be too costly for RRDBs on demonstrating performance. It may also be too costly for the borrowers, who may find it difficult to switch to more growth oriented activities. RRDBs should be keen enough to find out the field of investment in the technology sectors instead of agriculture. The diversification of portfolio in technology and raising the income of poor may help RRDB to generate revenues, sustain initiatives and improve the performance.

Below certain portfolio size, it is less likely for RRDB to attain efficiency. Once RRDBs grow and increase operational and financial leverage, profitability is likely. Profitability is a function of efficiency and not of size only up-to a point. Once RRDBs reach certain level of portfolio size, economies of scale do not seem to be a significant factor in determining efficiency, thereby, having serious implications on RRDBs' performance.

RRDBs average loans below certain size (Rs. 10000) have difficulty on achieving reasonable efficiency. They have high administrative expenses compared to other similar institutions. When expenses ratio is high, external dependency is required for viability. As RRDBs mature, loan size typically increases. There are at least three reasons on why RRDBs increases loan sizes throughout their life. First, the *Policy-induced increase* occurs due to changes in loan-supply criteria adopted by RRDB as a response to threats on their sustainability or redefinition of its market niche. These increases may reflect search for wealthier clients, who *ceteris paribus,* demand larger loans than poorer clients. Second, usually, accumulated knowledge and experience in the market and revised perceptions of risk enable RRDBs to increase initial loan size and/or accelerate growth of loan size for additional repetitions along with the sequence for a client with a given, imperfectly observed repayment capacity and level of poverty commonly known as *Information-induced increases.* Thirdly, RRDBs work in an environment wherein once an individual customer grows and improves their repayment capacity, she demands for larger loans i.e. *Client-induced increases*. With maturity, the RRDBs portfolio increases share of these established

clients among total number of borrowers. Product diversification strategies adopted by RRDBs (general loan, seasonal loan, enterprise loan, etc.) is the instances in response to such changes. Further, loan size has direct relationship on RRDBs' portfolio efficiency. Usually larger loan sizes increases portfolio efficiency at given level of portfolio quality. The average balance of individual clients increases with additional repetitions thereby contributing towards performance improvement.

RRDBs reporting are often below standard and inaccurate. The reporting inaccuracies are more serious for factors such as non-performing loans, aging of overdue loan and loan loss provisioning. RRDBs should improve the reporting system as per standards suggested by internal institutions involved on setting reporting standard in MFI like CGAP. For instance, as an immediate practice, loan loss provision should be sufficiently made as per directives provided by legal and regulatory authorities and a matching of loan loss provision with reserve requirement should be ensured.

4. CONCLUSION AND RECOMMEDNATIONS

4.1 Conclusion

This paper presented current performance of Nepalese RRDBs within their operating framework and adopting standard techniques recommended by CGAP. RRDBs are able to get access to the poorest of the poor women to bring them to the formal money markets so that they can get relief for the exorbitant rates of interest on borrowings from informal money lenders. Most vulnerable and vastly neglected women have come under the umbrella of RRDBs to form a 'club of poor'. More importantly it has united women and to a large extent it has created an environment in such a way that women create their own security. It has been contributing in improving social development indicators and in this field its achievement is quite satisfactory.

The growth of membership, loan amounts, savings, bank branches and staff, etc. show that RRDBs have successfully proliferated to the poor. Although group-based lending was not a new one, RRDBs have been successful in getting back of its loans. RRDBs have developed a broad based loan portfolio with a view to diversify risks. The relatively small amount of loan size is a costly option for RRDBs. It is indeed necessary to increase its criteria to be a

member. Moreover, graduated loanee should be provided relatively large amount of loans within existing framework.

Relatively poor problems in RRDBs stem from methodological rigidity. Due to complex methodology, high social preparation cost and inability to transfer fee to cover services provided, RRDBs could not perform well. Mostly RRDBs adopted "*zero tolerance*' policy towards credit risk, because loans were unsecured and borrowers lacked credit histories. This risk averse approach necessitates need to design most tailored lending methodology that takes performance parameter into accounts.

RRDBs are not viable and self-sustainable at present. The ERRDB, WRRDB and CRRDB have prospects for attaining viability and self-sustainability, while viability and sustainability of MWRRDB and FWRRDB is doubtful. RRDBs interest rates are kept low and do not allow them to cover all the transaction costs (administrative cost, financial cost, loan losses and imputed cost of capital). They are administratively inefficient. In addition, there is significant inefficiencies on realising interest income as evident by significant differences between effective interest rate charged and return on APA realised. The results indicate that RRDBs are dependent on subsidies. Consistent to their viability level, ERRDB, WRRDB and CRRDB have relatively low SDI than MWRRDB and FWRRDB.

Despite almost identical operating conditions and policies on governance and institutional linkages; operational strategy; products and delivery; MIS, internal control; financial management and accounting policies; and human resource management, there exist considerable variations on performance of five RRDBs due to differences on practices and micro level differences. Ownership, working only with rural women only, lending methodology, high transaction cost, diversification of loan product, portfolio size, loan size and reporting standard and accuracies are some of the problems encountered by RRDBs that need to be addressed.

4.2 Recommendations

The framework condition, under which RRDBs emerged and are currently operating, provides basis on causes of their poor performance. Essentially, low return on APA has

constrained RRDBs to attain FSS. Unless return on APA is realized at effective interest rate level, it is less likely that RRDBs can sustain OSS and FSS level already attained.

Administrative expenses constitute single largest components in RRDBs cost structure. Improving operating efficiency is an effective way of attaining viability from existing lending rate. In situation of limited prospects to increase effective interest rate in view of policy and political consideration, improvement in operating efficiency is one of the options to attain OSS and FSS. ERRDB and WRRDB has attained OSS and about to attain FSS. Maintaining the efficiency level attained is a challenges for future to these institutions.

RRDBs have reached a level of operation that requires adequate management information system. Use of efficiency management information software as well as other innovative banking technologies can contribute to a reduction in administrative costs, an increase in staff productivity and improve credibility of accounting system. While using new technology can be strongly beneficial for RRDBs, it is equally true that it introduces additional costs, which can handicap their performance in immediate future. Furthermore, using technology requires some capabilities. Thus, it is the RRDBs' responsibility to identify best practices as well as cost-effective ways to use new technology to improve outreach, efficiency and client satisfaction, which are becoming requirements of viability and sustainability in an increasing competitive microfinance sector.

In order to improve performance, RRDBs must set standards on (i) return on APA, (ii) ratios like financial cost and operating cost to APA, number of loan to motivators, outstanding portfolio to motivators, motivators to total staff ratio and loan size and (iii) amount of transactions to be carried out at a given level of expenditures. This necessitates RRDBs to initiate a system to monitor and evaluate their status and performance based on these standards and institutionalize for improving their performance.

Building sustainable RRDBs requires a long term efforts, some patience, and outside support. The outside supports is particularly required for institution building (training, information and sensitizing, etc.) as well as for establishing new branches and developing innovative products.

ANNEXES

Annex A: Outreach, Operational and Financial Aspects of the RRDBs

Table A1: Overview of the RRDBs (As of July)

S.N.	Particulars	Unit	ERRDB			CRRDB			WRRDB			MWRRDB			FWRRDB		
			2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
A	**Outreach Status**																
1	Centre	No	1341	1363	1375	915	1112	1172	1050	1086	1111	530	538	551	565	583	594
2	Group	No	10310	10860	11274	5606	7062	7712	7193	7791	8038	3608	3754	3897	3233	3355	3419
3	Members	No.	49413	51697	53270	27874	35105	37357	37077	39694	40140	18030	18770	19485	17876	18694	19198
4	Loan clients	No.	46256	47728	49233	26048	33992	36274	36055	39604	38942	15854	16281	16515	13282	11944	11755
13	Total loan disbursement	Rs. '000	2296205	3000433	3947861	521220	918419	1328020	1038869	1534546	2043858	531983	703712	830971	663305	683723	822070
14	Total loan collection	Rs. '000	1974463	2588982	3473390	357848	704180	1093339	768438	1205121	1694884	425425	574283	709579	560047	576177	714617
15	Total loan outstanding	Rs. '000	321742	411451	474471	163372	214239	234681	270431	329425	348974	106558	129429	121392	103258	107546	107453
16	Total loan overdue	Rs. '000	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
17	Personal savings balance	Rs. '000	4252	10942	18704	6442	9886	4198	7961	6885	11114	2455	2119	2278	1704	1445	1502
18	Group fund balance	Rs. '000	95573	121965	14904	27218	116822	22964	61708	77018	89872	33970	40873	58022	39472	45004	48921
19	Group fund loan outstanding	Rs. '000	2649	3110	3419	1243	1936	2836	2254	1548	1230	4784	6196	5226	8471	9586	9900
20	Total Staff	No.	344	333	330	242	245	264	219	253	244	141	138	121	167	139	135
21	Motivators	No.	223	216	214	157	159	171	142	164	158	91	89	78	108	90	87
21	Branches	No.	47	44	44	32	34	38	42	41	41	21	22	22	22	21	20
22	VDC covered	No.	259	259	262	239	247	246	230	262	273	99	102	102	80	80	83
23	District covered	No.	8	8	9	12	12	12	13	13	13	4	4	4	5	5	5
B	**Outreach indicators**																
1	Average outstanding loan	Rs/member	6956	8621	9637	6272	6303	6470	7501	8318	8961	6721	7950	7350	7774	9004	9141
2	Average savings balance	Rs/member	86	212	351	231	282	112	215	173	277	136	113	117	95	77	78
3	Clients per staff	No	144	155	161	115	143	142	169	157	165	128	136	161	107	134	142
4	Loan client per staff	No	134	143	149	108	139	137	165	157	160	112	118	136	80	86	87
5	Membership growth	%	-	5	3	-	26	6	-	7	1	-	4	4	-	5	3
6	Growth in outstanding loan balance	%	-	28	15	-	31	10	-	22	6	-	21	-6	-	4	0
7	Growth in savings	%	-	157	71	-	53	-58	-	-14	61	-	-14	8	-	-15	4
8	Growth in group fund balance	%	-	28	-88	-	329	-80	-	25	17	-	20	42	-	14	9

S.N.	Particulars	Unit	ERRDB			CRRDB			WRRDB			MWRRDB			FWRRDB		
			2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
9	Growth in branches	%	-	-6	0	-	6	12	-	-2	0	-	5	0	-	-5	-5
10	VDC covered	%	-	0	1	-	3	0	-	14	4	-	3	0	-	0	4
11	Growth in average outstanding loan	%	-	24	12	-	0	3	-	11	8	-	18	-8	-	16	2
12	Growth in average savings balance	%	-	146	66	-	22	-60	-	-19	60	-	-17	4	-	-19	1
13	Outstanding loan per staff	Rs. '000	935	1236	1438	675	874	889	1235	1302	1430	756	938	1003	618	774	796
14	Clients/motivator	No.	222	239	249	178	221	218	261	242	254	198	211	250	166	208	221
15	Loan clients/motivator	No.	207	221	230	166	214	212	254	241	246	174	183	212	123	133	135
16	Outstanding loans/staff	Rs. '000	1443	1905	2217	1041	1347	1372	1904	2009	2209	1171	1454	1556	956	1195	1235

Table A2: Operational and Financial Aspects of the RRDBs (As of July)

S.N.	Particulars	Unit	ERRDB			CRRDB			WRRDB			MWRRDB			FWRRDB		
			2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
A	**Income Statement**																
1	**Income**	Rs. '000	50384	63720	79858	33551	46731	55308	47266	66132	76127	18153	18606	16058	16607	16564	19928
	Interest income	Rs. '000	47553	62563	79174	33312	46300	53604	45763	63420	72656	18153	17866	16058	16514	16514	19388
	Other income	Rs. '000	2831	1157	684	239	431	1704	1503	2712	3471	0	740	0	93	50	540
2	**Expenses**	Rs. '000	58522	65748	77025	40875	56550	58717	46292	65621	74983	18655	23604	47344	33077	33152	74573
	Interest expenses	Rs. '000	20834	25049	25631	17495	22313	27798	19934	28676	32460	6062	7147	6744	10806	11634	13632
	Staff expenses	Rs. '000	29446	33986	33064	15699	26877	24172	17985	22239	20707	12542	13176	12238	17273	16324	15742
	Office operating expenses	Rs. '000	7167	5213	5602	6355	6320	6302	6948	9968	8988	0	3220	2777	3926	3133	3405
	Loan loss provision	Rs. '000	1075	1500	9913	784	531	0	853	4413	12100	51	61	25585	1072	2061	41794
	Other expenses	Rs. '000	0	0	2815	542	509	445	572	325	728	0	0	0	0	0	0
3	**Net Income**	Rs. '000	-8138	-2028	2833	-7324	-9819	-3409	974	511	1144	-502	-4998	-31286	-16470	-16588	-54645
B	**Balance Sheet**																
1	**Asset**	Rs. '000	424420	475574	544599	363225	464020	488985	482172	599331	685558	189141	206358	231089	285027	316509	393282
	Cash balance	Rs. '000	1853	2717	6188	3912	2938	7554	2048	4986	4733	469	543	896	2045	3468	3951

S.N.	Particulars	Unit	ERRDB			CRRDB			WRRDB			MWRRDB			FWRRDB		
			2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
	Bank balance	Rs. '000	11738	26330	29849	9364	15612	25919	49257	45873	82821	23099	17214	30473	12817	36194	21909
	Loans and advances	Rs. '000	324397	414625	474620	162455	216264	237416	272245	330971	347851	110760	135625	127023	112489	117160	117508
	Investment	Rs. '000	800	800	800	159415	189415	189654	138815	191815	222815	25815	15815	5815	63300	98300	118300
	Fixed assets	Rs. '000	4546	4063	3568	3450	3162	2795	2895	2876	2585	4046	3787	3616	2865	2543	2233
	Other assets	Rs. '000	15909	23934	29574	7394	9474	10083	16912	22810	24753	6529	9901	8506	22939	39485	55376
	Accumulated losses	Rs. '000	65177	3105	0	17235	27155	15564	0	0	0	18423	23473	54760	68572	19359	74005
2	**Liabilities**	Rs. '000	363759	414924	470717	302636	403431	428396	420461	537530	605661	129099	130655	126175	226452	257934	292913
	External borrowing	Rs. '000	244301	257768	271691	255333	319427	331135	337774	426604	482585	86111	83022	73213	147362	154958	166366
	Deposits	Rs. '000	102367	135856	171574	34480	70456	72691	67874	88454	104327	36222	44121	50132	42213	47173	51563
	Other liabilities	Rs. '000	17091	21300	27108	12823	13548	24570	11689	19040	14516	6766	3512	2830	36877	55803	74984
	Accumulated profit	Rs. '000	0	0	344	0	0	0	3124	3432	4233	0	0	0	0	0	0
3	**Capital**	Rs. '000	60661	60650	73882	60589	60589	60589	61711	61801	79897	60042	75703	104914	58575	58575	100369
	Paid-up capital	Rs. '000	60000	60000	60000	60000	60000	60000	60000	60000	60000	60000	60000	60000	58500	58500	58500
	Reserve	Rs. '000	661	650	0	589	589	589	1711	1801	2032	42	1003	990	75	75	75
	Capital grants	Rs. '000	0	0	0	0	0	0	0	0	0	0	14700	18000	0	0	0
	Loan loss provision	Rs. '000	0	0	13882	0	0	0	0	0	17865	0	0	25924	0	0	41794
4	**Liabilities + Capital**	Rs. '000	424420	475574	544599	363225	464020	488985	482172	599331	685558	189141	206358	231089	285027	316509	393282
5	**Asset - (liabilities + capital)**		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
6	**Financial structure**																
	Average performing asset	Rs. '000	-	391630	477965	-	379688	442386	-	518005	615933	-	164670	166702	-	222887	258395
	Interest income	Rs. '000	-	63720	79858	-	46731	55308	-	66132	76127	-	18606	16058	-	16564	19928
	Financial costs	Rs. '000	-	25049	25631	-	22313	27798	-	28676	32460	-	7147	6744	-	11634	13632
	Administrative cost	Rs. '000	-	39199	41481	-	33706	30919	-	32532	30423	-	16396	15015	-	19457	19147
	Loan losses	Rs. '000	-	1500	9913	-	531	0	-	4413	12100	-	61	25585	-	2061	41794
	Capitalisation (8%)	Rs. '000	-	7833	9559	-	7594	8848	-	10360	12319	-	3293	3334	-	4458	5168

S.N.	Particulars	Unit	ERRDB			CRRDB			WRRDB			MWRRDB			FWRRDB		
			2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
	Imputed cost of capital	Rs. '000	-	4852	5911	-	4847	4847	-	4944	6392	-	6056	8393	-	4686	8030
	Salary cost	Rs. '000	-	33986	33064	-	26877	24172	-	22239	20707	-	13176	12238	-	16324	15742
7	**Cost structure**																
	Return on performing asset	%	-	16.3	16.7	-	12.3	12.5	-	12.8	12.4	-	11.3	9.6	-	7.4	7.7
	Financial costs	%	-	6.40	5.36	-	5.88	6.28	-	5.54	5.27	-	4.34	4.05	-	5.22	5.28
	Administrative cost	%	-	10.01	8.68	-	8.88	6.99	-	6.28	4.94	-	9.96	9.01	-	8.73	7.41
	Loan losses	%	-	0.38	2.07	-	0.14	0.00	-	0.85	1.96	-	0.04	15.35	-	0.92	16.17
	Capitalisation	%	-	2.00	2.00	-	2.00	2.00	-	2.00	2.00	-	2.00	2.00	-	2.00	2.00
	Imputed cost of capital	%	-	1.24	1.24	-	1.28	1.10	-	0.95	1.04	-	3.68	5.03	-	2.10	3.11
8	**Annualised effective interest rate**	%	-	18.86	18.50		16.92	15.27	-	14.79	14.46	-	16.34	35.91	-	17.03	36.81
9	**Sufficiency level**																
	Operating self sufficiency	%	-	96.9	103.7	-	82.6	94.2	-	100.8	101.5	-	78.8	33.9	-	50.0	26.7
	Financial self sufficiency	%	-	90.3	96.3	-	76.1	87.0	-	93.7	93.6	-	62.7	28.8	-	43.8	24.1
10	**Efficiency analysis**																
	Transaction cost	Rs. '000	58522	65748	77025	40875	56550	58717	46292	65621	74983	18655	23604	47344	33077	33152	74573
	Administrative cost	Rs. '000	36613	39199	41481	22596	33706	30919	25505	32532	30423	12542	16396	15015	21199	19457	19147
	Personnel cost	Rs. '000	29446	33986	33064	15699	26877	24172	17985	22239	20707	12542	13176	12238	17273	16324	15742
	Administrative cost/Transaction cost	%	62.6	59.6	53.9	55.3	59.6	52.7	55.1	49.6	40.6	67.2	69.5	31.7	64.1	58.7	25.7
	Personnel cost/Administrative cost	%	80.4	86.7	79.7	69.5	79.7	78.2	70.5	68.4	68.1	100.0	80.4	81.5	81.5	83.9	82.2
	Personnel cost/Transaction cost	%	50.3	51.7	42.9	38.4	47.5	41.2	38.9	33.9	27.6	67.2	55.8	25.8	52.2	49.2	21.1
11	**Subsidy dependence**																
	Market interest rate = m	%	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07
	Subsidies on concessional	Rs. '000	3433	2505	5398	2792	4979	470	8461	7378	8624	2501	1753	1890	2464	2515	1623

S.N.	Particulars	Unit	ERRDB			CRRDB			WRRDB			MWRRDB			FWRRDB		
			2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003	2001	2002	2003
	loans (SCL)																
	Annual average equity = E	Rs. '000	60661	60650	73882	60589	60589	60589	61711	61801	79897	60042	75703	104914	58575	58575	100369
	Subsidy on equity = E*m (SE)	Rs. '000	4246	4246	5172	4241	4241	4241	4320	4326	5593	4203	5299	7344	4100	4100	7026
	Miscellaneous grant (MG)	Rs. '000	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
	Profit/Loss (P)	Rs. '000	-8138	-2028	2833	-7324	-9819	-3409	974	511	1144	-502	-4998	-31286	-16470	-16588	-54645
	Total subsidy = SCL+SE+MG-P (TS)	Rs. '000	15817	8778	7736	14357	19039	8120	11807	11193	13073	7206	12050	40520	23035	23203	63294
	Interest income = LP*I (II)	Rs. '000	50384	63720	79858	33551	46731	55308	47266	66132	76127	18153	18606	16058	16607	16564	19928
	Subsidy dependence index (TS/II)	%	31.4	13.8	9.7	42.8	40.7	14.7	25.0	16.9	17.2	39.7	64.8	252.3	138.7	140.1	317.6

Annex B: Analysis of the RRDBs Related Information

S.N.	Particulars	Unit	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
A	**General information**							
1	Date of establishment	Year	1992	1996	1995	1995	1992	
2	District covered	No.	9	12	13	4	5	43
3	VDC covered	No.	262	246	273	102	83	966
4	Branch offices	No.	44	38	41	22	20	165
5	Centres	No.	1375	1172	1111	551	583	4792
6	Groups	No.	11274	7712	8038	3897	3419	34340
7	Members	No.	53290	37357	40140	19485	19198	169470
8	Loan clients	No.	49233	36274	38942	16515	11755	152719
9	Proportion of loan clients	%	92	97	97	85	61	90
10	Total staff	No.	330	264	244	121	135	1094
11	Motivators	No.	215	171	160	80	86	712
B	**Number of MFI clients**							
	1997	No.	33018	177	4394	4207	10800	52596
	1998	No.	35219	5192	9414	9782	9916	69523
	1999	No.	39236	12656	19787	13363	10287	95329
	2000	No.	44228	18150	30415	14991	11895	119679
	2001	No.	46256	26048	36055	15854	13282	137495
	2002	No.	47728	33992	39604	16281	11944	149549
	2003	No.	49233	36274	38942	16515	11755	152719
	Average growth last four years	%	2.72	18.90	6.37	2.45	-0.30	6.28
C	**Number of MFI members**							
	1997	No.	33512	535	5000	5065	11796	55908
	1998	No.	35662	5985	9721	11080	13477	75925
	1999	No.	40135	13710	21594	14525	14985	104949
	2000	No.	45135	18846	31543	16575	16971	129070
	2001	No.	49413	27874	37077	18030	17876	150270
	2002	No.	51697	35105	39694	18770	18694	163960
	2003	No.	53270	37357	40140	19485	19198	169450
	Average growth last four years	%	4.23	18.66	6.21	4.13	3.13	7.04
D	**Proportion of loan clients to total clients**							
	1997	No.	98.5	33.1	87.9	83.1	91.6	94.1
	1998	No.	98.8	86.8	96.8	88.3	73.6	91.6
	1999	No.	97.8	92.3	91.6	92.0	68.6	90.8
	2000	No.	98.0	96.3	96.4	90.4	70.1	92.7
	2001	No.	93.6	93.4	97.2	87.9	74.3	91.5
	2002	No.	92.3	96.8	99.8	86.7	63.9	91.2
	2003	No.	92.4	97.1	97.0	84.8	61.2	90.1
	Average growth last four years	%	-1.45	0.21	0.15	-1.61	-3.32	-0.71

S.N.	Particulars	Unit	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
E	**Financial services of the MFIs 2003**							
	Average savings balance	Rs.	351	112	277	117	78	223
	Average loan size	Rs.	9637	6470	8961	7350	9141	8459
F	**Value of savings**							
	1997	Rs. '000	1068	9	779	645	1749	4250
	1998	Rs. '000	1305	669	1970	1509	2039	7492
	1999	Rs. '000	1897	1513	5155	2128	2107	12800
	2000	Rs. '000	2622	2831	8075	2720	1826	18074
	2001	Rs. '000	4252	6442	7961	2455	1704	22814
	2002	Rs. '000	10942	9886	6885	2119	1445	31277
	2003	Rs. '000	18704	4198	11114	2278	1502	37796
	Average growth last four years	%	63.43	10.35	8.31	-4.34	-4.77	20.25
G	**Value of outstanding loans balance**							
	1997	Rs. '000	163861	679	15122	15794	54441	249897
	1998	Rs. '000	194023	14602	32201	49548	67260	357634
	1999	Rs. '000	217573	49664	115853	69884	84195	537169
	2000	Rs. '000	250696	84190	198849	87972	95765	717472
	2001	Rs. '000	321742	163372	270431	106558	103258	965361
	2002	Rs. '000	411451	214239	329425	129429	107546	1192090
	2003	Rs. '000	474471	234681	348974	121392	107453	1286971
	Average growth last four years	%	17.29	29.21	15.10	8.38	2.92	15.73
H	**Effective Interest Rate Calculation for 2002**							
1	**Financial structure**							
	Average performing asset	Rs. '000	391630	379688	518005	164670	222887	1676879
	Return on performing assets	Rs. '000	63720	46731	66132	18606	16564	211753
	Financial costs	Rs. '000	25049	22313	28676	7147	11634	94819
	Administrative cost	Rs. '000	39199	33706	32532	16396	19457	141290
	Loan losses	Rs. '000	1500	531	4413	61	2061	8566
	Capitalization (8%)	Rs. '000	7833	7594	10360	3293	4458	33538
	Imputed cost of capital	Rs. '000	4852	4847	4944	6056	4686	25385
	Salary cost	Rs. '000	33986	26877	22239	13176	16324	112602
2	**Cost structure**							
	Return on performing asset	%	16.27	12.31	12.77	11.30	7.43	12.63
	Financial costs	%	6.40	5.88	5.54	4.34	5.22	5.65
	Administrative cost	%	10.01	8.88	6.28	9.96	8.73	8.43
	Loan losses	%	0.38	0.14	0.85	0.04	0.92	0.51
	Capitalization	%	2.00	2.00	2.00	2.00	2.00	2.00
	Imputed cost of capital	%	1.24	1.28	0.95	3.68	2.10	1.51
	Salary cost	%	8.68	7.08	4.29	8.00	7.32	6.71

S.N.	Particulars	Unit	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
3	**Annualized effective interest rate**	%	18.86	16.92	14.79	16.34	17.03	16.68
4	**Sufficiency level**							
	Operating self sufficiency	%	96.9	82.6	100.8	78.8	50.0	86.5
	Financial self sufficiency	%	86.6	72.9	87.0	69.2	44.0	76.1
I	**Effective Interest Rate Calculation for 2003**							
1	**Financial structure**							
	Average performing asset	Rs. '000	477965	442386	615933	166702	258395	1961380
	Return on performing assets	Rs. '000	79858	55308	76127	16058	19928	247279
	Financial costs	Rs. '000	25631	27798	32460	6744	13632	106265
	Administrative cost	Rs. '000	41481	30919	30423	15015	19147	136985
	Loan losses	Rs. '000	9913	0	12100	25585	41794	89392
	Capitalization (8%)	Rs. '000	9559	8848	12319	3334	5168	39228
	Imputed cost of capital	Rs. '000	5911	4847	6392	8393	8030	33572
	Salary cost	Rs. '000	33064	24172	20707	12238	15742	105923
2	**Cost structure**		-14.8	-36.2	-36.9	-50.9	-60.7	-35.7
	Return on performing asset	%	16.7	12.5	12.4	9.6	7.7	12.6
	Financial costs	%	5.4	6.3	5.3	4.0	5.3	5.4
	Administrative cost	%	8.7	7.0	4.9	9.0	7.4	7.0
	Loan losses	%	2.1	0.0	2.0	15.3	16.2	4.6
	Capitalization	%	2.0	2.0	2.0	2.0	2.0	2.0
	Imputed cost of capital	%	1.2	1.1	1.0	5.0	3.1	1.7
	Salary cost	%	6.9	5.5	3.4	7.3	6.1	5.4
3	**Annualized effective interest rate**	%	18.5	15.3	14.5	35.9	36.8	19.9
			21.2	20.8	19.8	54.2	59.1	27.0
4	**Sufficiency level**							
	Operating self sufficiency	%	103.7	94.2	101.5	33.9	26.7	74.3
	Financial self sufficiency	%	92.2	81.9	87.2	31.7	25.0	66.5
J	**Operating efficiency**							
	Administrative cost/Transaction cost	%	53.9	52.7	40.6	31.7	25.7	41.2
	Personnel cost/Administrative cost	%	79.7	78.2	68.1	81.5	82.2	77.3
	Personnel cost/Transaction cost	%	42.9	41.2	27.6	25.8	21.1	31.8
	Admin. cost to APA	%	8.7	7.0	4.9	9.0	7.4	7.0
	Loan size	Rs.	9637	6470	8961	7350	9141	8459
	Clients/motivator	No.	248	218	251	244	223	238
	Loan clients /motivator	No.	229	212	243	206	137	214
	Outstanding loan per	Rs. '000	2207	1372	2181	1517	1249	1808

S.N.	Particulars	Unit	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
	motivator							
	Salary cost to APA	%	6.9	5.5	3.4	7.3	6.1	5.4
S.N.	Particulars	Unit	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
I	**Comparative assessment**							
A	**Outreach**							
1	Active loan clients/total clients	%	92	97	97	85	61	90
2	Growth in client during last four years	%	4.23	18.90	6.37	2.45	-0.30	6.28
3	Growth in loan client during last four years	%	2.72	18.90	6.37	2.45	-0.30	6.28
4	Growth in personal savings	%	63.4	10.4	8.3	-4.3	-4.8	20.3
5	Average personal savings	Rs.	351	112	277	117	78	223
6	Growth in group fund	%	-35.3	12.4	26.5	30.7	9.4	5.6
7	Average group fund balance	Rs.	280	615	2239	2978	2548	1385
8	Growth in outstanding loan	%	17.3	29.2	15.1	8.4	2.9	15.7
9	Average loan size	Rs.	9637	6470	8961	7350	9141	8459.492
B	**Financial performance**							
1	Return on APA	%	16.7	12.5	12.4	9.6	7.7	12.6
2	Financial cost ratio	%	5.4	6.3	5.3	4.0	5.3	5.4
3	Administrative cost ratio	%	8.7	7.0	4.9	9.0	7.4	7.0
4	Loan loss ratio	%	2.1	0.0	2.0	15.3	16.2	4.6
5	imputed cost of capital	%	2.0	2.0	2.0	2.0	2.0	2.0
6	OSS	%	103.7	94.2	101.5	33.9	26.7	74.3
7	FSS	%	92.2	81.9	87.2	31.7	25.0	66.5
C	**Operating performance**							
1	Administrative cost to transaction cost	%	53.9	52.7	40.6	31.7	25.7	41.2
2	Personal cost to administrative cost	%	79.7	78.2	68.1	81.5	82.2	77.3
3	Personal cost to transaction cost	%	42.9	41.2	27.6	25.8	21.1	31.8
4	Administrative cost to APA	%	8.7	7.0	4.9	9.0	7.4	7.0
5	Client per motivator	No	248	218	251	244	223	238
6	Loan client per motivator	No	229	212	243	206	137	214
7	Outstanding loan portfolio per motivator	Rs. '000	2207	1372	2181	1517	1249	1808
8	Salary cost to APA	%	6.9	5.5	3.4	7.3	6.1	5.4
D	**Portfolio quality**							
1	Loan loss ratio	%	2.1	0.0	2.0	15.3	16.2	4.6
2	Reserve ratio	%	0.0	0.2	0.5	0.8	0.1	0.3

S.N.	Particulars	Unit	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB	Total
E	**Sustainable interest rate**	%	18.5	15.3	14.5	35.9	36.8	19.9
F	**Subsidy dependence index**	%	9.7	14.7	17.2	252.7	317.6	53.7
	Rating Results							
A	**Outreach**	21	12	18	17	9	5	12
1	Active loan clients/total clients	%	2	3	3	1	0	2
2	Growth in client during last four years	%	1	3	2	1	0	1
3	Growth in loan client during last four years	%	1	3	2	1	0	1
4	Growth in personal savings	%	3	2	2	0	0	1
5	Growth in group fund	%	0	3	3	3	2	2
6	Growth in outstanding loan	%	3	3	3	2	1	2
7	Average loan size	Rs.	2	1	2	1	2	2
B	**Financial performance**	45	31	17	26	13	14	20
1	Return on APA	%	3	0	0	0	0	1
2	Financial cost ratio	%	3	2	2	5	5	3
3	Administrative cost ratio	%	1	1	2	3	4	2
4	Loan loss ratio	%	4	2	4	0	0	2
5	imputed cost of capital	%	4	4	4	5	5	4
6	OSS	%	10	6	10	0	0	5
7	FSS	%	6	2	4	0	0	2
C	**Operating performance**	28	8	6	14	10	9	51
1	Administrative cost to transaction cost	%	1	1	2	3	4	2
2	Personal cost to administrative cost	%	1	1	1	1	1	1
3	Personal cost to transaction cost	%	1	1	3	3	3	2
4	Client per motivator	No	0	0	1	0	0	0
5	Loan client per motivator	No	1	1	1	1	0	1
6	Outstanding loan portfolio per motivator	Rs. '000	3	1	3	2	1	2
7	Salary cost to APA	%	1	1	3	0	0	43
D	**Portfolio quality**		0	0	2	2	0	1
1	Reserve ratio	%	0	0	2	2	0	1
	Total		51	41	59	34	28	84

Annex C: Framework for Comparative Assessment of the RRDBs

Table C1: Basic for Rating RRDBs

S.N.	Indicators	Scale	Score
1	**Outreach**		**21**
a	% of active client	▪ > 95% = 3 ▪ 90-95% = 2 ▪ 85-90% = 1 ▪ < 85% = 0	3
b	Growth in clients	▪ > 10 % = 3 ▪ 6-10% = 2 ▪ 2-6% = 1 ▪ < 2% = 0	3
c	Growth in loan clients	▪ > 10 % = 3 ▪ 6-10% = 2 ▪ 2-6% = 1 ▪ < 2% = 0	3
d	Growth in personnel savings	▪ > 10 % = 3 ▪ 6-10% = 2 ▪ 2-6% = 1 ▪ < 2% = 0	3
e	Growth in group fund	▪ > 10 % = 3 ▪ 6-10% = 2 ▪ 2-6% = 1 ▪ < 2% = 0	3
f	Growth in outstanding loans	▪ > 10 % = 3 ▪ 6-10% = 2 ▪ 2-6% = 1 ▪ < 2% = 0	3
g	Average loan size	▪ > Rs. 10,000 = 3 ▪ Rs. 8,000-10,000 = 2 ▪ Rs. 6,000-8,000 = 1 ▪ < Rs. 6,000 = 0	3
2	**Financial performance**		**45**
a	Return on APA (%)	▪ Equal to lending rate = 5 ▪ < 5% deviation to lending rate = 4 ▪ 5-10% deviation = 3 ▪ 10-15% = 2 ▪ 15-20% = 1 ▪ > 20% = 0	5
b	Financial cost ratio (%)	▪ < 20% of transaction cost = 5 ▪ 20-30% of transaction cost = 4 ▪ 30-40% of transaction cost = 3 ▪ 40-50% of transaction cost = 2 ▪ 50-60% of transaction cost = 1 ▪ > 60% of the transaction cost = 0	5
c	Admin. cost ratio	▪ < 20% of transaction cost = 5 ▪ 20-30% of transaction cost = 4 ▪ 30-40% of transaction cost = 3 ▪ 40-50% of transaction cost = 2 ▪ 50-60% of transaction cost = 1 ▪ > 60% of the transaction cost = 0	5
d	Loan loss ratio	▪ < 1% of outstanding loan = 5 ▪ 1-2% of outstanding loan = 4 ▪ 2-3% of outstanding loan = 3 ▪ 3-4 % of outstanding loan = 2	5

S.N.	Indicators	Scale	Score
		▪ 4-5% of outstanding loan = 1 ▪ > 5% of outstanding loan	
e	Imputed cost of capital	▪ < 10% of transaction cost = 5 ▪ 10-20% of transaction cost = 4 ▪ 20-30% of transaction cost = 3 ▪ 30-40% of transaction cost = 2 ▪ 40-50% of transaction cost = 1 ▪ > 50% of the transaction cost = 0	5
f	OSS	▪ > 100% = 10 ▪ 95-100% = 8 ▪ 90-95% = 6 ▪ 85-90% = 4 ▪ 80-85% = 2 ▪ > 80% = 0	10
g	OSS	▪ > 100% = 10 ▪ 95-100% = 8 ▪ 90-95% = 6 ▪ 85-90% = 4 ▪ 80-85% = 2 ▪ > 80% = 0	10
3	**Operating performance**		**28**
a	Admin. cost to transaction cost	▪ < 30% = 4 ▪ 30-40% = 3 ▪ 40-50% = 2 ▪ 50-60% = 1 ▪ > 60% = 0	4
b	Personal cost to admin. cost	▪ < 50% = 4 ▪ 50-60% = 3 ▪ 60-70% = 2 ▪ 70-80% = 1 ▪ > 80% = 0	4
c	Personal cost to transaction cost	▪ < 20% = 4 ▪ 20-30% = 3 ▪ 30-40% = 2 ▪ 40-50% = 1 ▪ > 50% = 0	4
d	Clients per motivator	▪ < 400 = 4 ▪ 350-400 = 3 ▪ 300-350 = 2 ▪ 250-300 = 1 ▪ < 250 = 0	4
e	Loan clients per motivator	▪ < 350 = 4 ▪ 300-350 = 3 ▪ 250-300 = 2 ▪ 200-250 = 1 ▪ < 200% = 0	4
f	Outstanding loan per motivator	▪ > 2.5 million = 4 ▪ 2.0-2.5 million = 3 ▪ 1.5 – 2.0 million = 2 ▪ 1.0 – 1.5 million =1 ▪ < 1.0 million = 0	4
g	Salary cost to APA	▪ < 20% of return on APA = 4 ▪ 20-30% of return on APA = 3 ▪ 30-40% of return on APA = 2 ▪ 40-50% of return on APA = 1 ▪ < 50% of return on APA = 0	4

S.N.	Indicators	Scale	Score
4	**Portfolio quality**		**6**
a	Reserve ratio	▪ equal to loan loss ratio = 6 ▪ 80-100% of loan loss ratio = 5 ▪ 60-80% of loan loss ratio = 4 ▪ 40-60% of loan loss ratio = 3 ▪ 20-40% of loan loss ratio = 2 ▪ 0-20% of loan loss ratio = 1 ▪ None = 0	6
	Total		100

Table C2: Results of Rating RRDBs

S.N	Indicators	Unit	ERRDB	CRRDB	WRRDB	MWRRDB	FWRRDB
A	**Outreach**	**21**	**12**	**18**	**17**	**9**	**5**
1	Active loan clients/total clients	%	2	3	3	1	0
2	Growth in client during last four years	%	1	3	2	1	0
3	Growth in loan client during last four years	%	1	3	2	1	0
4	Growth in personal savings	%	3	2	2	0	0
5	Growth in group fund	%	0	3	3	3	2
6	Growth in outsatnding loan	%	3	3	3	2	1
7	Average loan size	Rs.	2	1	2	1	2
B	**Financial performance**	45	31	17	26	13	14
1	Return on APA	%	3	0	0	0	0
2	Financial cost ratio	%	3	2	2	5	5
3	Administrative cost ratio	%	1	1	2	3	4
4	Loan loss ratio	%	4	2	4	0	0
5	imputed cost of capital	%	4	4	4	5	5
6	OSS	%	10	6	10	0	0
7	FSS	%	6	2	4	0	0
C	**Operating performance**	**28**	**8**	**6**	**14**	**10**	**9**
1	Administrative cost to transaction cost	%	1	1	2	3	4
2	Personal cost to administrative cost	%	1	1	1	1	1
3	Personal cost to transaction cost	%	1	1	3	3	3
4	Client per motivator	No	0	0	1	0	0
5	Loan client per motivator	No	1	1	1	1	0
6	Outstanding loan portfolio per motivator	Rs. '000	3	1	3	2	1
7	Salary cost to APA	%	1	1	3	0	0
D	**Portfolio quality**		**0**	**0**	**2**	**2**	**0**
1	Reserve ratio	%	0	0	2	2	0
	Total		**51**	**41**	**59**	**34**	**28**

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