Community-Based Savings and Credit Cooperatives in Nepal

A Sustainable Means for Microfinance Delivery?

Chris D. Gingrich

Abstract: Savings and credit cooperatives (SCCs) provide a variety of microfinance services to households in three of Nepal’s distinct regions—the Hills, Terai, and Kathmandu Valley. Nearly all Nepali SCCs are self-funded using member savings and equity. Most Nepali SCCs are also profitable, including those located in poor, remote areas of the Hills region. Key reasons for the SCCs’ strong financial performance include reliance on member savings and control of administration costs. High-profit SCCs also show superior interest earnings on loans compared to low-profit SCCs. Nepali SCCs do not need concessionary funds, because they are already profitable and able to mobilize member savings. While savings-led microfinance in Nepali SCCs is a slow process, there is significant long-term outreach potential in local communities. The government and donors should pursue institution-building strategies to strengthen Nepali SCCs and should not provide concessionary funding.

By most indicators, the outlook for economic development and poverty alleviation in Nepal is bleak. Living standards in the country are among the lowest in the world and are declining in many categories. The country’s difficult topography poses challenges for market development and
limits agricultural investment options. The country is currently plagued by political instability, including a Maoist insurgency. In addition, formal financial markets fail to reach most poor households. According to one recent estimate (CECI, 2001), only 10% of rural households can access formal financial markets. Many government and nongovernment agencies implement a variety of microfinance programs to increase poor households’ access to financial services (Bhatta, 2001).

Nepal’s geography influences the nature of microfinance programs. The Himalayan mountains cover the northern third of Nepal. Sparse population and few business activities are found in this region. The middle third of Nepal—known as the Hills—contains roughly 40% of the country’s population. In Hills communities subsistence agriculture is the primary way of life. Hills topography consists of steep peaks and valleys between 500 and 3,000 meters above sea level. Many Hills communities are far removed from modern amenities and infrastructure. The Terai comprises the southern third of Nepal and features flat, fertile, and densely populated landscapes. In the geographical center of Nepal lies the Kathmandu Valley, the heart of government and business activities. Existing microfinance programs are mostly concentrated in the Terai and the Kathmandu Valley (Bhatta, 2001), though some organizations are expanding their activities to the Hills (CECI, 2001).

In general, there is much debate regarding the financial sustainability of microfinance institutions (MFIs). Critics argue that most MFIs can only cover operating costs under the most optimistic conditions (Hassan, 2002; Morduch, 1999). Sustainability is especially challenging in Nepal’s Hills. Poor communication and transportation infrastructures increase administration costs and complicate routine tasks such as savings and loan collection. Poverty is widespread in the Hills, so the requirements for clients’ savings and loan amounts are small. Limited access to urban markets suggests that microentrepreneurs in this region

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have few options for developing new products. Consequently, the conventional wisdom among Nepal’s microfinance community is that MFIs in the Terai and Kathmandu Valley find it comparatively easier to achieve sustainability than MFIs in the Hills. However, there is no available evidence that either supports or refutes this claim.

One popular type of MFI in Nepal is the community-based savings and credit organization. Organizations of this type range from informal dhikuti groups (Seibel & Shrestha, 1988) to legally recognized savings and credit cooperatives (SCCs). Nepali SCCs provide financial intermediation between cash-surplus and cash-deficit households. They differ from other MFIs because they are locally owned and managed. To paraphrase Ashe and Parrott (2002), Nepali SCCs resemble village banks without the external funds and structural rigidity typically imposed by donors. There are presently more than 1,300 SCCs in Nepal (CECI, 2001). Because these organizations are locally owned and managed, there is some suggestion that they can provide sustainable microfinance services for Nepal’s poorest rural communities (CECI, 1998). However, these institutions’ financial status and potential for sustainability is unknown.

This paper examines the financial performance of community-based SCCs in Nepal and their ability to provide sustainable microfinance services under various conditions. Special attention is devoted to comparing the SCC performance of Nepal’s distinct geographic regions—the Hills, Terai, and Kathmandu Valley. Some factors affecting SCC profitability are also identified. The following section briefly reviews the literature on MFI sustainability and SCC performance. The section after that describes the data and methods used in this study. Then Nepali SCCs’ financial performance is examined and some of the factors affecting profitability are identified. The next section discusses the implications for policy makers and the donor community and assesses Nepali SCCs’ outreach potential. The final section summarizes the paper’s findings.
Review of the Literature

Although microfinance programs promote poverty alleviation and community development (Khandker, 2003; Pitt & Khandker, 1998; Amin, Becker, & Bayes, 1998), there is growing concern regarding MFIs’ financial sustainability. A recent survey of seventy-two MFIs shows that only half are profitable even though all report a “commitment” to financial sustainability (Microbanking Bulletin, 1998). Morduch (1999) cautions that these results should not be extrapolated and that, in reality, a much smaller fraction of MFIs are financially sustainable. Many “profitable” MFIs also receive concessionary funds and do not include client training and development costs in their profit calculations (Hassan, 2002; Yaron, 1994). Bennett, Goldberg, and Hunte (1996), Schmidt and Zeitinger (1996A), and Basix and Ramola (1996) provide further examples of MFIs that fail to achieve financial sustainability.

Many factors affect MFI financial sustainability. The MFI’s orientation and philosophy, for example, play an important role. Some authors argue that most nongovernment organizations (NGOs) are not well suited for sustainability because of their social orientation (Schmidt & Zeitinger, 1996B; Dichter, 1996). Microfinance donors are also guilty of ignoring sustainability issues with their NGO partners (Von Pischke, 1996). The MFI’s orientation toward profitability affects loan repayment, efficiency, and staff productivity (Yaron, 1994; Schmidt and Zeitinger, 1996A).

There is also a growing awareness that client ownership and participation greatly affect MFI performance and sustainability (Rajasekhar, 1996; Morduch, 1999; Hassan, 2002). Bennett et al. (1996) cite evidence from five South Asian MFIs to show how reliance on member savings improves loan repayment and compels management to control costs. Ashe and Parrott (2002) find that women’s groups in Nepal’s Terai are sustainable because they are completely financed using member savings. Matthews and Ali (2002) report similar results for remote communities in Bangladesh using savings-led microfinance schemes.
Gender is another potential factor affecting MFI sustainability. Among the challenges for women’s MFIs are that women generally grow more subsistence crops than men and operate smaller businesses with low profit margins (Holt & Ribe, 1991). One study found that women’s SCCs in Nepal generally lack important inputs such as management systems, organizational visions, and networks with government and other agencies (CECI, 1998). On the other hand, women’s groups in Grameen-type programs typically show superior loan repayment and are more efficient (Hassan, 2002; Hassan & Tufte, 2001).

The evidence is mixed regarding SCC performance and financial sustainability (Huppi & Feder, 1990; Schmidt & Zeitinger, 1996a). Results from several countries show that SCCs promote member savings and client-owned structures. SCCs can also provide accurate information to management about borrowers. However, inefficiency, concentrated investment portfolios, and inadequate savings mobilization from deficit households are problems frequently found in SCCs. Moral hazard is another concern since default by a few borrowers encourages widespread default, and because local communities may hesitate to penalize delinquent borrowers.

**Data Description**

The Nepal Federation of Savings and Credit Unions (NEFSCUN) is an apex institution for Nepali SCCs. NEFSCUN’s primary tasks are SCC advocacy and the provision of development services to member institutions. There are presently 219 active NEFSCUN members.¹ These SCCs submit annual audited financial statements and membership data to NEFSCUN. Since this study examines community-based SCCs and their ability to implement microfinance activities, district-level SCCs and SCCs heavily involved in nonfinance activities (such as merchandise trading) are excluded from the sample. The latter group is defined as any SCC that earns less than 20% of its total revenue from loan interest and fees. Table 1 describes the sample SCCs used in this study. The extent to which the sample
fairly represents all Nepali SCCs is unknown, though NEFS-CUN membership privileges may lead to members’ improved financial performance over nonmembers. The most motivated and committed SCCs are also those most likely to join NEFS-CUN. Nonetheless, the sample NEFS-CUN SCCs are assumed to represent all of Nepal’s community-based SCCs.

Nepali SCCs have an average membership of 178 people, making them larger than Ashe and Parrott’s (2002) Terai-based women’s groups (roughly 20 members each) but much smaller than most MFIs worldwide. Average total assets are approximately

Table 1. Description of NEFSCUN member SCCs: grouped by region

<table>
<thead>
<tr>
<th>Variable</th>
<th>All regions</th>
<th>Hills</th>
<th>Terai</th>
<th>Kathmandu Valley</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active NEFSCUN SCCs</td>
<td>219</td>
<td>89</td>
<td>61</td>
<td>69</td>
</tr>
<tr>
<td>SCCs with missing or unreliable data</td>
<td>7</td>
<td>4</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>District-level SCCs</td>
<td>14</td>
<td>8</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>SCCs receiving less than 20% of their revenue from loan interest and fees</td>
<td>13</td>
<td>3</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Number of SCCs in data set</td>
<td>185</td>
<td>74</td>
<td>49</td>
<td>62</td>
</tr>
<tr>
<td>Means (Standard deviation in parentheses)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Age, years</td>
<td>4.9 (2.4)</td>
<td>5.1 (2.3)</td>
<td>4.3 (2.1)</td>
<td>5.2 (2.7)</td>
</tr>
<tr>
<td>Total assets, US$1,000</td>
<td>25.8 (52.0)</td>
<td>23.1 (59.7)</td>
<td>19.6 (41.7)</td>
<td>30.9 (49.6)</td>
</tr>
<tr>
<td>Members per SCC</td>
<td>178.1 (312.8)</td>
<td>186.6 (312.0)</td>
<td>199.6 (431.7)</td>
<td>151.0 (175.3)</td>
</tr>
<tr>
<td>Savings per member, US$</td>
<td>98.9 (112.2)</td>
<td>72.1 (82.3)</td>
<td>86.1 (121.5)</td>
<td>140.9 (124.2)</td>
</tr>
<tr>
<td>Savings / total assets as %</td>
<td>72.3% (17.0)</td>
<td>69.3% (18.9)</td>
<td>70.8% (16.3)</td>
<td>77.2% (14.1)</td>
</tr>
</tbody>
</table>

<sup>a</sup> Variable definition provided in Appendix.
<sup>b</sup> Data originally measured in Nepali rupees: US$1 at 78 Nepali rupees
<sup>c</sup> Reject null hypothesis of equal means at the 95% confidence level.
US$26,000, though total assets for 40% of the SCCs are less than US$6,500. Average SCC age is five years. The mean values for membership, assets, and age are not statistically different between the Hills, Terai, and Kathmandu Valley. SCCs in all three regions finance the bulk of their assets from member savings. Kathmandu SCCs are the most dependent on savings (77.2% of total assets), and Hills SCCs the least dependent (69.3% of total assets). The mean per-member savings in Hills SCCs (approximately US $72) is half that in Kathmandu SCCs, suggesting that Hills SCCs are located in Nepal’s poorest communities.

Because each SCC is locally managed, it is impossible to provide a general description of financial policies and procedures. However, discussions with SCC managers reveal several common characteristics. Unlike many MFIs, Nepali SCCs typically provide loans to individuals, not peer groups. Some SCCs provide consumption loans, while others restrict borrowing to income-generating activities. Membership in the form of equity shares is usually required to use SCC services. Many SCCs also require members to participate in a regular savings plan. Maximum loan amounts are typically calculated in proportion to individuals’ established savings.

Data limitations prevent any analysis beyond the SCCs’ financial status. Detailed loan data such as delinquency, size, and duration are unavailable for most SCCs. No data are available regarding SCC clients’ socioeconomic status. Transportation and communication infrastructures and other characteristics of the SCC communities are unknown.

Financial Performance of Nepali SCCs

Nepali SCCs earn strong profits (see Table 2). The mean rate of return on assets is 3.5%, which exceeds the 2 to 3% recommendation for MFIs from Yaron, McDonald, and Charitonenko (1998). Profitability is highest for Hills SCCs (4.4%) and lowest for Kathmandu SCCs (2.2%). Figure 1 further reveals that all sample SCCs from the Hills earn positive profits, while only about 85% of SCCs from the Terai and Kathmandu Valley are
profitable. Mean dividend yields on member shares are 19.6%, which easily exceed the current 5 to 6% yield on commercial savings accounts (NRB, 2001–2003a). There is no statistical difference in mean dividend yields between regions.

The fact that Hills SCCs are generally more profitable than SCCs in the Terai and Kathmandu Valley regions is counter

**Table 2. Profitability of Nepali SCCs: means grouped by region**

<table>
<thead>
<tr>
<th>Variable</th>
<th>All regions</th>
<th>Hills</th>
<th>Terai</th>
<th>Kathmandu Valley</th>
<th>F-test for equality of means across regions (df=2,184)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit as %</td>
<td>3.5%</td>
<td>4.4%</td>
<td>3.6%</td>
<td>2.2%</td>
<td>5.85*</td>
</tr>
<tr>
<td></td>
<td>(3.9)b</td>
<td>(3.2)</td>
<td>(5.2)</td>
<td>(3.1)</td>
<td></td>
</tr>
<tr>
<td>Dividend yield as %</td>
<td>19.6%</td>
<td>23.3%</td>
<td>15.3%</td>
<td>18.6%</td>
<td>0.70</td>
</tr>
<tr>
<td></td>
<td>(37.4)</td>
<td>(31.3)</td>
<td>(20.8)</td>
<td>(51.7)</td>
<td></td>
</tr>
</tbody>
</table>

Note. Variable definitions provided in Appendix.

a Reject null hypothesis of equal means at the 95% confidence level.

b Standard deviation in parentheses

**Figure 1. Profitability of Nepali SCCs: Distribution grouped by region**

![Distribution Chart](image)

SCC Profit:
- **above 10%**
- **5 to 10%**
- **0 to 5%**
- **-5 to 0%**
- **below -5%**

Variable definition provided in Appendix.
intuitive in light of the widespread poverty and difficult geography in the Hills. One possible explanation is that Hills communities may be more committed to their local SCC. First, many Hills communities remain isolated and ethnically homogeneous, whereas Terai and Kathmandu communities contain significant immigrant populations. Common language and cultural practices in Hills communities facilitate progress toward a shared goal. Second, Hills SCCs were more likely conceived independent of donor or government programs, which creates an increased sense of member ownership. Third, there are simply fewer MFI alternatives available to poor households in the Hills. Members realize that no alternative for financial services is available if the local SCC fails.

Skeptics should rightly ask whether positive profits for Nepali SCCs are merely the result of widespread subsidies. Profit alone does not imply financial sustainability, since MFI financial statements do not necessarily reveal subsidies (Yaron, 1994; Hassan, 2002). If Nepali SCCs are financially sustainable and not just operationally sustainable, they must show independence from subsidies (Morduch, 1999). Using external loans as a possible subsidy indicator shows that most Nepali SCCs are self-reliant since the mean external loan-to-asset ratio is only 5% (see Table 3). Though this ratio is slightly higher for Hills and Terai SCCs (5.8% compared to 3.5% for Kathmandu SCCs), use of external funds is still minimal. Figure 2 reveals that over 60% of all SCCs do not use external loans, and only 15% of all SCCs have external loans exceeding 20% of their total assets. Furthermore, external loans are not widely subsidized, since mean capital costs, including the interest rate paid on loans, do not decline for SCCs with higher external loan-to-asset ratios (see Figure 2).

Mean profits for women’s and mixed gender SCCs are not statistically different (see Table 4). If women’s SCCs received disproportionate subsidies, it would nullify this result, but mean external loans and capital costs are not statistically different between each gender category. This finding supports Ashe and
Parrott’s (2002) conclusions regarding women’s savings and credit groups in the Terai. It also follows evidence found in other countries that women’s microfinance programs perform at least as well as men’s and mixed gender programs (Hassan & Tufte, 2001; Holt & Ribe, 1991).

Table 3. Nepali SCCs’ reliance on external loans: Means grouped by region

<table>
<thead>
<tr>
<th>Variable</th>
<th>All regions</th>
<th>Hills</th>
<th>Terai</th>
<th>Kathmandu Valley</th>
<th>F-test for equality of means across regions (df=2,184)</th>
</tr>
</thead>
<tbody>
<tr>
<td>External loans payable / total assets as %</td>
<td>5.0%</td>
<td>5.8%</td>
<td>5.8%</td>
<td>3.5%</td>
<td>6.20&lt;sup&gt;a&lt;/sup&gt;</td>
</tr>
<tr>
<td></td>
<td>(11.5)&lt;sup&gt;b&lt;/sup&gt;</td>
<td>(12.2)</td>
<td>(11.4)</td>
<td>(10.8)</td>
<td></td>
</tr>
</tbody>
</table>

<sup>a</sup> Reject null hypothesis of equal means at the 95% confidence level.

<sup>b</sup> Standard deviation.

Figure 2. Nepali SCCs’ reliance on external loans, including mean capital costs: Distribution grouped by region

- External loans payable / total assets [mean capital costs]<sup>a</sup>
  - above 20% [8.3%]
  - 10 to 20% [7.5%]
  - 5 to 10% [8.6%]
  - 0 to 5% [7.2%]
  - no loans [7.0%]

<sup>a</sup> Variable definition provided in Appendix.
Several other factors may be associated with variations in SCC profit. Factors such as size and age are exogenous to the SCCs. Large SCCs possibly incur lower per-unit costs for marketing, rent, and other items and obtain easier access to financial markets. However, large SCCs may find it difficult to manage information, and members may experience a reduced sense of ownership. Older SCCs may earn higher profits due to positive learning-by-doing effects, while SCCs with inadequate policies and low member participation may experience decreased profits over time.

Other potential profit factors such as interest rates, administration costs, and reliance on member savings are endogenous to management decisions. High interest rates on loans receivable should increase revenue and profit, provided loan demand is price inelastic. While increased capital costs reduce profit, SCCs must pay a sufficiently high yield on savings to attract member deposits. Most importantly, the spread between the effective interest rate on loans receivable and capital costs must be sufficiently large to cover administration costs. Member savings provide incentives for increased member ownership and participation and reduced loan delinquency. Savings-led SCCs also have greater incentive to control administration costs. However,
because other funds, such as member equity or concessionary loans, may be less expensive, the a priori relationship between savings and profit is ambiguous. To investigate the above effects, the sample SCCs are grouped into profit quartiles and mean factor values are derived for each quartile (see Table 5).

Table 5 suggests that several factors are not associated with varying profit levels. Although the most profitable SCCs are relatively small, the mean asset values between quartiles are not statistically different. Mean cooperative age also does not differ statistically between quartiles. These findings for Nepali SCCs resemble those for the Grameen Bank, where neither age nor size affect efficiency (Hassan & Tufte, 2001). Similarly, there is no significant difference between mean quartile values for administration costs, capital costs, and external loans. It is especially noteworthy that high profits are not associated with increased external loans or concessionary funds. Nepali SCCs’ mean administration costs are 5% of total assets, which compares favorably with the 3 to 13% range that Yaron (1994) reports for other MFIs. This result is surprising since small loan size in poor communities and difficult topography in the Hills presumably increase per-unit administration costs. Thus, it appears that SCCs’ reliance on member savings provides strong incentives for cost control. Many SCCs also rely on volunteer labor.

For the remaining factors, there are statistically significant differences between mean quartile values. Member savings are the primary source of funds for SCCs in all quartiles, though there are some slight differences. Mean savings-to-asset ratios exceed 70% in all quartiles, except for the top quartile, at 64.7%. On average, SCCs in the first three quartiles finance at least 100% of their loans receivable using member savings; however, this share declines to 78.9% for the top quartile. In comparison, Richardson (2001) recommends that SCCs maintain a savings-to-asset ratio between 70 and 80%, and Yaron (1994) finds savings-to-loan ratios in five successful MFIs ranging from 31 to 110%. Slightly lower savings occur in the most profitable SCCs due to increased equity financing. The mean equity-to-asset ratio is almost 30%
Table 5. Potential SCC profit factors: Mean values grouped by profit quartiles

<table>
<thead>
<tr>
<th>Variable</th>
<th>All profit levels</th>
<th>Bottom quartile</th>
<th>Second quartile</th>
<th>Third quartile</th>
<th>Top quartile</th>
<th>F-statistic for equal means across quartiles (df = 3,184)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age,(^a) years</td>
<td>4.9 (2.4)</td>
<td>5.0 (2.5)</td>
<td>5.3 (2.6)</td>
<td>5.2 (2.4)</td>
<td>4.2 (1.9)</td>
<td>2.29</td>
</tr>
<tr>
<td>Total assets(^b), US$1,000</td>
<td>24.8 (52.0)</td>
<td>29.7 (53.7)</td>
<td>36.8 (81.4)</td>
<td>23.7 (30.7)</td>
<td>9.1 (10.9)</td>
<td>2.49</td>
</tr>
<tr>
<td>Effective interest rate earned on loans(^a)</td>
<td>15.2 (6.2)</td>
<td>13.7 (5.2)</td>
<td>13.6 (3.7)</td>
<td>17.3 (8.8)</td>
<td>16.1 (5.0)</td>
<td>4.38(^c)</td>
</tr>
<tr>
<td>Capital costs(^a) as %</td>
<td>7.3 (3.1)</td>
<td>7.6 (3.9)</td>
<td>6.9 (1.9)</td>
<td>8.0 (3.6)</td>
<td>6.7 (2.5)</td>
<td>1.75</td>
</tr>
<tr>
<td>Savings / total assets as %</td>
<td>72.3(^a) (17.0)</td>
<td>72.6(^a) (19.1)</td>
<td>78.7(^a) (13.5)</td>
<td>73.3(^a) (14.9)</td>
<td>64.7(^a) (17.3)</td>
<td>5.87(^c)</td>
</tr>
<tr>
<td>Savings / loans receivable as %</td>
<td>97.8(^a) (38.3)</td>
<td>108.4(^a) (57.5)</td>
<td>103.9(^a) (26.2)</td>
<td>100.4(^a) (32.4)</td>
<td>78.9(^a) (19.3)</td>
<td>6.01(^c)</td>
</tr>
<tr>
<td>External loans payable / total assets as %</td>
<td>5.0(^a) (2.2)</td>
<td>8.6(^a) (15.1)</td>
<td>3.0(^a) (10.2)</td>
<td>4.4(^a) (10.8)</td>
<td>4.0(^a) (8.5)</td>
<td>2.20</td>
</tr>
<tr>
<td>Interest paid / total assets(^a) as %</td>
<td>5.6(^a) (2.4)</td>
<td>6.2(^a) (3.2)</td>
<td>5.6(^a) (1.5)</td>
<td>6.1(^a) (2.3)</td>
<td>4.6(^a) (1.9)</td>
<td>4.37(^c)</td>
</tr>
<tr>
<td>Administration costs / total assets(^a) as %</td>
<td>5.0(^a) (4.3)</td>
<td>6.2(^a) (5.7)</td>
<td>4.6(^a) (3.0)</td>
<td>4.4(^a) (3.9)</td>
<td>4.8(^a) (4.0)</td>
<td>1.75</td>
</tr>
<tr>
<td>Equity / total assets(^a) as %</td>
<td>20.1(^a) (11.7)</td>
<td>15.7(^a) (10.5)</td>
<td>15.8(^a) (7.8)</td>
<td>19.4(^a) (8.1)</td>
<td>29.5(^a) (13.6)</td>
<td>18.98(^c)</td>
</tr>
</tbody>
</table>

\(^a\)Variable definition provided in Appendix

\(^b\)Data originally measured in Nepali rupees: US$1 at 78 Nepali rupees

\(^c\)Reject null hypothesis of equal means at the 95% confidence level.

\(^d\)Standard deviation
for the top quartile and between 15 and 20% for the bottom three quartiles. The advantage to SCCs of equity financing is reduced interest expenditures: top quartile SCCs have a mean interest paid-to-asset ratio of 4.6% compared to 6.2% for the least profitable SCCs. In addition, equity financing provides similar incentives as savings for member participation and ownership.

There is a clear relationship between profit and the interest earned on loans. High profit SCCs earn 3 to 4 percentage points more on loans than low profit SCCs. Whether the difference is due to higher nominal rates, improved loan repayment, or some combination of the two is impossible to know. Given Nepal’s inflation rate of 2 to 4% (NRB, 2001–2003b), high profit SCCs’ real loan earnings are approximately 12 to 15%, which resemble the upper range in other successful MFIs (Yaron, 1994).

**Discussion and Implications**

Nepali SCCs are profitable and show evidence of financial sustainability, while most MFIs worldwide struggle in these areas. There are several possible explanations. First, nearly all Nepali SCCs depend on member savings. Savings create incentives for member participation in SCC activities and decisions. Similarly, because funds are generated within the local community (which Bennett et al. [1996] describe as “hot” money), borrowers are motivated to repay loans, and managers to control costs. Second, because the SCCs are community-based organizations, there are internal loan-monitoring and enforcement mechanisms. Third, many Nepali SCCs operated for years as informal savings groups before obtaining formal cooperative status. Hence, members are familiar with the principles and challenges of group savings programs.

An important question is whether Nepali SCCs sacrifice client outreach to achieve financial sustainability. Hassan (2002) and Navajas, Schreiner, Meyers, and Gonzalez-Vega (2000) suggest four possible MFI outreach categories: (1) breadth of outreach refers to the number of clients reached; (2) depth of outreach is the clients’ socio-economic status; (3) scope of outreach includes
the variety and relevance of microfinance services offered; and (4) outreach length measures the number of years an MFI provides financial services.

Nepali SCCs do face serious challenges regarding their breadth and depth of outreach. While savings mobilization in poor communities is a slow process, MFIs that use external funds can quickly provide credit to a large number of clients. Internally-financed SCCs must also charge sufficiently high interest on loans to cover all costs, which may deter poor households from borrowing. The problem is exacerbated if SCCs link clients’ credit availability to their established savings (Rajasekhar, 1996). Despite these concerns, it is unclear whether Nepali SCCs’ ability to serve poor households greatly differs from other MFIs. There is broad consensus that interest rates are only one of many costs affecting poor households’ demand for credit (Morduch, 1999). In addition, an assessment of outreach depth should also consider the number of poor households with access to savings accounts (Paxton, 2002). Nepali SCCs are strong in this regard. Finally, many Nepali SCCs serve isolated communities that are not accessed by other MFIs, thereby expanding both the breadth and depth of microfinance outreach.

Nepali SCCs’ scope and length of outreach are also quite strong. The SCCs are significantly ahead of most MFIs in recognizing poor households’ need for convenient savings instruments (Morduch, 1999). Their strong financial position may enable expanded client services, such as life and health insurance, in the future. They should also be able to serve their communities for many years. In contrast, MFIs that give insufficient priority to sustainability implicitly assume that poor households need only a one-time injection of cheap credit (Schmidt & Zeitinger, 1996B).

Findings from this study support the suggestion from Yaron (1994) and Bennett et al. (1996) that governments and donors adopt institution-building strategies to promote microfinance sustainability. There is no evidence that Nepali SCCs need external funding, since they can effectively mobilize local savings even
in poor, remote communities. Donors should instead provide support programs through a network organization—such as NEFSCUN—to easily access a large number of SCCs. As part of these programs NEFSCUN should establish regional service centers to increase its outreach and effectiveness.

Several specific institution-building strategies stem directly from this study’s findings. Such programs should emphasize (1) interest-rate management, (2) record keeping and information systems, (3) the importance of internal funding, and (4) the development of new financial products and services. SCC managers need to understand the relationship between interest rates and profits uncovered in this study. SCCs that perform poorly should be encouraged to adopt interest-rate policies that increase profit and savings mobilization. Information systems must be easy to implement and provide useful information. For rural Nepali SCCs, this means using manual, double-entry systems, since the infrastructure for computers is inadequate. However, donors should help devise improved systems that allow up-to-date loan monitoring. SCCs should be urged to effectively mobilize and manage internal funds, since external funds provide no advantages in financial performance. SCCs that pursue external funds divert attention away from internal management issues. Donors that offer concessionary funds exacerbate this problem. SCCs with strong financial performance should be encouraged to provide expanded financial services, such as insurance and flexible savings plans. SCCs will need technical assistance in these areas.

**Summary and Conclusion**

Nepali SCCs earn strong profits and show significant potential as sustainable microfinance institutions. This is true for all regions of Nepal, including the Hills. Nepali SCCs are almost entirely financed via member savings and equity. The rate of interest earned on loans is a key factor affecting SCC profitability. Nepali SCCs incur low administration costs and generate significant member savings even in poor, remote rural locales.
Community-Based Savings and Credit Cooperatives in Nepal

communities. In light of these findings, the government and donors should adopt microfinance support strategies that build on SCCs’ ability to mobilize member savings. The government and donors should give attention to microfinance institution building and should not provide concessionary funding. While Nepali SCCs may sacrifice short-term growth and outreach to achieve financial sustainability, they serve thousands of poor households in remote areas and provide a variety of microfinance services for the long term.

Appendix

Variable definitions

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<tr>
<th>Variable</th>
<th>Definition</th>
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<tr>
<td>Age</td>
<td>number of years between the SCC’s most recent financial statement and its legal cooperative registration</td>
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<tr>
<td>Profit</td>
<td>(predividend surplus of revenue - expenditures / total assets)</td>
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<tr>
<td>Dividend yielda</td>
<td>(profit x 25%) / member equity</td>
</tr>
<tr>
<td>Capital costs</td>
<td>(interest paid on member savings + interest paid on external loans) / (member savings + external loans)</td>
</tr>
<tr>
<td>Effective interest earned on loans</td>
<td>(interest earned on loans receivable + service earned on loans + fees earned + penalty and other fees) / loans receivable</td>
</tr>
<tr>
<td>Equity / total assets</td>
<td>(total member equity + reserve funds) / total assets</td>
</tr>
<tr>
<td>Administration costs / total assets</td>
<td>annual noninterest expenses such as rent, salaries, supplies, etc. / total assets</td>
</tr>
<tr>
<td>Interest paid / total assets</td>
<td>(annual interest paid on member savings + total annual interest paid on external loans) / total assets</td>
</tr>
</tbody>
</table>

aNepali cooperative law permits a maximum of 25% of annual profits to be distributed as dividends to members.

Notes

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1. This number does not include SCCs that are inactive but have not officially closed or cancelled their NEFSCUN membership.
2. SCCs should monitor the effective interest rate earned on loans and not merely the nominal rate. If there are service fees, penalty charges, or high loan delinquency rates, the nominal and effective rates could differ substantially. Nominal loan rates are unavailable for the sample SCCs.

3. Before 1992, the number of legally registered SCCs in Nepal was negligible. The Cooperative Act of 1992 simplified the registration process, and many informal savings groups became legal cooperatives (CECI, 2001).

References


