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**NEPAL MICROENTERPRISE
SECTOR ASSESSMENT AND
RECOMMENDATIONS FOR USAID
SUPPORT**

FINAL REPORT

Submitted to:

**USAID/Nepal
and
USAID/Washington**

By

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Abbreviations

ADB	Asian Development Bank
ADBN	Agriculture Development Bank of Nepal
AEC	Agro Enterprise Center
AEPC	Alternate Energy Promotion Council
ANSAB	Asian Network for Sustainable Agriculture and Bio-resources
APPA	Appreciative Participatory Planning and Action
ATI	Appropriate Technology International
BDS	Business Development Services
BMO	Business Membership Organization
CB	Commercial Bank
CBED	Community Based Enterprise Development
CBO	Community Based Organization
CCI	Chamber of Commerce and Industry
CCODER	Center for Community Development and Research
CDC	Community Development Center
CECI	Canadian Center for International Studies and Cooperation
CEFE	Competency-based Economies through Formation of Enterprises
CODEB	Community Development Bank
CRT	Center for Rural Technology
CSD	Center for Self-help Development
CSIDB	Cottage and Small Industries Development Board
CTEVT	Council for Technical Education and Vocational Training
CVECA	Caisse Villagesoise pour Epargne et Credit Association (Village Bank for Savings and Credit Association) in Mali
DANIDA	Danish International Development Agency
DCCI	District Chambers of Commerce
DCSI	Department of Cottage and Small Industry
DDC	District Development Committee
DEPROSC	Development Project Service Center
DFID	Department of International Development (UK)
DPP	District Partners Programme
DTC	District Tourism Committee
EDP	Enterprise Development Programme
EMT	Enterprise Management Training
EU	European Union
FAO	Food and Agriculture Organization
FBE	Forest Based Enterprise
FINGO	Financial International NGO
FNCCI	Federation of Nepal Chambers of Commerce and Industry
FNCSI	Federation of Nepal Cottage and Small Industry
FSN	Foreign Service National
FUG	Forest User Group
GARDP	Gumi Agricultural and Rural Development Program
GBB	Grameen Bikas Bank
GDP	Gross Domestic Product

GO	Government Organization
GTZ	German Technical Cooperation
HMGN	His Majesty's Government of Nepal
HRD	Human Resource Development
HURDEC	Human Resource Development Center
HVA	High Value Agriculture
ICIMOD	International Center for Integrated Mountain Development
IDE	International Development Enterprises
IEDI	Industrial Enterprise Development Institute
IEM	Institute for Environmental Management
IFAD	International Fund for Agricultural Development
IGP	Implementation Grant Program (USAID)
INGO	International Non-governmental Organization
ITDG	Intermediate Technology Development Group
LA	Line Agency
LDP	Local Governance Development Programme
LTF	Local Trust Fund
MCPW	Micro Credit Project for Women
MDLD	Market Demand Led Development
ME	Microenterprise
MED	Microenterprise Development
MEDEP	Micro Enterprise Development Program (UNDP)
MFI	Microfinance Institution
MIS	Management Information System
MoFSC	Ministry of Forest and Soil Conservation
MoL	Ministry of Labor
MSE	Micro and Small Enterprise
MSED	Micro and Small Enterprise Development
NGO	Non-Governmental Organization
NRB	Nepal Rastra Bank
NRM	Natural Resource Management
NNN	Nepal Network for Non-Timber Forest Products
NTB	Nepal Tourism Board
NTFP	Non-Timber Forest Products
OSS	Operating Self-Sufficiency (Earned Income/Operating Costs)
PAR	Portfolio At Risk
PCRW	Programme for Credit for Rural Women
PDDP	Participatory District Development Project
PMA	Production and Marketing Association
PPP	Public Private Partnership
PRSP	Poverty Reduction Strategy Paper
PS	Private Sector
PSPP	Private Sector Promotion Project
RAP	Rural Access Programme
RCDC	Regional Community Development Center
RDP	Rural Development Project

REAP	Rural Enterprise Development Programme (GTZ)
RMDC	Rural Microfinance Development Center
RUPP	Rural-Urban Partnership Programme
SAARC	South Asia Association of Regional Countries
SAMANATA	Institute for Social and Gender Equality
S.C.	Share Company
SCO	Savings and Credit Organization
SDC	Swiss Development Co-operation
SFCL	Small Farmers Cooperative Limited
SIP-P	Small Industries Promotion Programme (SDC)
SME	Small and Medium Enterprises
SMEDP	Small and Micro Enterprise Development Programme
SNV	The Netherlands Development Organization
SO	Strategic Objective
SOAG	Strategic Objective Agreement
SPO	Small farmer Promotion Organization
SWOT	Strengths Weaknesses Opportunities and Threats
TA	Technical Assistance
TfE	Training for Employment
TMI	The Mountain Institute
TRPAP	Tourism for Rural Poverty Alleviation Programme
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USAID/G/MD	United States Agency for International Development, Global Bureau, Office of Microenterprise Development
USAID SPO	USAID Special Project Objective
VAT	Value Added Tax
VDC	Village Development Committee
WEAN	Women Entrepreneurs Association of Nepal
WEP	Women's Empowerment Program
WTO	World Trade Organization

Executive Summary

From August 26 to September 17, 2002 two consultants from Weidemann Associates, Inc. conducted an assessment of existing and potential microfinance (MF) and accompanying business development services (BDS) that could have significant impact on incomes of the poor, particularly in the underserved hill districts of the Midwest and Far West of Nepal. The assessment produced an analysis of the issues related to rural economic development in those regions and the potential for a USAID sponsored microfinance/business services component that would form a pillar of the upcoming Mission economic growth strategy. The draft strategy is targeted at reducing the growing inequality in growth reflected in declining incomes and employment, particularly in rural areas. Linkages are made with the recently approved conflict special objective as well as the new democracy and governance strategy being designed. Activities are recommended that can achieve meaningful results within a three to four year period beginning in early FY 2003.

The data collection involved a thorough review of relevant documents, visits to stakeholder national and state governmental and non-governmental organizations (NGOs) in Kathmandu and Nepalgunj, and interviews with donor agencies with current involvement or interest in the microenterprise (ME) sector. The team also participated in a roundtable discussion of 14 public and private organizations involved in micro and small enterprise development (MSED) in Nepal. Potential partner institutions were assessed through detailed discussion and analysis of approaches, results and costs, with a focus on activities in targeted hill areas in the Mid and Far West. The current volatile security situation precluded field visits therefore, assessments will not give complete, on-the-ground details except where prior work permitted. Institutions visited included banks, microfinance institutions (MFIs), technical and business skills training institutions, technology promotion organizations, international and local NGOs, donor programmes, and Chambers of Commerce. A site visit to Nepalgunj exposed the team to a regional market outlet and supply source for the Midwest and Far West target regions.

Discussions and analysis of issues revolved around five major thematic issues:

1. Microfinance in the hill areas,
2. Training and other business development support services,
3. Markets and marketing channels for micro and small enterprise (MSE) products and employment opportunities for rural poor,
4. Strategies for working in rural areas under the current socio-political and economic conditions in Nepal, and
5. Policy and institutional issues affecting development of and services to the MSE sector.

Highlights of the team's findings include:

- Basic rural infrastructure is still lacking in many parts of hill areas.
- Access to financial services, though rapidly expanding in the Terai, is still very limited in the hills, and current practices actually threaten the viability of the industry.
- There is a gap in credit availability for growing microenterprises.

- The microfinance sector has suffered from inconsistent and inadequate policies and supervision.
- Access to appropriate technical skills training services is limited and much of it is not oriented to actual markets and rural poor.
- Demand and supply markets for appropriate business skills training services are very limited. Access to business skills training services for MSEs is very limited in hill areas.
- Access to appropriate market information and market opportunities for local, regional, interregional and international trade is limited though there appears to be significant demand for market access in the target hill areas.
- Microenterprise technology development and dissemination are limited and both supply and demand markets are undeveloped.
- Private sector development for potential business linkages is in its infancy as far as hill areas, but there is potential as infrastructure develops.
- Social awareness of the positive role of the private sector and self-help in the economic development process is still very low.
- Gender differences severely limits women's access to services and resources. Gender sensitive approaches are required to reach poor women.
- Caste restricts social and economic mobility. Program approaches are needed that are culturally sensitive and provide opportunity to those who might otherwise be excluded because of caste.

To address these challenges, strategy recommendations include:

- An integrated, private sector focused process is the framework within which specific activities are sequenced and aligned. Specific recommended interventions fall under four mutually reinforcing areas listed in the sequence of their implementation: *social marketing, community based organization (CBO) institution building, business development, and microfinance.*
- Social marketing is needed to create a positive and secure environment for all interventions. An aggressive campaign to raise the hill area and the general public's awareness of the positive role the private sector and self-help can have in socio-economic development could have a positive impact on the security situation, with or without peace talks, by countering Maoist propaganda about the predominant role government should take in the development process.
- Developing market opportunities that bring additional money into communities is a priority for initiating the process of micro and small enterprise development in rural areas of the Midwest and Far West Hill regions. This will require market led product development together with business chain development.
- The creation of viable job opportunities in market towns for migrants from rural areas is necessary to mitigate the negative impacts of insurgency and poverty induced migration from hill areas while contributing to expanding the economy in and around those centers. Labor intensive, export industry development should be supported in market centers.
- Gender sensitive approaches that take into account higher illiteracy, innumeracy and exclusionary practices that women face in the hills are necessary in all activities. Activities should be designed to alleviate consequences of male migration from hill areas

as well as facilitate women's participation. At the same time there should be a balance of male participation in project activities.

- To speed results, the project could be started by one local NGO with successful experience in Hill areas using the recommended approach.
- USAID should take a leading role in donor coordination in rural MSED in Nepal drawing upon its decades of leadership in the development of MED best practices in microfinance and more recently in BDS.

The following sections contain: an introduction to the context of the work; methodology used; overall issues and constraints; status of ME development (MED) in Nepal including areas of need and key issues; recommended strategies and interventions; and recommendations on follow-up actions. Annexes contain the scope of work, summary tables of MFI and BDS activity analyses, donor activities, people interviewed, documents reviewed and costing of one integrated approach and an example of the cost for incentives for market town job creation.

I. Introduction

I.1. Background

Nepal is landlocked between China and India with some of the most rugged topography on earth. The country has made significant progress since 1951, when the medieval kingdom opened to outside influence. However, much of the socio-economic and political transition to a modern, democratic, market economy has yet to reach rural areas, particularly in the hills and mountain regions of the Midwest and Far West. Per capita income is \$240, however, it is estimated that 42% of the population of 23.2 million earn less than \$100 per year and 53% live on less than one dollar a day. 85% of the poor live in rural areas where subsistence agriculture, on which four out of five poor people depend, is of critical importance. The Maoist insurgency has severely reduced tourism and the manufacturing sector has suffered major setbacks in the last three years as demand in foreign markets and foreign investments have declined. Trends in rural non-farm production indicate that the majority of rural producers do not have access to urban markets not only because of inadequate infrastructure (roads and communications) but also because they do not know how to identify, design and produce quality products that meet market demands.

Table 1. Selected Statistics for Enterprise/Agriculture Sectors

Per Capita income	\$220 (2000-2001)
Economic growth: 2000-2001 ¹	4.9 % (GDP) – 4.0 % Agric; 5.1% Ind; 5.9% (Service)
GDP by sector 1994-1995	Agr.39.9% Ind 13.8 % Serv. 27.9%
US\$5.6 bil. 2000-2001	Agr.36.9% Ind 19.9 % Serv. 38.1%
Percent employed in SMEs and Agr.	NA % in SMEs; 80%+ in agriculture
SMEs as % of economic activity	40%
Poverty rate	42%
Inflation: 3% 1999-2001 5% in hills	

Source: Nepal Development Forum Economic Update 2002. World Bank January 30, 2002

I.2. Scope of Work

The assessment team included James Hochschwender, Micro and Small Enterprise Development consultant and Prashant Rana, BDS Advisor, both from Weidemann Associates, Inc. under subcontract to Abt Associates, Inc., under the SEGIR Financial Services IQC Task Order No.4200-02TM-001. The team was tasked with identifying potential strategies involving microfinance, BDS, and the private sector. Such strategies would focus on the rural economic development component USAID/Nepal's economic growth strategic objective.

Specifically, the assessment and recommendation objectives were to:¹

- Identify key constraints to delivering effective microfinance services in Nepal (legal framework, His Majesty's Government of Nepal (HMGNN) policies and regulations,

¹ See the complete scope of work in Annex A.

- the institutional environment, existing MFIs capacity and sustainability, procedural constraints, the insurgency situation, and total availability of capital for lending);
- Identify complementary needs, such as skills development (e.g. literacy and numeracy training, etc.);
 - Identify business development services in marketing, product development, accounting, etc. that are critical for the success of microfinance initiatives, or would enhance the impact of a microenterprise development activity;
 - Summarize existing data on credit and savings needs by location (districts in most need) and sectors in which credit is most needed or most appropriate;
 - Identify gender issues as related to the distribution/availability of credit and other business services;
 - Analyze the most appropriate institutions with which USAID could work in the delivery of microfinance and business development services, and what needs to be done to strengthen the services delivery capabilities of those institutions;
 - Propose implementation mechanisms for a possible microfinance program supported by USAID; and
 - Provide guidelines to levels of funding needed for sustainable and effective rural poor income improvement through micro and small enterprise development program (e.g. policy assistance, institutional development and support, complementary business development services, etc.).

I.3. Methodology

Information was collected from the following sources: existing studies and reports, government agencies, and interviews with key staff in government, donors, NGOs and MFIs. Because of the security situation it was not possible to neither visit existing and potential clients in the field nor do a thorough assessment of the field operations of microfinance and business development service activities. Complete information on existing MSED activities in the Midwest and Far West regions of Nepal was not available in Kathmandu, therefore, undoubtedly some activities that should have been included in the report are not.

The approach to the interviews was to first review relevant documents, identify issues and ideas for discussion and then try to limit the formal presentations to a minimum in order to elicit maximum data on lessons learned, institutional strengths and weaknesses, threats and opportunities and exchange ideas on how to best serve the needs of rural poor in hill areas under current circumstances. Many of the organizations visited did not have current and/or planned activities in USAID targeted rural hill areas. However, the team felt that lessons learned in other areas would have relevance to project planning in the target areas. Activities in a range of physical environments were discussed to see what different types of micro and/or small enterprise potential there is in hill areas of Midwest and Far West of Nepal. Nepalgunj was visited because, even though it is in the Terai, it is one of the major outlet and supply markets for the Midwest and Far West hill regions. Also, it allowed the team to confirm the limited degree to which regional microfinance and other business service activities are reaching out from that market center into the hill districts.

An attempt was made to visit as broad a variety of activities as possible because the ability of MED activities to provide opportunities for the poor to fully lift themselves out of

poverty requires linking MEs to the mainstream economy. Microfinance by itself does not accomplish this. Also, the current trend in best practice MED is increasingly recognizing the need to complement microcredit and savings with other business development services. This approach required taking into consideration the overall private sector development process in Nepal. For example, the Nepal Carpet Exporters Association was visited because of its links to external markets, while the Bheri Vocational Training Center was visited to determine the availability and quality of technical training services. Organizations that had the largest outreach (number of clients served) in rural areas were intentionally selected as a proxy of institutional and service capability.

II. Constraints and Issues related to Rural Economic Development in Nepal and Around USAID's Involvement

At present there are several significant constraints to economic development in Nepal. There are general ones that have overarching effects and then there are ones that are more specific to financial or non-financial service delivery. Each one is discussed briefly in terms of its context and consequences and implications for USAID activity design.

II.1. Macroeconomic Factors

a. The Conflict – The team found this to be a topic in most discussions. One issue is whether conflict resolution is a pre-condition for starting typical microenterprise or any economic development activities. The second issue is how development activities can work in insurgency affected areas. Without a doubt the insurgency is a factor that cannot and should not be ignored. There are daily news reports of attacks, murders and destruction of public and community property. Those reports reinforce the impression both internally and externally that Nepal is not a safe place to live, travel to or try to do business in. Consequences include the precipitous drop in tourism, off by 70% or more from what it was two or three years ago. The insurgency will raise the already high cost of service delivery in hill areas in two ways. It will increase staff turnover and extra security measures add costs. In addition, loan losses will likely increase from destruction of production capacity and borrower deaths/disappearance.

Too often the insurgency is used as an excuse for any decline, from domestic production and sales, to exports and government revenues. While there is some truth to this, it must be noted that there are other factors influencing these outcomes, including substandard management performance in the face of more challenging global economic conditions. One case in point is the 30% drop this year in carpet exports. The insurgency is cited as having influenced that result but the truth is that lack of innovation in carpet designs and inadequate quality control resulted in those declines.

Generally lacking is any concerted response promoting a viewpoint contrary to that of the Maoists. There is an unrecognized opportunity for government, business and community leaders to present the case of the future direction of the country. Feedback from interviews acknowledged that no leader is coming out with a clear statement of the big picture of where Nepal should be/is heading over the next 10-25 years. Without a vision that the majority of

Nepalis can agree with, little meaningful progress will be made in any development direction let alone in diffusing the Maoist insurgency.

The most immediate implication of the conflict issue for USAID activity design is the selection of partners who have demonstrated that they can work effectively in areas near or in conflict zones. It also suggests that promotion of USAID's involvement in field activities be minimized. Finally, local people both for security reasons and acceptability should conduct all field activities.

b. Infrastructure – Physical infrastructure in the Midwest and Far West hill areas is very limited. The vertical terrain, fragile ecology and marginality of the populations provide significant challenges to the development of that infrastructure. Though there has been some improvement in recent years, there is still a general lack of roads and electricity in the hills. Nearly 30 districts in the isolated mountain/hill areas have less than 1 km of road density per 100sq. km. of area. The majority of hill communities in the Midwest and Far West are not along the few existing roads, and therefore, tend to be very isolated. Most are more than a half-day walk to the nearest road, and that may not even be an all weather road. This makes transport of goods to outside markets more difficult and costly.

Most rural communities do not have electricity or communication services (telephone/telegraph/ fax/internet), which limits their access to information needed for expanding or upgrading their economic activities. Though Nepal does have abundant hydropower resources, it has not been able to effectively exploit them.² Rural communities also lack access to social services such as clean water, sanitation, health clinics or schools. These factors heavily reduce productivity. On the other hand, recent inroads of mass media and telecommunications have increased rural dwellers awareness of the growing disparity in incomes and lifestyles in Nepal. The Maoists are exploiting that increased awareness to sow dissent and recruit followers. Very limited education and lack of employment opportunities make the rural poor, particularly unemployed youth, easy to recruitment.

These infrastructure limitations together reduce the options of comparative advantage goods that can be produced and delivered viably to outside markets, increase the cost of service delivery in these areas, and leave the rural poor on a subsistence treadmill.

The implications for USAID/Nepal are that rural MSED activities should follow North-South road corridors³ in order to maximize impacts in the next 3 to 4 years. A more complete record of road infrastructure should come out of the USAID/Nepal Special Project Objective infrastructure inventory being done in 10 districts in the Midwest and Far West. USAID might

² The USAID private sector led hydropower development strategic objective is addressing this element, but it is in its early stages.

³ A recent study analyzed the cost effectiveness of investments in roads in hill areas and found that North-South roads returned significantly more than East-West roads did because the North-South roads linked disparate markets while the East-West roads tended to link more similar hill markets, thus providing hill producers much less increased access to more lucrative markets. An example of a North-South road is the one from Dailekh to Surkhet to Kohatpur, which then connects to Nepalgunj and the main road to external markets via Bhutwal. Pokhara to Bhutwal is another example of a North-South road in the West region.

also use other rural infrastructure development, such as planned "green roads" and small-scale hydropower activities to guide selection of areas for this project.

c. *Policy Environment* – Overall the policy environment for business in Nepal has been improving over the last decade. The business registration process has been streamlined, reducing opportunities for corruption along the process. The bilateral trade agreement with India opened up many business opportunities and facilitated employment driven season migration. However, there continues to be some unpredictability in the policy environment that creates an uncertain business investment climate.⁴ One example is the price floor on handmade carpets imposed several years ago. According to industry experts, even after adjustment last year, prices are still higher than international market rates. This constrains exports and thereby employment in that sector. Recent changes in the customs rules and procedures between India and Nepal make strategic business planning for access to the Indian market difficult, thus reducing opportunities for business development in the hills. Another example is the practice of the Ministry of Forestry to encourage communities to allocate resources to community forests. They then make it next to impossible for communities to derive any economic return from them. Labor laws could be improved to better balance between labor interest and private sector development. For example, it is very difficult and expensive to fire an employee, even for fully justifiable reasons. There is room for rationalization of policies between government agencies and overcoming procedural hassles by streamlining procedures, establishing clear and transparent systems and elaborating rules/guidelines/system to reduce chances for interpretation. This improved transparency in the regulatory mechanism of the government would support private sector development.

The success of HMGN's current work towards joining the WTO is in part dependent on a stable macroeconomic policy environment. Not all impacts of joining WTO will be positive in the short run. The potential for rural economic development in the hills areas will only be enhanced with a stable macroeconomic environment. This will ensure that protectionist inclinations will not take the fore in the process of favorable resolution of the impending loss of textile quotas in the US market in 2005.

Although there is policy related to microfinance, it is fragmented⁵ and not market oriented. Interest rate and loan size caps in particular actually restrict microfinance development. The unpredictability of government policy extends to MF. Recently, in order to stem abuses of some urban financial institutions, an income tax was imposed on cooperative income. This cuts into cooperative capital appreciation from retained earnings, thus unnecessarily slowing their growth. The new tax on savings income has resulted in a 15% reduction in the interest earned by poor savers. That may not sound like much, but coupled with the added burden on MFIs to calculate and report it, it makes MFIs less viable because of higher administration costs. HMGN needs to look for ways to exclude MF from such taxes.

The loan size cap has also created an artificial service gap for the more successful and growing MEs that wish to invest in facilities and equipment upgrades to improve productivity

⁴ This scope of work did not provide for fully investigating the macro policy environment. Examples are anecdotal data collected from interviews.

⁵ Nepal currently has ten different Parliamentary Acts in force that govern microfinance.

and product quality. HMGN should want to support, microenterprises that are growing and could create more employment. (See further discussion below in section II.2. Microfinance Services.)

II.2. USAID Policy Factors

a. Acceptable Models – For many years now, the USAID/EGAD/Office of Microenterprise Development has promoted minimalist microcredit and microfinance, and more recently it has extended that concept to BDS. However, existing conditions in the hills areas of Nepal of very limited development awareness, limited access to clean water, sanitation and low cost fuel, and to viable markets all result in low productivity. Recent program successes in hill areas similar to those USAID/Nepal would like to target suggest that a more integrated approach is needed for effective economic growth activities. Rural economic development programs need to combine social mobilization, development education and counseling, introduction of productivity enhancing technologies, market based business development as well as self-sustaining microfinance. Though certain elements of this approach can become self-sustaining within a reasonable period of time, others may not.⁶ The issue is how willing is the Mission to consider paying for upfront costs of this more integrated approach. In most rural hill communities, no meaningful MSED and/or community based organization activities can really start without significant awareness-raising among the community in general and the poorer segments in particular. Not all communities will require the same amount but experience has shown, that this aspect of the socio-economic development process has too often not been given sufficient emphasis and overall project results are limited because of this omission.⁷ Also, there may need to be other subsidies for interventions that are more focused on developing the infrastructure for community based social services.

Second, the fluid conditions in the country and in the target hill areas necessitate a very flexible, opportunistic planning approach, which not all USAID staff and management are comfortable with. The preference of most Missions is a project with activities planned well in advance. Annual plans are called for with detailed levels of effort and schedules of activities.⁸ Given the many activities of other donors, HMGN Line Agencies (LA), and community groups, anticipating the specific needs and the best timing for servicing them and balancing between which communities respond most to opportunities facilitated by the project is a very dynamic process. It requires constant adjustment to the differing paces of various communities and flexibility to rapidly respond with unanticipated technical resources as needs arise. For example, a sub-sector analysis may reveal an immediate opportunity for input supply upgrading that will

⁶ This approach goes beyond the most integrated existing "credit with education" self-sustaining microfinance model that Freedom from Hunger, Pro Mujer and other local and INGOs are implementing in poor communities in other countries.

⁷ The final report of the Chemonics MARD project mentions that although CBO institution building was part of their activities plan, the level of effort needed for it was significantly underestimated, the amount needed was not delivered and not doing so adversely affected the long term results of the project. NGOs have learned that unless people are dealt with starting at their level of awareness of things as problems or not, no lasting changes will occur in attitudes and/or actions of project target groups after all the money has been spent.

⁸ One common complaint from NGOs is that they cannot access Line Agency resources when needed because those agencies work strictly on plans made a year in advance. Second, the process for accessing personnel and other resources is cumbersome and time consuming. The result is they are forced to go around official channels and hire the same personnel unofficially, thereby consuming more of their own limited financial resources.

create viable employment for a significant number of poor. However, that opportunity was not anticipated. Unless the project is able to hire technical-assistance as needed, these kinds of employment and income generation opportunities may be missed.

b. Methodology development and eligible partners – A complete, self-sustaining model for economic growth in the hills does not presently exist. There are at least a couple of local organizations that have done significant work in developing such a methodology and should be supported in further work. US government contract regulations and lean management structures in the Mission preclude direct contracts with most local NGOs and/or private sector organizations. Working through large international consulting organizations can rapidly multiply activity costs without necessarily adding significant impact benefit. On the other hand, some international contractor involvement can enhance business development performance by providing better access to external markets and technologies and approaches not yet practiced in Nepal. There are several issues here. One is what kind of support will best achieve the goal of arriving at an optimal approach. The other is how to maximize the flow of resources to local partners without wasting resources on international contractor overheads. The past tendency has been to work through an apex organization to maximize potential outreach.⁹ The Mission needs to decide whether, in the early stages of an economic growth project for hill areas of the Midwest and Far West, some kind of direct support to implementing organizations might not be more effective than the usual apex approach to methodology development with its long lead times as far as methodology development and testing. A related issue is that this support may distort the service delivery market.

II.3 Microfinance Services

There are a number of constraints and issues more specifically related to the area of microfinance.

a. Developing a Self-Sustaining Mf Model for Rural Hill Areas - This is recognized as being only partially accomplished even by those organizations that purport to have one. There is broad agreement that rural MF should be based on community based savings and credit organizations (SCOs) because that approach taps under-utilized local resources, is cost effective by devolving normally salaried functions to the community, and will expand financial intermediation. Weaknesses of this approach include the failure to integrate best practices and gender best practices in programs and weakened potential for sustainable depth and breadth of outreach. Support to date has focused too little on capacity building while placing too much emphasis on seed capital. There has been a lack of vision of sustainable growth, both among MFIs and promoters. SCOs will not be able to contribute significantly to rural economic development without links to other SCOs in their district and region and without complementary business development activities.¹⁰ Viable district and regional level networks, associations, or cooperatives and national federations yet need development and that will take some up front

⁹ The USAID sponsored Women's Empowerment Project (WEP) is a good example of this approach. WEP worked with hundreds of local NGOs and INGOs, training their trainers and field staff to implement field activities related to women's empowerment with apparently far-reaching results. But there has been some question as to the sustainability of some of the activities engendered by that project, in particular literacy training and village banking.

¹⁰ CECI Overview of MF Sector in Nepal for IFAD Western Uplands Development Program, Kathmandu 2001

investment. Given the topography and infrastructure in the Hills, there may not be economies of scale for a national level support system currently being promoted. The self-sustaining provision of technical services that local and village development committee (VDC) level groups of SCOs will need to ensure their financial intermediation operations are secure needs to be developed at the district level and perhaps regional levels. A second aspect of this issue is cost effectively linking SCOs to outside funding, such as those available through the rural microfinance development center (RMDC), with which they can accelerate community investment within its absorptive capacity. District or region level SCO banks or cooperatives could be the means for RMDC to extend its second story financing services further into hill areas.¹¹

There are two other related issues. One is the *impact of the security situation on lending*. The other is *market access* of rural microenterprise and ME supplied and serviced industries. The implications of the first are obvious; it increases costs through staff turnover and actual loan losses. The implication of the second is that impacts of MF activities will be minimal unless access to larger, more viable markets is achieved as an integral part of the activity.

b. Regulation and Supervision of MFIs – The current plethora of laws governing MF activities needs to be streamlined and coordinated. The question is the extent to which HMGNN is willing to reconsider a major overhaul of the legislation relating to MF in the near future. There are two specific policies that need immediate attention. One is the interest rate cap. The other is the loan amount ceiling. Current microcredit regulation limits interest to 25%. The assumption is that because people are poor they should pay less interest. Research in Nepal has shown that in fact they are already paying much higher interest rates; moneylenders charge from 36% to over 100% in rural hill areas.¹² This interest rate cap has serious implications for the viability of MF in hill areas as costs tend to be higher due to more difficult access to less concentrated populations. The cap needs to be removed.

The second regulation factor is the maximum loan an MFI can make, currently at R30,000 (\$US375). The Nepal Rastra Bank (NRB) reported that they are about to increase it to R40,000 (\$US500) and one person reported that a movement to raise the limit to R100,000 (\$US1,250) is underway. This limitation unnecessarily fragments the financial market. It also restricts the ability of MFIs to meet the credit needs of their most successful, growing ME clients and to cross subsidize smaller loans with income from larger loans. Those clients could be creating more jobs and income in the community if they had access to larger loans. A second consequence of the loan size cap is the significant gap between the maximum amount that MFIs lend (R30,000 - US\$375) and what commercial banks lend.¹³ Two government owned commercial banks make loans as small as R500,000 (\$US6,250). However, according to sources in the Nepal Rastra Bank, private commercial banks do not lend below R2 or 3 million (\$US 25,000-37,500) and few even at those levels. Most MEs are not ready for that size loan. Furthermore, commercial banks are by law supposed to lend against acceptable collateral, which means in practice land and buildings in urban areas. Growing MSEs can seldom provide such collateral. It is unrealistic to expect that commercial banks are going to enter into best practice

¹¹ This has been done quite successfully in other countries such as Mali in West Africa under somewhat similar (difficult) rural conditions, in the village bank network of CVECA in the Pays Dogon area.

¹² From various impact studies done of CECI MARD and CBED activities.

¹³ That is the legal limit on loan size that MFIs can lend to MEs.

microcredit because it is prohibitively expensive for them to do so and they are disinclined to work that hard.

A third factor is the inability of the NRB to actually supervise MFIs, be they development banks, or financial international NGOs (FINGOs). Limited human and other resources make it difficult to collect and review performance data or even do annual audits. This situation is unlikely to change in the near or medium term. The NRB is thinking that supervisory functions should be devolved to apex organizations such as the RMDC, an MF industry association and the National Cooperative Bank (for financial oversight of cooperatives).

The issue related to USAID's economic growth project design is how involved USAID wants to get in addressing MF regulation and supervision constraints. This is not a small task at this point in the process. MF policy in Nepal needs to be streamlined and rationalized to support the development of a viable MF industry. USAID is recognized as a worldwide leader in microfinance. Though the World Bank and IMF are supposed to be doing financial sector reform work in Nepal, they have not been known for effective work in the area of MF regulation and supervision. USAID has done significant action research and provided technical assistance in this area in a growing number of countries, formally and informally.¹⁴ For project design and costing, USAID/Nepal will want to decide whether to pursue this activity formally or informally.

c. Pricing of MFI Products in the Hills Areas – Most MFIs are not charging enough for their financial services or are not efficient enough to fully cover their costs. This, in part, stems from government sponsored subsidized credit programs and the emergence of MF out of social service NGO that fell into microcredit because of their clients' demand for it. Furthermore, HMGN continues to implement subsidized credit programs targeted at the poor in the name of microenterprise development. HMGN needs to end subsidized interest rates that allow allocation of resources¹⁵ to inefficient MEs, undermines the MF industry as a whole, and sets an untenable political precedent of below cost service provision to poor people. Though HMGN is like any other government that wants a cost effective MF industry as soon as possible, it is actually preventing that from ever occurring with its present policies and practices.

The current political environment would seem to discourage looking at raising interest rates in order to be able to extend microfinance services further into hill areas. The implication for project design is the types of MF models USAID will consider supporting. SCOs appear to offer a way around this issue as they decide as a group on what interest to charge their members and usually do not pay any staff, which minimizes their costs.

d. Funding of MFIs – As MFIs grow there is a tendency to look more to savings deposits as a major source of funding. These deposits cost the institutions 5-8% interest plus the

¹⁴ To mention a few: USAID/Bolivia was very active in assisting the Bolivian Central Bank to formulate MF regulation in the early to mid-1990s. Then in the late 1990s USAID provided training to Central Bank staff in MFI supervision. In West Africa, USAID/Mali is working with the regional Central Bank (BCEAO) on establishing MFI performance standards that will facilitate supervision through MFI networks in the French West Africa region. EGAD/MD has published and distributed research results and held numerous workshops on MF regulation and supervision around the world.

¹⁵ Sixty percent of microcredit in Nepal is provided by the five government owned Grameen Bikas Banks which regularly de-capitalize as they are not covering operating costs with interest and fee income.

cost of managing the savings accounts' records and transactions, which can add several percentage points to the cost. In small SCOs this is not as major as those costs are minimized with volunteer labor. Also, experience has shown that community funding through savings can enhance repayment rates. But to a development bank that wants to provide these savings services to the poor, this is very expensive given the relatively low interest rate being charged on loans. Using a higher and higher percentage of these expensive funds will actually make it more difficult for MFIs to attain full cost recovery. The issue is access to sources for low cost (concessional rates of 1 to 5% interest), long-term (at least 10 years or more) loans that will enable MFIs to viably fulfill their original mandate of providing low cost financial services to rural poor. RMDC has the mandate and funds to do this, and has lowered their wholesale lending rates to 6%. But the question remains whether they will find a way to work with smaller MFIs to provide the funding the stronger ones among them need to attain the economies of scale necessary to be self-sustaining.

e. MFI Staff Development - Staff and management development is key to viable development of the microfinance industry in Nepal. Mention has been made of the establishment of a training program for MF specialists. Funding and materials are needed. International microfinance best practices need to be made part and parcel of that training, at both management and staff levels. USAID is the leader in the development of microfinance and related training.¹⁶ Some of the training materials exist in Nepal¹⁷, but the curriculum is not complete. The issue is whether USAID will have the resources to support this national level effort under its economic growth strategy.

f. Resolution of the Grameen Bikas Banks as Public Sector Lenders - These banks provide a significant portion of the microcredit, mostly in Terai areas, but on a subsidized basis that undermines the overall MF industry. There has been a recent recapitalization of these banks in anticipation of divesting them to the private sector. But issues related to staff unions will have to be resolved before any privatization is likely. If not resolved, these banks will continue to be a drain on public resources while setting a precedent as far as low interest rates that will make it politically very difficult for MFIs in hill areas to ever become self-sustaining.

II.4. Non-Financial Services / Business Development Services

Non-financial or business development services (BDS) for micro and small enterprise (MSE) include any service that those businesses use to support their operation. Therefore, accounting and tax services, legal advice, communications, warehousing, production advice, business and technical skills training, labor and time-saving technology development, information dissemination, marketing, lower cost and higher quality input supply, market information and access, and private sector linkages are all examples of BDS. The following are the key BDS constraints and issues related to rural economic development in the Midwest and Far West hills.

¹⁶ USAID/Bolivia, using the MicroServe contract, has supported the development of the first microfinance specialist diploma program outside of the US. Dr. Claudio Gonzales-Vega of Ohio State University led the curriculum and materials development. This one-year program includes fieldwork in an MFI.

¹⁷ PACT/Nepal and CMF as well as individual MFIs have some of these.

a. Developing a Model for Rural Hill Areas – All concerned see this as an important activity. Similar to microfinance, BDS enterprise development models for the hills are still in their infancy. This is due to several issues. One is the limited awareness of MSEs about the benefits of needed BDS. Related to this is the willingness and ability to pay for services at full cost. Another issue is the availability of effective BDS “products” that address hill MSEs’ constraints. Cost effective marketing of those BDS services is a challenge. At this stage in the BDS market development process and in the severely constrained BDS markets of the Hills, one primary issue is USAID’s willingness to work with individual services providers versus wholesaling services more broadly and having less direct involvement with individual providers. The advantage of the later is broader outreach.¹⁸ The disadvantage is shallower involvement and potentially more limited results as far as viable model development.

Another related issue is USAID’s willingness to support BDS in Midwest and Far West market centers rather than in rural areas. An example would be an incentive investment in the input supply chain for a market center based industry, say handmade carpets, that could employ significant numbers of poor (up to 4,000 per \$400,000 investment), which had migrated from hill areas due to poverty and /or the insurgency. Since the team was not able to visit rural market centers, it was not possible to identify other industries with similar potential. However, it is quite possible that product development of pashmina into products beyond shawls for local and external markets might hold similar potential. No doubt there are other labor-intensive industries for which there might be a comparative advantage. Product developers, who are experienced in selling to external markets, are best placed to identify business opportunities.

b. Networking with Other Donors on BDS– A number of donors agencies have been involved in different micro and small enterprise development activities. The issue is the extent to which USAID is willing to capitalize on other donor experiences and build on their existing activities versus mounting its own effort in a particular BDS for rural enterprise. An example would be labor and energy saving technology dissemination that is not being done in some of the districts that USAID is considering for this project. Rather than mounting an entire effort for that technology dissemination, USAID might tap into existing resources, paying only incremental costs for linking technology developers and disseminators to get something going in new districts. There is a need to capitalize on the experience gained by various agencies working in hill areas. But doing so will require flexibility in implementation planning to capitalize on opportunities and leverage resources through joint action.

c. Networking with Local Organizations Involved in the Field – There are many local organizations that have worked in the area of BDS in rural areas. They include Center for Self-Help Development (CSD), Development Project Service Center (DEPROSC), International Development Enterprises (IDE), and others. However, the organizations that seem to have gone the furthest in terms of developing a coherent and comprehensive approach are Center for Self-help Development (CSD) and Center for Community Development and Research (CCODER). Here again, the issue is USAID’s willingness to allow a contractor to flexibly collaborate with different partners in different places. Doing so would allow synergies to develop and expand while keeping program costs to a minimum.

¹⁸ WEP was an example of the wholesale approach that involved PACT/Nepal training staff of 234 INGOs/NGOs to implement literacy, village banking and rudimentary business skills training.

III. Summary of Status of Micro and Small Enterprise Development in Nepal

Micro and small enterprise and the private sector in general are still in the early stages of development in Nepal. Highlights of the team's findings include:

- Basic **rural infrastructure** is still lacking in many parts of hill areas. In particular, roads and electricity adversely affect the potential of economic development, especially in the hill areas of the Midwest and Far West.
- **Social awareness** on the role of the private sector and self-help in the socio-economic development process is very limited and needs to be increased both in the general public, and in and around conflict areas.
- Access to **appropriate and viable financial services**, though rapidly expanding, is still very limited, especially in the hills and mountains. Current practices threaten the viability of the industry.
- The **microfinance** sector has suffered from inconsistent or inadequate policies and supervision that limits the viability of the industry.
- Access to appropriate **technical skills training** services is limited and much of it is not oriented to actual product markets, to rural poor or to women.
- Access to appropriate **business skills training** services is very limited and not reaching very far into rural hill areas.
- Access to appropriate **market information and market opportunities** for local, regional, interregional and international trade is limited in rural areas and has tended to focus on markets for agriculture products. There is a need to expand that to include other labor-intensive production for which there is some comparative advantage in the Hills.
- **Technology development** work has gone on for over 20 years in Nepal and dissemination is still limited in certain rural hill areas. Labor and time saving technologies are available and need to take first priority to improve household productivity and rural enterprise performance.
- **Private sector development** is in its infancy but there appears to be potential for building links between rural production and processing and regional market centers and Kathmandu.
- The **insurgency/Maoist conflict** exacerbates the impact of all of the above factors constraining economic development in Nepal. Program planning and approaches must take this into consideration.
- Gender differences severely limits women's' access to services and resources. Gender sensitive approaches are required to reach poor women.
- Caste restricts social and economic mobility. Program approaches are needed that are culturally sensitive and provide opportunity to those who might otherwise be excluded because of caste.

III.1. Status of Micro and Small Business Finance in Nepal

The following discussion is predicated on the assumption that the Mission is looking for interventions that can have significant and lasting impact within a 3-4 year period starting in early FY 2003. Another assumption is that MED microfinance best practices, as promoted by the

USAID EGAD/MD office are to be applied as much as possible in the activities the Mission supports. Therefore, concepts like market supply and demand, cost recovery, and ways to make services more efficient and self-sustaining will be an important part of the following discussion.

III.1.1 Preface

Microfinance is the provision of financial services mainly savings and loans, to people who generally do not have formal access to these services. In a few instances, savings can be configured in ways that allow them to serve as insurance products. Despite some form of micro and small business credit activities since the mid-1970s, the microfinance industry in Nepal is still in the early stages of its development. This stage is characterized by the predominance of a single operational model, little product differentiation, a primary focus on credit rather than savings, and limited competition in most markets. Small-scale agricultural credit is often confused with microcredit. Marginally cost-effective microcredit models have been developed for the more concentrated population areas of the Terai, but the same cannot be said for the hill areas. Government owned development banks continue to provide most of the microcredit in the country on a subsidized basis. Almost all of their lending is in the Terai.

The total outreach of microfinance in Nepal is estimated at 700,000, which is approximately 7% of the 10 million people living in poverty. It has penetrated a high percentage of the markets in the Terai and a much low percentage in hill areas. Formal microfinance activities in Nepal have been started and dominated by HMGNN and still today the five Grameen Bikas Banks and other public sector institutions control 59% of the total outreach of around 650,000 borrowers and have provided 42% of the total outstanding loans in the sector. The rest of the outreach is spread amongst private sector development banks, MFIs, cooperatives¹⁹, NGOs, SCOs and financial international NGOs (FINGOs) as can be seen below in Table 2.

Table 2. Outreach of Microcredit in Nepal

Type of Institution	Approx No. of Members	No. of Borrowers	Loans Outstanding '000 Rupees	Collection Rate
Public Sector	405,000	386,000	910,000	
SFDP	180,000	180,000		<50%
MCPW	60,000	60,000	115,000	-
Grameen Banks*	130,000	120,000	723,000	97%
PCRW	35,000	26,000	72,000	-
Private Sector	295,000	262,000	1,265,000	
Cooperatives	90,000	80,000	240,000	-
SFCL	60,000	55,000	725,000	58%
NGO Dev't Banks (CSD, DEP, Nird, Sappo)	95,000	82,000	300,000	98%

¹⁹ It should be noted that activities of the SFDP, cooperatives and Small Farmer Cooperatives Limited (SFCLs) included here generally focus their lending activities on agricultural lending, which is not the same as microcredit as it has a different set of risks attached to it. However, SFCLs do also provide some microcredit.

Type of Institution	Approx No. of Members	No. of Borrowers	Loans Outstanding '000 Rupees	Collection Rate
Others	50,000	45,000	30,000	-
Total	700,000	648,000	2,175,000	
Public % of Total	58%	59%	42%	
Private % of Total	42%	41%	58%	

Estimates from data collection and conversations

Currently the most common form of MF in the hills is informal credit, consisting of moneylenders (landlords, merchants/traders, goldsmiths, pawnbrokers and friends/relatives) traditional savings and credit associations such as *dhikuti*, and grain savings and labor savings systems.²⁰ More recently community based savings and credit organizations (SCOs) have been promoted through several donor programs, such as Participatory District Development Project (PDDP-UNPD), Rural Access Program(RAP-DFID), Micro Enterprise Development Program (MEDEP-UNDP), Local Governance Development Programme (LDP), CBED (Community Based Enterprise Development-USAID) and the Women's Empowerment Program(WEP-USAID).²¹ New MFIs continue to enter the field, but most are community level, small-scale SCOs that have no way to spread loan portfolio risks beyond a very limited local market. User group cooperatives are equated with microfinance though they often provide mainly agricultural credit, which should not be confused with best practice microcredit. Few markets have more than one institution offering microfinance services, so there is little competitive pressure to improve products and efficiency.

As already mentioned, the MF policy environment is fragmented with inconsistencies among the numerous authorities over different types of organizations. There are at least ten acts of Parliament that govern MF activities in Nepal. They include: the Nepal Rastra Bank Act (1955), the Agricultural Development Act (1967), the Development Bank Act (1978), the Societies Registration Act (1978), the Finance Companies Act (1985), the Social Welfare Act (1991), the Co-operative Act (1992), the Companies Act (1997), the Financial Intermediary Society Act (1998), and the Insurance Act. On top of having interest rate and loan amount caps, the Nepal government has continued to introduce highly subsidized microcredit programs. For example, the Programme for Credit for Rural Women (PCRW), started in 1998, had a 5% interest rate and did not enforce collection, thus undermining the concept of credit discipline in areas where it was prevalent.²²

NRB Non-banking Regulation and Supervision Division needs support and guidance on how MFIs (be they development banks, cooperatives, INGO/NGO MFIs, small farmers cooperative limited (SFCLs) or SCO networks) can be efficiently and effectively monitored and controlled while supporting healthy growth in the industry. NRB has suggested that a MF industry apex organization such as RMDC needs to play a greater role in the self-regulation of

²⁰ CECI Overview of MF Sector in Nepal for IFAD Western Uplands Development Program, Kathmandu 2001

²¹ The village banking model promoted through WEP is a form of SCO.

²² This program was to be closed in August 2002.

MFIs by establishing agreed-upon industry standards, facilitating training and other organizational development, and monitoring member performance. RMDC and CMF appear to be the most appropriate organizations to study impacts of specific regulations and supervisory policies and practices, and lobby HMGN for any needed changes. Indications are that the NRB needs the inputs from the MF sector as they do not have first hand experience in best practice MF but have to get through the legislature to improve microfinance laws. To their credit, the NRB Non-Bank Regulation and Supervision Department is holding sessions with interested parties before and after formulating new policy to obtain input and feedback.

As a result of all these factors, microfinance in Nepal will encounter continued challenges to its growth as a viable industry. The government needs to simplify and provide a more consistent and unfettered policy environment. The hills environment where formal microfinance has yet to make significant inroads will provide even greater challenges with its more dispersed populations and reduced economic opportunities for MSEs. That does not mean that MF cannot be viable in the hills. However, it will definitely require improved economic opportunities and better market access if microfinance is to have much impact at all.

III.1.2. What Microfinance Can and Cannot Do

It is important to note what MF can and cannot do to engender rural economic growth and development and under what conditions that is possible. Below is a partial list of the things that microfinance schemes (microcredit and savings) can and cannot be expected to do in rural economic development.

Table 3. What Microfinance Can and Cannot Do in Rural Areas

Microfinance can do:	Microfinance cannot do:
1. Best practice microcredit can be used to encourage diversification beyond subsistence and non-viable small-scale cash crop agriculture.	1. Best practice microcredit <u>cannot</u> substitute for agricultural credit because the cash flows from agriculture preclude periodic payments and the risks of ag credit are higher. ²³
2. There is greater demand for voluntary savings in rural areas than there is for credit (number of savers/borrowers, not necessarily amount) and so savings services can achieve financial deepening by bringing more people into formal financial networks	2. Neither microcredit nor savings can increase incomes of the poor if they do not have access to economic opportunities and that comes from access to viable markets for products they can produce and deliver.
3. MF can be used to create a disciplined credit culture in an area that has had government giveaways and failed credit schemes. ²⁴	3. No microcredit model by itself can guarantee high repayment rates – it must be applied in a disciplined manner to do so.
4. MF can be a means for women’s empowerment by raising awareness, increasing economic returns to their labor and wealth accumulation.	4. MF cannot function well in an unsafe environment (costs for security increase overall cost considerably)
5. MF can increase the impact of other development	5. MF cannot guarantee that people’s income will

²³ Time and again MFI that have ignored this fact have later come up short when the normal risks of weather and pests associated with agriculture manifested.

²⁴ Dependence on local savings combined with proper awareness raising and skill training has been found to greatly increase the likelihood of effective peer pressure for on-time repayments.

Microfinance can do:	Microfinance cannot do:
interventions such as technical and business skills training and counseling, labor/time savings technologies, etc., but ONLY if participants have access to viable markets for the products for which they acquired skills to produce.	increase even if they do have access to markets for their production or services. MEs must also be educated to look beyond the one or two brokers who monopolize product purchases in that area.
6. Microcredit can be delivered cheaper than moneylender credit and can, in the long run bring the cost of moneylender credit down. ²⁵	6. Microcredit is usually not deliverable at less than commercial bank lending rates because of the small size of loans.
7. MF savings can be used to generate funds for social development projects ranging from health and education to roads, water, sanitation, etc. ²⁶	7. Microcredit cannot guarantee that markets accessed one season will still be available and viable in the future.
8. Microcredit can best be used to access productive assets with which people can shift into production of new products or to adopt new labor/time savings technologies. ²⁷	8. Microcredit cannot compensate for the impacts that a new road may have on local markets for traditional products.
9. Microcredit can be effectively used for purchase of BDS services, such as training, but only if the returns from the purchased service are immediate enough to meet loan repayment requirements.	9. Microcredit cannot be used to finance payments for BDS services if the financial returns from that service are not immediate. ²⁸
10. Microfinance can offer insurance for health and death benefits but only after: (a) the group has reached significant size; (b) premiums have accrued for a period of more than a year or two to provide enough based to start the scheme; (c) insurance professionals have been used to establish actuarial tables and definite realistic benefits; (d) a grassroots system for verifying claims is established.	10. Small microfinance organizations (less than 10,000 members) cannot likely afford to offer insurance unless they link with a much larger group to adequately spread risk.
11. MF can be a means for communicating many types of messages (social, technical and economic) by bringing people together in group learning/information sharing.	11. MF cannot originate these other social, technical and economic messages, they need to be introduced by persons from other agencies expert in them.

The above list could of course be extended, but the points made are relevant to the situation in Nepal.

²⁵ An impact claimed of the CBED project is a decline in local moneylender rates from 36% to 23% interest.

²⁶ Some of these projects, such as establishing a health center may require external matching funds, but some, such as latrines, can easily be funded locally.

²⁷ Examples of this is barber tools to add R50-250 per week to family income by providing barbering services, or a local ice seller borrowing R2,000 to buy a bicycle and ice chest to be able to make R300 per day.

²⁸ An example of immediate returns would be training, input supplies, technology purchase for which there is an existing product order. An example of non-immediate returns would be awareness or development training with no immediate and accessible market for product.

III.1.3. Workable Microfinance Models in Nepal

There are a few different microfinance models in Nepal including Grameen Bank Replications, literacy and savings-led village banking, community development with microfinance integrated into the process, user and producer group cooperatives, and small scale SCOs either stand alone or as part of multipurpose community based organizations. All of the larger scale models are functioning only in the lowland Terai areas. One exception is the SFCLs. It is an agriculture lending focused initiative that is replacing the Small Farmers Development Programme. Some loans are made for non-farm economic activities, but that is not a major focus of SFCLs.²⁹ Most of the large-scale models have not achieved operating self-sufficiency (OSS) let alone financial self-sufficiency.³⁰

The Grameen Bank model³¹ is by far the most common microcredit model in Nepal. It is widespread in the Terai region with its larger population concentrations and better physical infrastructure than the hill areas. But even there, only a couple of the NGO formed development banks and one government MF bank have achieved operating self-sufficiency. Because of high costs, there have been very few attempts to extend this model into the hills. This model is a replication of the group-lending model from Grameen Bank in Bangladesh. Groups of 5 people are grouped into *Centers* of 2-10 groups and conduct mostly lending activities with some forced savings of 10% of loan amounts for loan security. Repayment rates tend to be high (98% +), but administrative costs also tend to be high because the model requires Bank staff attendance at weekly *Center* meetings where loans are repaid, savings accepted, new loans are applied for and approved loans are disbursed. In the traditional Grameen model, there is little to no other training or education in literacy or business, but there is some sharing on business experience.³²

The Women's Empowerment Program (WEP) implemented by PACT Nepal 1996-2001 introduced a women focused, literacy and savings led, village banking model in the Terai and reached as many as 40,000 women.³³ There are several differences between that model and the Grameen approach. First, an existing economic group of 20-40 members joins WEP through a local NGO. Sometimes they receive some outside assistance from an NGO in that village bank formation process. But the PACT-Nepal WEP approach is designed to minimize those costs.³⁴ Members obtain materials by depositing about one third their value in a group savings account. A literate member or community volunteer helps group members learn to read using the WEP

²⁹ Because agriculture lending has different characteristics and risks than microcredit, this model is not considered MF by the study team.

³⁰ Operating self-sufficiency is calculated by dividing earned income (interest and other fees) by total operating costs plus loan loss provisions. Financial self-sufficiency is calculated by dividing earned income by total operating costs plus loan loss provisions and the cost of loan portfolio funding calculated at market rates.

³¹ This model is a replication of the group-lending model from Grameen Bank in Bangladesh. Groups of 5 people are grouped into *Centers* of 2-10 groups and conduct mostly lending activities with some forced savings of 10% of loan amounts for loan security. Repayment rates tend to be high (98% +), but administrative costs also tend to be high because the model requires Bank staff attendance at weekly *Center* meetings where loans are repaid, savings accepted, new loans are applied for and approved loans are disbursed.

³² After the WEP training, some of the NGO MFIs introduced additional training (literacy, numeracy business planning and other basic skills as well as health and other issues in their Grameen model *Center* meetings.

³³ An additional 50,000 were reached in directly through Grameen Replicator MF model implemented by other NGOs.

³⁴ As currently configured, materials are not paid for.

Women in Business series of booklets. The material starts with literacy skills and reviews the principles for developing strong groups. Members meet frequently (up to 6 times per week) for about three months to accelerate learning literacy skills. After those are acquired, they meet less regularly (2-4 times per week) to read the guide to forming a village bank. It includes literacy and numeracy training, advice on setting aside mandatory and voluntary savings, and guidance on using simple math to track funds. If groups decide to form a village bank, they go on to the next booklet that covers successful village bank lending, and bookkeeping. The village bank is then started with women agreeing to save a certain amount of money each week. A management committee keeps full records of attendance, transactions and bank account records. The group then begins to make loans from an internal loan fund and keeps records to track those transactions. Loans are all for 16 weeks. Group members then read materials on entrepreneurship that give them sound business practices, innovative product ideas and market opportunities. Product ideas range for trading, to services, food processing and manufacturing. Loans are made with 50% or more of group funds and dividends are paid from interest earned at the end of each 16 week loan cycle, which keeps interest earned within the group. From 1998-2001 WEP tripled the number of women who can read and write, more than doubled their savings from \$720,00 to \$1,800,000, increased number of women in business from 19,000 to 89,000, achieved an eightfold increase in annual income from \$1.2 to \$10 million, with loan defaults in less than 4% of the groups, increased decision-making role of 89,000 women concerning family planning, marriage of their children, buying and selling property, and sending daughters to school. This was the result of a \$5.2 million investment by USAID.

The trend in the hills is towards a more community-based approach centered on local SCOs with savings often being the first service offered instead of credit.³⁵ This model is cheaper because it requires only 10-15 days of awareness development and limited technical skills training and capacity building by "barefoot bankers". It is similar and yet different than the WEP Village Banking model in that it does not include literacy and numeracy training. It focuses more narrowly on savings and credit as tools for development and the mechanics of managing an SCO. Ten to fifteen days of training is not adequate to impart all the skills needed for an SCO to be secure and grow to meet the expanding needs of its community.

Both the SCO model and the WEP Village Banking model are too limited in their present forms. First, it does not allow for much financial intermediation between surplus savings areas and deficit savings areas. Second, it has inherently higher risk because all loan investments are made in the very limited market area of the SCO community. That is, in effect, putting all their eggs in one basket. There is a need for spreading risk beyond one small group. Financial intermediation can be too limited because of limited productive investment (loan) opportunities. This is much more of a factor in the hills than in the Terai. Without roads to access markets and without awareness of economic opportunities those markets represent, there are not enough viable economic activities in hill communities. The result is that the savings of SCOs and village bank participants could languish, or worse, be at greater risk.

Some communities, where there is less economic opportunity should be net savers while others, where there are greater investment opportunities, will be net borrowers. The SFCL program has begun to establish a Small Farmers Development Bank. There is talk of forming a

³⁵ There are an estimated 12,000 of these SCOs in Nepal at present. CECI Overview of MF Sector in Nepal.

National Cooperative Bank that would finance and supervise cooperatives. At least one NGO MFI has taken the organization of SCOs into a VDC level community bank that has at least ten SCOs as owners.³⁶ However, this still limits the range of risk spreading and the possibilities for financial intermediation. More than one organization talked of the need for a national federation or association of SCOs.³⁷ Missing from those concepts are the intermediate level organizations that are close enough to oversee the operations of groups in their area. A centrally located organization could never afford to do this because it would be too expensive. As such, the four MF development banks have something closer to the ideal as they are operating in only 4 to 9 districts.

One promising model for viable microfinance in the hills of Nepal is actually an integrated community and business development with microfinance model implemented by CCODER in six hill districts (5 in the West and one in the East). The model recognizes the importance of raising awareness and community based institution building as pre-requisites to viable microfinance. The concept of three different types of collateral (savings, group member's time, and active participation in the group) provides the foundation for the rest of the activities.³⁸ Savings is started early in the group formation process, so the microfinance is savings led. The model allows for identifying viable economic opportunities prior to embarking on microcredit. Focus is on three general areas of business: 1. High value agriculture and livestock, 2. Medicinal plants, and 3. Community tourism. CCODER has been able to continue even in conflict areas in Gorkha because they have theme tours such as mobile doctor clinics with a group of doctors from the US. Maoists cooperate because they recognize the value to poor people.

VDC level financial networking is achieved through RCDCs while District level financial intermediation is in the process of being implemented through cooperative societies that are called Community Development Banks (CODEBs). An average of 700-900 members (3,500 family members affected) per VDC have been reached within three years with this model at a total cost of less than \$19,000. With current staffing levels CCODER can start 10 new VDCs per year while continuing follow-up and district level bank and business development.³⁹ One very key aspect of the CCODER program is that it has continued to function effectively in zones of conflict, such as Gorkha. Whereas most other MF and development activities have been forced to shut down, at least temporarily, CCODER has not had to slow down any of its operations thus far.

The following table highlights the key elements, advantages and limitations of these different models.

³⁶ Center for Community Development and Research (CCODER), which operates in 6 districts in the West (5) and East (1) regions.

³⁷ ADB/N mentioned it for the SFCLs.

³⁸ Discussions on those topics are part of the development education first phase which also includes the following topics: Getting Acquainted Analyzing our Situations, Setting Goals, Developing a Plan of Action, Institutional Development, The Association / CDC, Economic Development/ Banking, Micro-Industry and Savings, Social Development/ Health, Infrastructure, Education, Savings of Time.

³⁹ CCODER grew out of Gorkha Ayurvedic Company, an herbal medicine company. The leader of that company realized that the impact of the company was minimal without some other development inputs.

Table 3. Microfinance Models in Nepal

Name	Features	Advantages & Limitations
<p>Grameen Bank Replication Model</p>	<p>Groups (5 members) of groups (2-10) that meet weekly in Centers for mainly loan and savings transactions and solidarity. Emphasis on microcredit and standardized products (e.g. all loans are for 12 months). Increasing maximum loan amount. Group and Center loan guarantee with no other collateral. Requires external funding and permanent MFI staff involvement. Average # borrowers/field staff >300 This model is used by Grameen Bikas Banks and all of the NGO MF Development Banks as well as NGO MFIs</p>	<p>Very strict group qualifying process that instills positive principals. Cross guarantees ensure high repayments except in crisis periods. Focus on poor women. Requires MFI staff at all Center meetings so it works best in concentrated population areas like the Terai. Heavy administrative burden on field staff. Savings emphasis is as loan collateral than for other purposes. Can reach large numbers of people, which then requires staff training and sophisticated financial and other management capacity in MFI. This model is not recommended for hill areas of Nepal.</p>
<p>Literacy and Savings Led Village Banking (as promoted by WEP)</p>	<p>Groups of 20-40 with weekly, bi-weekly or monthly meetings for savings and loan transactions. Standard loan products of 16-week loans. Increasing maximum loan amount with good repayment up maximum allowed by group. Cross-guaranteed loans. Provide other services like literacy, numeracy and business skills training as part of weekly meetings. This model is an incomplete version of the Village Banking model successfully implemented by INGOs such as FINCA, Pro Mujer, and Freedom from Hunger Foundation in other countries around the world. In that model, there is an ongoing relationship with the parent MFI, and networking between VBs</p>	<p>Women focused. Low cost once VB is established as VB members do all administrative functions. Can either rely entirely on groups' generated savings or if external resources available, can leverage savings to more rapidly expand lending. Has apparently had significant short-term impact in increasing incomes, improved literacy and appreciation of value of education for girls and children in general. Very limited size due to local capacity to manage. Administrative records are often hard to find unless there is outside oversight providing that discipline. Very limited networking, unless provided by outside agency (MFI or NGO so limited potential for financial intermediation between surplus savings and net borrowing communities. Model mostly practiced in Terai - not yet proven in hill areas but should work there as well. Not recommended as MF system unless self-sustaining network of VBs created. That will increase costs considerably and significant portion of interest income would leave group to cover those costs. This might change group dynamics.</p>
<p>Small Farmer Cooperative Limited (SFCL)</p>	<p>Farmer groups that borrow mainly for agriculture inputs, but also can borrow for non-farm economic activities</p>	<p>User groups can provide cheaper access to ag inputs, tools and equipment. Some peer technical education occurs. This is an expensive approach because it requires up-front and ongoing funding in addition to technical assistance to start SFCLs. Focus on ag lending too risky without government or other safety net for weather induced production crises. Only generate 11% of funding from savings.</p>
<p>Integrated Community Development Model with MF (as done by Center for Community Development)</p>	<p>MF is one element of an integrated community development process. Extended awareness raising, development education, community based institution building and savings precede business development which precedes microlending. Social development follows from successful MF and business development.</p>	<p>Awareness raising and community based institution building before credit. Also, business opportunity identification and provision of technologies and technical skills accelerates and multiplies the impact of microcredit Using mostly local human resources keeps travel and staff costs to a minimum. Forming district level MF institutions with CBO ownership resources strengthens the integration of the network. District level banks</p>

Development and Research - CCODER)		should facilitate access to RMDC loan resources that could accelerate investment and increase local incomes. The District level banks are only just being formed and their systems are not yet proven
User/Producer Group Cooperatives	These are similar to Small Farmer Cooperatives but are credit unions of people connected by using common facilities such as irrigation systems, watershed areas or by producing similar products such as non-timber forest products. Their savings and credit functions take a variety of forms, but the purpose tends to be similar – financial intermediation.	The advantage is that standardized loan products are possible because the subsector is well known and its business aspects are well understood. In the case of resource based economic activities, risks are increased by concentrating lending in too narrow a range of economic activities which can be adversely impacted

Overall in Nepal, microfinance has been equated with microcredit, which is only one of the financial services that poor people need.⁴⁰ Given the fact that there is more demand for savings services than for credit⁴¹, the savings initiated SCO approach with awareness raising and literacy would seem most appropriate for the Hills. MF needs to be approached from the broader perspective of providing needed income smoothing services through various types of savings and credit that match the income flows and expenditure needs of the users, and provide the means to take advantage of existing economic opportunities. Services like health and life insurance are just a more advanced form of income smoothing financial services. The ideal microfinance model would, therefore, combine the literacy/numeracy, business practices and perhaps some other training elements of the WEP village banking model together with the CCODER integrated community development model that provides networking of both finance and business development. No MF model will achieve significant results in hill areas without access to economic opportunities for poor people to exploit with their savings and microcredit. Women will also need labor saving technologies like water jars and fuel efficient stoves to allow them time to participate in those economic activities. Other potential partners include CSD and INGOs who would be willing to adopt the integrated community development model and would be willing to add significantly to the funding to defray their ex-patriot staff costs.

III.1.4. Funding for Microfinance

There is no shortage of funds available for lending in the microfinance sector. ADB has most of its \$20 million waiting for qualified MFIs to borrow from it through the Rural Microfinance Development Center. Other donors have funds available in their rural development projects for micro and small-scale projects.⁴² Most of those funds are to be disbursed through community-based organizations. The Nepal Rastra Bank has the Rural Self Reliance Fund that is available to cooperatives and financial NGOs for onlending to microenterprises. The biggest reserve of resources for the small and microenterprise sector is the Priority Sector Lending

⁴⁰ The works of Stuart Rutherford in Bangladesh and the experience of the Unit Desa of Bank Rakyat Indonesia (BRI) and many others have exposed the fact that there is a greater demand for savings services than for credit amongst the poor and that different forms of financial intermediation meet different needs.

⁴¹ Number of people served, not the amount

⁴² REAP, RUPP, PDDP, CBED, MARD and other donor projects all had/have some funds available for community economic projects.

Directive that dictates that commercial banks direct 7-12% of their total loan portfolio to priority sectors that include the poor and disadvantaged. Most of the commercial banks are purchasing government bonds in lieu of taking on the hard work of actually getting directly involved in lending to marginal sectors. However, a recent change in that law allowed banks to meet their requirement by investing in institutions that are lending to priority sectors. Nirdhan and CSD have received that kind of equity funding for their development banks from two commercial banks. Most MFIs in Nepal are losing money every year and are not capitalized well enough to be able to access sufficient other sources to meet the increasing high demand level for even small loans. The solution is no further funding until they better bring costs in line with income and income in line with costs.

As so many SCOs in rural hill areas have demonstrated, there is significant untapped savings potential in rural communities. The key to keeping the cost of that source to a minimum will be in having local volunteers do most of the administration of the savings functions and paying dividends from the net earnings on loans rather than any fixed interest rate on savings deposits.

The NRB is in the process of developing a fund from 2% of NRB net profits to be used to create a microfinance training center that will provide MF best practice training adapted to the context of Nepal. Certificate graduates would be specialists in microfinance. Given USAID's global leadership in the field of MF, it might be appropriate to offer its expertise to this endeavor.⁴³

III.1.5. Status of Grameen Bikas Banks

The significance of these banks to this present study is what is going to happen to them in the future. They are losing money because of too narrow an interest rate margin and because of being used as an employment agency by government, coupled with their inability to get rid of excess staff because of strong employee unions. In the Midwest region, the Madhya Paschimanchal Grameen Bank has the objective of serving all 15 districts but at present is only functioning in four in the Terai. It was started in March of 1996 and currently has 137 staff serving through 22 branches and the one central office. It adheres very closely to the original Grameen Bank approach of group credit through *Centers*. They offer three types of loans: General Loan up to a maximum of R12,000 for 1 year, Seasonal Loan up to R5,000 also for one year, and Latrine loan up to R3,000 for one year. In the first year, the maximum that a one person can borrow is R8,000 (minimum is R1,000). In the second year the maximum total borrowings is R20,000, and in the third year and beyond the maximum is R30,000 between the three types of loans. It does not extend its services into the hills areas because it cannot afford to. That status is unlikely to change in the near or medium term future. The bank has had to close four of its branches due to the insurgency, but borrowers continue to hold weekly meetings and are paying bi-weekly at the Bank's headquarters in Nepalgunj. Any failure of this bank could have negative implications for microfinance performance of a USAID economic growth project. It is not a good candidate for being a partner in a USAID hills microfinance initiative.

⁴³ USAID has established MF training centers in several different countries around the world including, Bolivia, Uganda, and Poland, with similar activities being planned in Africa, Central America and Central Asia.

III.1.6. Impact of the Security Situation on Lending

The Grameen Bikas Bank in Nepalgunj and a couple of NGO development banks spoke of having to curtail operations due to insurgency actions. The Grameen Bank had to close 4 branch offices and is requiring client centers to come to its offices in Nepalgunj to make their monthly payments.⁴⁴ It is a tribute to the discipline already instilled in its clients that the repayment rate is still above 90% even in the closed branch areas. One NGO had a staff member killed so they have curtailed activities in that area until security is restored. However, there is at least one NGO MFI that claims that none of its operations has been adversely affected by the poor security situation around it (in Gorkha district). As far as can be told without actually going and looking at their operations, it appears that the lessons to be learned are that the majority of the people in a community are actively involved and are benefiting from CCODER.

III.1.7. Microcredit Products Geared to the Evolving Needs of Successful Microentrepreneurs

Three Nepal Rastra Bank officials confirmed that the gap in lending between R30,000 and R1,000,000 does exist and that cooperatives are trying to fill the gap. Two state owned banks (RBB and NBL) do lend above R500,000, but mainly to urban clients. The lack of collateral is definitely a constraint to micro and small business access to credit above R30,000. But as significant is the fact that the jump from R30,000 to R500,000 is too great for them to manage. One entrepreneur in Nepalgunj could create 11 additional jobs producing garments and canvas bags for the local hill markets, but because the property owner's house is restricted, the bank will not approve his loan application. There are, no doubt, many more such stories. The fact is that one of the most successful MFIs in the world learned to grow up with its best clients. They continue to reach increasing numbers of poor people each year, but they also continue to service their most successful clients, the fastest growing enterprises that are creating new and better employment than microenterprise can.

III.2. Status of Microenterprise Non-Financial or Business Development Services

III.2.1. Preface

In recent years, the Committee of Donor Agencies on Small Enterprise – chaired by the World Bank has deliberated on Business Development Services (formerly non-financial services). Activities in this regard started in 1996 and culminated in the Hanoi conference in 2000 and the publication of donor guidelines on the topic now known as the “Blue Book” in 2001. Market demand, fees for services, and ways of making services more efficient and self-sustaining are important parts of the new thinking. The latest thinking in BDS has focused on the importance of building BDS markets that work effectively to address the needs of MEs. These discussions have highlighted the role of BDS in micro and small enterprise development and many projects are seen to be trying to adapt their programmes to fit best practices in the field. It is worthwhile reviewing a few points.

⁴⁴ It appears that all new lending has stopped in the affected areas.

BDS is important, but it may not address the most pressing constraints faced by enterprises. One needs to step back and analyze these constraints from a business' perspective to see what are the key constraints businesses face. The World Bank and the Federation of Nepalese Chambers of Commerce and Industry made such an attempt in 1999 with a survey of over 200 enterprises⁴⁵. The survey found that the most pressing problems faced by enterprises related to government policy and implementation. This was followed by - on the basis of priority - inadequate demand for products, poor access to finance, and inadequate infrastructure. Business services came further down in the list of priorities. Although the sample frame had fewer micro and small enterprises the results would not be very dissimilar. The neglect of such factors in programme design in the past led to expensive supply led programmes that were not sustainable in the long run. It should be noted that many small business owners do not recognize what really constrains their business growth. As one goes further down the scale of enterprise size, the more this is true. As such, it is not surprising that business services scored low in the WB survey. That does not mean that factors such as management expertise and systems, market awareness, budgeting, pricing, how to reduce costs and produce a better product, etc. are not important constraints that need to be addressed to increase incomes of micro and small businesses. Without awareness of need, there will be no demand for the particular BDS service that responds to that need.

The above described BDS paradigm shift has been seen to be effective in urban and semi-urban areas where there is some commercial activity to build on. The current challenge of the approach is to apply it to weaker rural markets. Some isolated experiences exist in Colombia, Guinea, Ethiopia and Senegal (ILO) where business skills training was able to cover most if not all of its costs from client fees. However, there are no fixed models to draw from that fit the context of the hills of Nepal.

Before looking at an alternative model, it is useful to look at the existing service suppliers in Nepal. Annex C contains more detailed summary description of BDS providers and programs in Nepal at present or planned for the near future. Below are examples of some of the more relevant activities.

III.2.2. Technical Skills Training

A variety of actors and institutions are involved in this field. Overall the team found very little technical skills training being conducted in rural Hill areas other than agriculture extension. However, if one considers literacy and numeracy technical skill training, then there has been a lot of it in the Terai region. Non-agriculture skills training tends to be: concentrated in urban areas; supply driven; and with a few exceptions, inappropriate for the uneducated poor.

One exception is the Department of Cottage and Small Industries (DCSI) and the Cottage and Small Industries Board (CSIDB). Between them they have offices in all 75 districts of the country. They provide a range of training programs – in more than 90 trades, like sewing, carpentry, masonry, etc. Most are short term lasting from a few days to a few weeks. However, these programmes are based more on the skills and preferences of the trainers (who are full time

⁴⁵ "The Business Environment and Manufacturing Performance in Nepal" Tyler Biggs, John Nasir, Kiran Pandey and Lan Zhao. World Bank Regional Programme for Enterprise Development and FNCCI. 2000.

staff) than on market demand either for the skills or for the products that would be produced by applying those skills. So it is predominantly supply driven training even though annual plans are done, and in theory demand for training is taken into account. There is no charge for the training and so it is entirely dependent on its government budget. Overall, the training provided by DCSI is more accessible by rural poor than other technical training currently available in Nepal. In the Nepalgunj DCSI office they indicated that they would be very open to collaborating on customized training. Other sources indicated that might be possible, but not to rely on it. *At this point it is not recommended that DCSI be considered as a potential partner.*

The Council for Technical Education and Vocational Training (CTEVT) is responsible for regulating the Technical Education and Vocational Training sector in Nepal. There are 14 technical schools under its umbrella. The Karnali, Bheri and Rapti Technical Schools are in the west. The instructional mode is formal with little adaptations and mainly in urban areas. Most require a minimum of 10 years of school, which makes them inaccessible for all but the rare rural person with that much education. The Bheri Technical School in Nepalgunj claimed to be able to mount short (2-3 weeks) customized technical training programs within 2-3 months, but other sources indicated that that would only be possible if they hired someone who already had prepared and was experience in the training and if there was political pressure to provide it. It would likely have to be paid for as well. *There did not appear to be any reason that these training centers would be viable partners for the proposed USAID project.*

The GTZ Private Sector Promotion Project (PSRP) and Swisscontact Small Industries Promotion Programme both work with suppliers of services to improve their products, expand their market and increase profits. PSP-P has supported trade fairs in the Terai that resulted in the creation of at least one very successful private business that is now employing 100 people producing low grade washing machines that are exported to India. PSP-P just launch technical assistance to the handmade carpet export industry, bringing in two German specialists in product design for the German market and one quality control expert from India. They will be in Nepal for most of the next year. This assistance fits well with the market demand led approach that is described in the proposed strategy, in which product developers are the catalysts for generating increasing orders for hand made products from lucrative markets. *Given the orientation of the PSP Program, and the flexible approach to responding to training needs as they come up, it would be useful for any project implementer to maintain close contact with them in order to look for opportunities to collaborate with them and take advantage of the expertise they bring into the country. They are open to consider support to complement USAID funding of specialized training for enterprise development in the Midwest and Far West.*

The Small Industries Promotion Programme (SIPP) is being implemented by Swisscontact for the promotion of small and medium enterprises from the manufacturing and service sectors mostly in urban areas of Nepal. They provide support to business service providers. Recently, they have discontinued working through Business Membership Organizations (BMOs) as it found them too ineffective in implementing training activities. SIPP has just redesigned its strategy and felt it was premature to recommend it or not to others. The focus on its activities is in the Kathmandu Valley, and so *SIPP is not a potential partner at this time.*

The Training for Employment (TfE) project supported by the Swiss Agency for Development (SDC) provides institutional and human resource development support to training providers. *TfE is not specifically focused on training of rural poor, and as such, is not a likely partner for this USAID project.*

INGOs such as CARE and local NGOs such as CCODER , CSD and DEPROSC assist rural communities to access technical training. Anecdotal evidence suggests that most of that training has been in agriculture and livestock. The Integrated Center for Integrated Mountain Development (ICIMOD) has broadly promoted beekeeping, but results suggest that only about 10% of families were able to generate enough return to increase their productivity. This example shows the care that needs to be taken in very broadly promoting any particular production technology and or product. One successful promotion can overwhelm the market and undo much of the benefit to the producers, though the market will have become more efficient. *Therefore, no formal partnership is recommended with organizations that are trying to promote single products such as honey without proper market linkages.*

The urban centers of Nepal and the capital have seen a mushrooming of private technical schools. There are numerous private computer training schools that might be useful to call upon in the event that MIS system development becomes a significant issue in development of microfinance networks. There are many others types of private business service providers, such as Lotus Holdings Pvt Ltd, which provides a wide range of office support services and some consulting to mostly medium scale enterprises. It remains to be seen if they would be interested in going to rural areas and if what they have to offer would be suitable to the target clientele. *USAID project would identify which of these providers would be most suitable to be part of the business chain supporting rural enterprise production.*

The Ministry of Agriculture has extension services for livestock and crop production. Because of limited resources and red tape, it is very difficult to access these technical resources at the VDC level or below. The Ministry of Forestry has technical resources for non-timber forest products, which could be useful as different economic opportunities are identified in different climatic zones of Hill areas. *Beyond database access, it may be difficult to tap into these technical resources on a timely basis unless project work is being done on a district level or above.*

The Asian Network for Sustainable Agriculture and Biodiversity (ANSAB) has an internet accessible library on sustainable agriculture and biodiversity issues and practices that draws on experience from throughout Asia. Likewise, the International Centre for Integrated Mountain Development (ICIMOD) located in Kathmandu conducts ongoing research in ten mountain countries in South Asia on sustainable livelihood development in mountain environments, including Nepal. It also has an extensive library both hardcopy in Kathmandu as well as available on the Internet. *These technical libraries and the expertise of their technical personnel are resources that local partners should be encouraged to tap into.*

The Mountain Institute (TMI) has implemented in Nepal and other Himilayan countries experimental projects in non-timber forest product development and eco-tourism. They have documented lessons learned and have personnel with hands on experience in these activities.

They are currently doing sub-sector analyses in Tibet to identify economic opportunities in those mountain regions. *Here again, is another technical resource that could be used for technical training or technical assistance in the proposed USAID project.*

III.2.3. Business Skills Training

Again the Department of Cottage and Small Industries (DCSI) and the Cottage and Small Industries Board (CSIDB) provide a range of training programmes related to entrepreneurship development and business management. However, these organizations lack the human and capital resources to make these programs meaningful.

The Industrial Enterprise Development Institute (IEDI) was created in 1996 as the successor to a GTZ assisted project that developed the Competency-based Economies through Formation of Enterprises (CEFE) methodology on entrepreneurship and business skills training. They also provide follow up consulting to the business skills training they do. Therefore, their staff has worked extensively with hundreds of small and micro as well as medium scale enterprises, in some cases, for a period of years. As a result they have had an opportunity to learn more about successful business than most people who work in only one enterprise for the same amount of time. Most of their demand has come from other development organizations, NGOs, HMGN agencies, and donor programs. This means that their fee income does not generally come from the final users of their services, which raises the question of the cost effectiveness of their services. If the numbers given for services delivered by the Nepalgunj office of IEDI are indicative, their staff are reaching significant numbers of businesses (over 100-200 or more per staff member) each year. The organization appears to have good human (half of them have MBA degrees) and capital resources and the on-going restructuring process should allow it to function more efficiently and effectively. In addition, many IEDI staff have as much as 18 years experience working with individual businesses, doing market and subsector analyses and providing consulting and training to small and microenterprises. SNV has selected IEDI as the implementer of its REAP programme in the Far West. *IEDI is a potential partner for business skills training development in the proposed USAID project.*

The GTZ Private Sector Promotion Project (PSP-P) and Swisscontact Small Industries Promotion Programme (SIP-P) both work with suppliers of business development services to improve their products, expand their market and increase profits. (See discussion above under Technical Training on PSP-P as a potential collaborator.)

The Federation of Nepal Chambers of Commerce and Industry (FNCCI) Small and Medium Enterprise Development Project (SMEDP), conducts a variety of trainings on business skills. These are done in cooperation with local chambers and associations. But they are directed at Chamber members who tend to be from medium and large enterprises. Taking Nepalgunj as an example, local Chamber staff agreed that the training they are providing, in subjects such as internal controls and audits, is not appropriate for micro and small enterprises in rural areas. *There is no potential for partnership in this area with FNCCI.*

In the past few years a number of private companies have entered the fray. The Human Resource Development Center (HURDEC) was an early starter in this regard as it was set up in

1989. PACT/Nepal developed the materials and has been doing a form of this training particularly geared to disadvantaged women in the Women's Empowerment Program (WEP) and they continue to work with those materials in two districts at present. The newcomers include the Centre for Business Development (CEBUD) and a range of private suppliers. The clientele of this group of private suppliers are mainly donors/projects and not the enterprises. However, the materials that PACT/Nepal developed appear to be effective, as far as they go, in business skill training for women in microenterprise. They might need to be tested in the Hill environment and possibly translated into local languages, but otherwise, should be useable. The Pact/Nepal materials for guiding the formation and implementation of village banks should also be considered business skills training, for MFIs and their clients. They are also gender sensitive. The fact that these materials are designed as part of literacy training process makes them very appropriate for use in the proposed project activities. *PACT/Nepal should be considered as a potential partner for the proposed project.*

The Centre for Microfinance (CMF) provides market research services to support microfinance and other industry expansion. It also provides seminar facilitation for planning and development in the MF field. They claim to have a complete set of best practice microfinance training materials. Those materials could not be entirely complete as a model for the hills is not yet fully developed. *CMF should definitely be considered a potential partner for training MFI management staff in MF best practices. CMF might also be a good candidate to work with Nepal Rastra Bank when it is ready to implement the MF training center.*

Specific opportunities with any of the above recommended service suppliers would and should be identified once the USAID economic growth activity is better defined and underway.

III.2.4. Market Access and Marketing Services

Most development programs and organizations state market access and marketing services as a needed function. In rural hill areas, this is even more important than in urban areas and market towns. As mentioned above in the section on issues and constraints, lack of access to markets in Hill areas is primarily because of lack of roads. The vertical and fragile nature of mountains makes travel and road building more difficult. Dispersed mountain populations make it harder to justify the expense of building modern roads to remote areas. Local markets in the mountains consist mainly of subsistence agriculture that if not productive enough feed people for no more than 4 to 9 months of the year. This forces males to migrate to the Terai or India in search of agriculture labor or other low paying jobs to make up the difference. This leaves women and children with the burden of surviving as best they can while the male is away. Without access to markets, there is little impact that any of the other business development services, including microfinance, can have in rural hill areas.

The second most important factor in market access after roads is awareness of market opportunities. Market information services are therefore another key element of rural economic development. Knowledge of market opportunities along with physical access allows rural people to come up with ideas for responding to those markets. But sometimes it is not possible to raise their awareness of the specific demands of the market without either taking them to the market or bringing the market to them, so to speak. The latter is done by bringing brokers and or what are

known as product developers to negotiate with and or provide assistance in designing marketable products. In agriculture, the product developers are the agro business buyers or brokers who live off of buying the product as low as possible and selling as high as possible in other markets.⁴⁶ Having options of buyers to consider before selling to the first broker to come by empowers rural people to get a better price for their production. This second factor is often the most misunderstood and least well-handled role by most development agencies. It is usually best handled by persons from the private sector.

There are some exceptions. The Agro Enterprise Centre (AEC) of the FNCCI works on market driven agro enterprise development and promotion agency. AEC was previously supported by USAID. It organizes trade fairs, is a source of market information and data on technology and product developments. *Here is a market awareness resource that could be very useful in the proposed USAID project.*

Rural development organizations such as CCODER recognize that local markets cannot provide economic opportunity to significant numbers of community members without some linkage to other markets. Their ties to Gorkha Ayurvedic, a medicinal herbs and oils processor and distributor is that link to the larger Nepalese market and potentially to the export market. Their choice of products that are high value, low weight and volume shows that they understand comparative advantage issues of production in the mountains. *Both CCODER and Gorkha Ayurvedic should be considered as potential partners for market access services.*

The Carpet Exporter's Association of Nepal has just launched a program to upgrade the product development and quality control to better access markets in Germany and elsewhere in Europe and the US with support from GTZ's PSP-P. *Expanding production beyond the Kathmandu Valley could represent an opportunity for creating employment in market towns in the Midwest to absorb migrants from the hills displaced by the conflict and poverty.*

There are other private companies, such as Dabar, that source inputs from microenterprises in rural areas. Some are more profit motivated than developmental. *Additional opportunities for linking urban-based companies with strong links to viable markets to rural producers should be further explored.*

III.2.5. Technology Development and Dissemination

Technology development and dissemination is not a new phenomena in Nepal. Appropriate Technology International (now just ATI) of the US, the International Technology Development Group (ITDG) from England and other NGOs and donors have been supporting these projects since the early 1980s. Ramjet hydro pumps, fuel-efficient stoves, and community biogas generation have a long history here. But that does not mean that those technologies have been broadly disseminated in the USAID target areas of the Midwest and Far West.⁴⁷ One of the

⁴⁶ Good agriculture extension services provide this kind of input, but the average agriculture extension service has very little exposure to markets outside local ones and so cannot provide the kinds of insights that someone from those markets who is familiar with the competition and used to dealing with producers to get what buyers want.

⁴⁷ Hopefully the infrastructure assessment done under the USAID SPO will have collected data on the distribution of infrastructure such as water jars, fuel efficient stoves and biogas generators in the ten target districts.

most serious constraints to income generating activities in rural mountain areas is the non-availability of female labor. Women are spending as much as 10 hours a day just to bring water and fuel for cooking to the house. This does not leave them much time, let alone energy, to be involved in income generating activities.

Another type of technology development and dissemination would be small hydro-electric power generation that could be at least part owned by communities so that revenues from power sales could channel back into the community to provide financial resources as well as electric power⁴⁸ for other economic activities.

More recently the focus on technology has shifted from the development side to the sustainable production and dissemination side. One example of that is the metal treadle pump project that the Institute for Development of Enterprise (IDE)⁴⁹ is about to receive an Implementation Grant Program (IGP) from the USAID Office of Microenterprise Development. The technology was developed, along with very precise production techniques, in Kenya by ApproTEC. IDE is training local producers in standardized production techniques and quality control, IDE is also developing a marketing strategy to increase demand for this needed labor saving and land productivity enhancing product.⁵⁰ *This NGO and other labor saving and productivity increasing technology producers and disseminators should be consider as potential partners for the proposed USAID project.*

The DANIDA supported Institute of Environment Management (IEM) provides training and consultancy on cleaner production, wastewater treatment, energy efficiency and air quality management. Their relevance to any USAID economic growth project in the hills is that they have a team of industrial and other engineers who can provide training in productivity improvement. Originally geared more towards large industry, they now also work with SMEs including with women entrepreneurs in production management. They have a loan fund of \$2 million for soft loans at 3% annual interest for loans from \$650 minimum to a maximum of \$40,000 for up to two years for energy saving, waste reduction and other productivity and environmental impact enhancing technologies. Their fees range from R5,000 for small and woman's enterprises, to R10,000 for medium enterprise. They guarantee energy savings of at least 10%, reduced raw material wastage of from 5-25% and "significant" improvement in environmental impact. *When small and medium scale enterprises are starting to emerge in rural communities, it might be appropriate to bring in IEM to ensure that productivity and energy efficiency are maximized.*

The umbrella organization for alternative energy is the Alternate Energy Promotion Council (AEPC), a public-private partnership. *It is another source of technical and technology information that might be of use in rural communities as they develop through the USAID project.*

⁴⁸ Electric power if used for cooking, could be a labor-savings technology that would free women from gathering fuel for income generating activities.

⁴⁹ International Development Enterprises (IDE) promotes low-cost treadle pumps and drip irrigation in 14 districts including in the west.

⁵⁰ This portable pump will lift water up from 5 meters down and then push it up and other 15 meters. It is very low cost irrigation and water collection that saves time and can increase agriculture productivity by 2-5 times, depending on the length of the growing season. It can enable off-season vegetable production in areas previous not possible.

The Intermediate Technology Development Group (ITDG) and the Centre for Rural Technology (CRT) are also active in the field with fuel-efficient stoves and water jars for labor and energy saving technologies. *Links should be developed with both organizations as needed in specific project areas.*

It is recommended that economic growth activities interface with these technology activities as appropriate and feasible in order to increase efficiencies and allow increased productivity in rural communities. Funding should be included to be to hire their personnel as necessary for training and/or consultation.

III.2.6. Organized Private Sector

The Federation of Nepalese Chambers of Commerce and Industry (FNCCI) was set as the apex organization of the private sector in 1965. It currently has 86 member chambers in 69 districts, 50 commodity and sector associations, 429 large public and private organizations and 9 bi-national chambers. The chamber of commerce movement has grown substantially in the 1990s as donor support switched from supporting government agencies to supporting the private sector. However, this has led to a situation where many chambers and associations were overloaded with funds and objectives that took them away from their core functions of advocacy and networking. FNCCI can best serve the project in two ways. First, it is the principle advocacy organization of the private sector and channeling information on the policy needs of rural micro and small business will help it fulfill that function. Second, it and its affiliates can be an excellent source of information on business linkages and networks. *The proposed project will not require a formal partnership, but there definitely should be an informal one with FNCCI.*

The Federation of Nepalese Cottage and Small Industries (FNCSI) was set-up in 1990. It now has 68 district committees, including women committees in 41 districts. Membership of FNCSI is open to only industries and excludes traders. Again, it could be a source of business networking. *The project will not likely require a formal partnership of any kind with FNCSI.*

The Women Entrepreneurs Association of Nepal (WEAN) supports women in any size enterprise, not just women business owners. Therefore they have a network that they use to create opportunities for women owned businesses. WEAN promotes women produced exports, advocates on policy issues related to women in business, and facilitates women's participation in business and trade. It also organizes training activities as it has resources to do so. The president of WEAN, for example, has a business that employs 1150 women across the country in the production of hand made paper and other hand made products for local and export markets. That represents a potentially useful source of information that could be relevant to women in rural communities in selecting income generating activities as roads open the way to markets. *An informal rather than a formal partnership is recommended with WEAN.*

IV. Other Donor Activities

A catalogue of donor activity in the field is attached in Annex D. The following are more relevant because they relate to BDS and enterprise development or relate to economic development in rural hill areas, especially around conflict areas.

IV.1. Enterprise Development

GTZ supports the Private Sector Promotion Project. Most activities are based in Kathmandu and urban areas in the Terai. However, it is trying to adapt BDS methodologies to weaker rural markets. It is also supporting product development and marketing and could be a useful collaborator with this rural economic development project.

SDC supports a number of projects in the field of training. They include; the SwissContact Small Industries Promotion Programme; the Training for Employment Project and assistance to the Training Institute for Technical Instructors.

SNV supports a number of projects in the area of rural business development. They are: the Pro-Poor Sustainable Tourism Project in Dolpa, Humla, Mugu and Jumla; the Community Based Forest Enterprises Project in Humla and the IEDI implemented Rural Enterprise Assistance Programme in the Karnali zone.

The UNDP supported MEDEP is active in 10 districts including Baitadi, Dadeldhura, Dang and Pyuthan in the West. The project attempts to develop and implement an integrated approach to microenterprise development through the supply of a variety of support services. A cursory review of its costs and results indicated that it is fairly expensive. Also, it does not attempt to recover its costs through fees for services, which will affect any BDS market development in the districts it is serving.

UNDP also supports the Rural Urban Partnership Programme (RUPP) in 32 market centres including Tribhuvannagar, Tulsipur, Nepalgunj and Birendranagar in the west. The aim of this project was to support linkages between rural producers and urban markets via urban traders. However, significant effort is dedicated to community mobilization through neighborhood associations in urban areas. They provide some support to processing industries in Nepalgunj, for example, rice processing, leaf plates, and baby food formula. None of these processing industries sourced products from hills areas. RUPP also has a group enterprise loan scheme for loans of up to R25,000 for one year at 18% interest for groups of 3-5 persons.

IV.2. Rural Economic Development

CIDA is funding the Community Based Economic Development (CBED) project in Baitadi, Dadeldhura and Jumla. This project is implemented by CECI.

GTZ has been working in rural development for nearly two decades. They have experience in 3 hill districts (Gorkha, Dhading and Lamjung) and Sankhuwasabha. GTZ pioneered the concept of "Green Roads" and still provides technical assistance on this to other donors. The on-going World Bank supported Rural Infrastructure Project tries to draw on this. A

common theme in these programmes has been to combine infrastructure development with savings and economic development activities.

GTZ has also been involved in business skills training projects for over a decade that resulted in the CEFE approach and materials mentioned above.

The DFID supported Rural Access Programme (RAP) also uses a similar "Green Roads" approach. This project is active in Dailekh, Accham and Doti. DFID is also supporting 2 projects implemented by CARE Nepal. They are; the Livelihood and Forestry Programme in Rukum, Rolpa, Salyan, Pyuthan and Dang; and the Accham Livelihoods Security Project. SNV supports the CARE implemented Bajhang Poverty Reduction Project.

The UNDP supported Participatory District Development Programme (PDDP) is active in 30 districts including 6 districts of the far-west, 14 districts in the mid-west and 4 districts in the west. It provides a wide range of services aimed at creating multipurpose CBOs with savings and credit components. An overriding objective was supposedly to devolve planning down to the DDC and VSCs and local level. In fact, what appears to be happening is PDDP works with local CBOs to develop and present action plans to VDCs, who then screens them and passes on approved projects to DDCs for further selection and channeling on to the central government.

It is hard to recommend working with any one or several of the above listed donor projects. That decision depends on where USAID chooses to focus its economic growth activities, what areas of services it chooses to support and what other donors are doing in those and/or nearby areas. However, *all of the above programs represent resources and experiences that any project team should tap into to leverage USAID resources.*

Also, several donors strongly suggested that *some form of donor coordination is needed to facilitate the interchange of ideas and experiences and to identify ways to better coordinate actions and provide mutual support in the field.* Since USAID is a recognized leader in the field of MED, they seemed very willing for it to take on that role. It was suggested that coordination function be at the technical level, involving project personnel in addition to Mission staff rather than at higher levels, as it is then more likely to be executed.

V. Recommended Strategies for MED in the Midwest and Far West Hills Region

V.1. Introduction

The SOW asked for recommendations for the role that microfinance and complementary business development services could play in enhancing livelihoods in hill areas of the Mid West and Far West. Some of that has been answered in earlier sections on microfinance and BDS. Microfinance by itself would have little impact on rural poverty or on stemming the tide of the Maoist insurgency. MF with technical and business skills training would also do little for disadvantaged people in rural areas. More fundamental groundwork is needed to bring rural poor, and poor women in particular, into the development process. Rural households need ways to produce and market demanded products to financially rewarding markets that can absorb a large infusion of small producer products.

Such markets do exist, but access to them requires basic infrastructure like roads and telecommunications. For many hill communities, it will be many years before they have a road nearby or telecommunications. But once there is basic infrastructure, productivity levels, knowledge and organizational infrastructure are needed to take advantage of the newly opened economic opportunities. Quite a bit of foundation building can occur before the basic infrastructure is fully in place. Traditional approaches that focus on just microfinance or just BDS are much less effective at creating on, off- and non-farm income-generating activities that generate lasting increase in family income, and thereby food security, and thus contribute to poverty alleviation. What is required is a broader approach than just a microenterprise development strategy.

The following summarizes the recommendations for one pillar of a USAID/Nepal economic growth strategy for enhancing livelihoods in hill areas of the Midwest and Far West of Nepal and the role that microfinance and complementary business development services could play.

- *An integrated, private sector development approach* is recommended for USAID to use as the overarching framework for rural, market town micro, and small enterprise development. Specific recommended interventions fall under four mutually reinforcing areas listed in the sequence of their implementation: *social marketing, community based organization institution building, business development, and microfinance.*
- *Social marketing* on the role of business and self-help in the socio-economic development process will mitigate the impact of the Maoist insurgency by creating a safer space for economic development program activities.
- *Community based institution building* will provide the means for raising awareness and the foundation for individual skill, business and microfinance development.
- *Market led product development leads the business development process.* Rural households need to produce for financially rewarding markets that can handle a large infusion of small producers. This requires developing products for and access to external markets and sustainable production. It can also be providing value-adding services to outside visitors who come to the community. Developing market opportunities that bring additional money into

communities is a priority for initiating the process of micro and small enterprise development in rural areas of the Midwest and Far West Hill regions. This will require market led product development together with business chain development.

- Exploitation of that market access drives the design and implementation of other needed services including lower cost and reliable input supply, customized technical and business skills training, technology development and dissemination, and business linkages for getting high quality products to market on a timely basis.
- The role of labor and time saving technologies in breaking the slavery of women to water and fuel collection in hill areas should not be underestimated. Links to NGOs and other technology activities should be an integral part of USAID/Nepal's activities to improve rural incomes. Simple water jars for collecting and preserving rainwater combined with perhaps low cost metal treadle pumps and fuel-efficient stoves could free up half the day or more in time and energy for many women in hill communities. That time and some of that saved energy could be used to produce more income for the household, if there is access to viable markets.
- The multiplier effects of new money coming into rural communities should not be underestimated for the other business development it can generate within the community. For each full time job producing community exports, at least one or more other jobs will be generated from the distribution of the increased income within the community market.⁵¹
- Creation of viable job opportunities in market towns for migrants from rural areas is necessary to mitigate the negative impacts of insurgency and poverty induced migration from hill areas, while contributing to expanding the economy in and around those centers. Labor intensive, export industry development should be supported in market centers.
- Gender sensitive approaches that take into account higher illiteracy, innumeracy and other disadvantages that women face in the hills are necessary in all activities. Activities should be designed to alleviate consequences of male migration from hill areas as well as facilitate women's participation.
- To speed results, the project could be started by one local NGO with successful experience in hill areas with the recommended approach.
- Donor coordination in MSED is needed to maximize the benefits of any USAID project and USAID/Nepal should take a leading role in that donor coordination, drawing upon its decades of leadership in the development of MED best practices in microfinance and more recently in BDS.

Using a private sector development approach allows the Mission to concurrently support social marketing, community based institution building, business development, MF industry upgrading with development of at least one sustainable hill model, while also supporting other necessary activities. This broader approach allows flexible support to a variety of focused complementary business development services at relatively low cost but with a higher chance of short-term impact. Options for specific and general activities in those areas are detailed below.

V.2. Proposed Private Sector Development Program

⁵¹ For evidence of that, look around Kathmandu at the number of service enterprises that emerged in the 1990 boom years when production and exports of carpets, pashmina shawls and handmade paper was soaring. Also look at communities in Ilam district that flourished with increased incomes from production and export of tea and ginger.

V.2.1. Social Marketing

At present, the government of Nepal has a major public relations problem. The Maoists have taken the forefront in promoting a future vision of Nepal. The government has fallen into the trap of trying to defend itself rather than presenting its own version of the future. One of the key principles of public relations is filling the information void, because if you do not, someone else will. There is currently one of those voids in Nepal in relation to democracy and the increasing role of the private sector, and the public in general, in the country's economic and social development. The Maoists fill that information void with their own form of the truth for the villagers they are recruiting. Another side of the story needs to get out broadly and perhaps in more concentration in those areas around conflict zones.

The current Maoist conflict adds extra pressure to the existing poverty in rural Nepal. The disruptive actions have exacerbated the overall economic slowdown resulting from the worldwide recession and the terrorist attacks on September 11, 2001. Such actions have created an image of insecurity, further diminishing tourism, previously one of the biggest foreign exchange earners for the country as a whole and a source of income for at least some hill communities in the Midwest and Far West. In addition, the Maoists are destroying some of what little rural infrastructure there is by bombing offices, roads, bridges, etc. Attempts to destroy hydroelectric facilities indicate that the Maoists' intention is the destruction of the country, not its liberation from an oppressive monarchy and corrupt government.⁵² That intention needs to be exposed for what it is, destructive. At the same time messages about the role that people play in a democracy and the positive role that an honest and productive private sector with supportive government policy can play in accelerating a country's development needs to be communicated broadly.

Activities

An aggressive campaign of social marketing is needed to raise awareness of development issues and opportunities. In the short term, this social marketing would focus on raising awareness, understanding of what good business is, and how the private sector can be an opportunity rather than an enemy of poor and disadvantaged people including women. Private business in Nepal has long been seen as nothing more than the oppressor of the masses. As soon as possible a vision of where Nepal is going over the next twenty years needs to be developed by the country's leaders. Perhaps some of it can come from the King, as he is respected more than any politician in the country at present. That vision then needs to be promoted to the general public. Part of the vision of Nepal's future should be a new image of an honest and fair private sector. That image of honest business could also promote a standard for more socially responsible business. The content of the social marketing campaign related to the proposed USAID rural private sector project would cover business and self-help. Posters, radio and TV public service announcements can all be used for this campaign. In addition, soap operas incorporating the campaign messages into the storyline have been found to be effective.

⁵² . Zimbabwe had a 12-year civil war. The "rebels" could demonstrate that they could strike anywhere in the country at will. But they never were so short sighted and destructive as to strike at the lifelines of the country, the Kiribu hydroelectric dam that provides a major portion of the electricity for the entire country.

Unemployed youth and the general public in both rural areas and market towns need to see an honest and productive private sector as the solution not the problem. Project field activities do not necessarily need to be linked to this campaign. However, field activities might incorporate aspects of it into the awareness raising process.

On the other hand, documentation of terrorism by Maoists and documented exposure of their lies should be done as soon as possible. A packet of these materials should be distributed along with how to use them to all DDCs and VDCs in conflict zones for their use in their general assembly meetings.

In the medium term, materials can be developed for primary and secondary schools and universities. Each target public will need its own marketing strategy, in particular women. Public service announcements and/or soap operas on local language radio, posters and cartoon books, modules to be included in school curricula at different education levels as well as word-of-mouth campaigns are needed to combat the Maoist propaganda. Given how conflict areas seem to move around, broader national coverage on a continuing basis may be necessary in addition to focused local efforts.

Groups with successful experience in social marketing should be used to develop the social marketing campaigns. This could be a separate contract or part of a larger one.

V.2.2 Community Based Institution Building

Numerous rural development programs have foundered on how to successfully involve local people and then exit from a project area and have activities continue without project support. Time and again one of the most under-emphasized elements of a project turns out to be lack of locally controlled and managed institutions to carry on key activities after the project ends. For example, in the Chemonics MARD final report, they pointed out that although time was taken for local institution building, the level of effort needed to effectively do so was underestimated. In the end local institutions were not strong enough to thrive on their own after the project. This lesson gives a key to lasting community development in hill regions of Nepal.

Activities

This first phase of the community development process takes from 6 to 9 months and includes: non-formal meetings for community mobilization; a community leaders workshop; development education program training of community facilitators; regular time contribution to the community development process; and regular monetary savings. Development education then introduces new techniques that individuals can apply to their lives. It could include some basic literacy training like that done in WEP. Gender sensitivity should be part and parcel of the training process.⁵³ Development education should cover:

1. Analysis of the individuals' situations;
2. Identification of problems, the setting of goals, planning;
3. Development of a multi-dimensional, institutional program;

⁵³ WEP materials and training of trainers process could possibly be incorporated into the CCODER methodology to ensure that literacy and gender issues are addressed.

4. Presentation of economic development;
5. Presentation of social development.

During the approximate three-month process of this training, 20-40 community members form a community development organization. Individual and institutional action plans will be developed and regular monetary savings will also begin.

Development education is followed by activities linking individual CBOs into regional groups of 15 CBOs, registration of that group as a legal entity, and the establishment of a community service center building. This process can take from 6 to 9 months to complete.

Methodology

Several organizations in Nepal have discovered effective techniques for raising awareness through community discussions. All activities that are community based have to work on increasing participants' awareness of what they can do for their own community development. In the rush to get results, programs sometimes rush through this step in the process and then wonder why no lasting change occurred after all the rest of their time and efforts were expended. Establishment of strong community-based organizations (CBOs) is thus the foundation for all other activities and is best done by a competent local NGO.

Establishing effective multipurpose CBOs does not happen in one or two or even a few training sessions. It is an ongoing process that evolves over a period of one to three years, depending on where the community awareness is to begin with. Selection of participating communities should include a very high percentage of households in the community represented by at least one person in the CBO. This helps the community establish the precedent of including the poorer member in the process. Not targeting just the poor allows increased interaction between the have and have-nots in the community and has been found, if properly facilitated, to improve communications between different economic segments of the community. There is no prescription of women only or men only or any particular combination. Eventually a mix of women and men will naturally evolve and provides opportunity to break out of old stereotypical roles as participants grow beyond one member from each family.

The process used with groups should be something like the Appreciative Participatory Planning and Action⁵⁴ or Development Education used with community groups for awareness raising through planning and action processes. A fundamental awareness necessary to community improvement and poverty alleviation is the role that people's assets play in creating activities that can generate more income. Those assets take the form of savings; finance, time and labor. This awareness raising helps move people in the CBO into the realm of business development and microfinance. Community projects that save time and labor (e.g. a water pump to save the 2 hour walk to the river) will free women to produce something that will increase

⁵⁴ APPA was apparently developed by The Mountain Institute as part of its work in mountain communities on conserving the fragile forest environment while assisting mountain people developing viable livelihood strategies. Much of that methodology has been adapted into WEP and other community development materials and procedures.

family income and improve family health.⁵⁵ More effective CBO facilitators have found that if two kinds of savings (money and time) are contributed and tracked in passbooks, then participation in the CBO is better engendered. The time savings (something like "Ten Minutes a Day" program) is used for community improvement and enhancement projects such as trail and street cleaning, irrigation ditch digging and maintenance, tube wells and latrines, grain mills, etc.

It should be noted that entry into a community should be demand driven, not prescribed by the project. For example, CCODER only goes where it has been invited and where at least 85% of the households⁵⁶ have actively agreed to participate in the CBO. It violates the notion of self-determinism if a community does not pre-qualify itself in a manner like that. Though the first communities to enroll may not be the poorest (they might be though), experience has shown that they become models and catalysts for poorer communities around them who then later want what they have and pull themselves together enough to qualify. That ensures the expansion process is market driven and reaches people who want what it offers. Once awareness has been raised and savings has begun to accumulate resources and become a way of life, then business development together with microfinance can begin in earnest. This phase of the process will take from between 12 and 18 months depending on where the community awareness is at the beginning of the process.

V.2.3. Business Development in the Midwest and Far West

As mentioned before, market demand should drive the development of all microenterprise business development services. Market demand means both the market demand for the products that rural microenterprises will produce as well as the demand for non-farm business development services. The market demand for ME products should bring additional money into the rural communities and not just redistribute what is already there. The demand for ME BDS services should support MSE income generation occurring and not just cater to what rural poor think they need. A third point is to link these services with the development process described above. With those two points in mind, the following is an indicative list of the types of activities that USAID/Nepal could support in non-financial MED services. Wherever possible, the project would draw on the existing resources of other institutions and programs, linking them to the community development process. Depending on the amount of funding available, it could be useful to have one person who is a BDS/MSED specialist with some experience in social marketing. This person would be responsible for developing the social marketing campaigns and recruiting private sector participants to defray as much of the out of pocket costs as possible. This person would also oversee technical assistance by local BDS providers to project participants and look for opportunities for upgrading of materials and methodologies and business strategies of those providers. That person would also work with local counterparts to identify and coordinate the provision of other technical resources needed such as product developers, technical skills trainers, business skills training, sourcing and quality control of key raw material input supply, technology and any other services that would enhance overall project

⁵⁵ Water jars, treadle pumps and fuel efficient stoves are examples of proven technologies that could be introduced to reduce the time women have to spend on gathering those basic inputs. Producing those technologies for local consumption could be another business venture for MEs in the community. There would need to be lines made to projects that could introduce these technologies into the project communities.

⁵⁶ It prefer and strives for 100% of households participation, so none are left behind.

impacts. With this strategy, there are three areas that USAID Nepal could participate in better job creation in the western parts of Nepal. One is directly in hill communities and the other is in market towns to which people have migrated from the hills. The other two are facilitation activities, labor-savings and productivity enhancing technology and private sector involvement

a. Rural production

For the first of those two, there is existing demand for products that rural poor, women and men, could make for markets that have much more money than the local rural market. An example of that is the household accessories market in the US and Europe. In the US, annual buying power totals about US\$126 billion, and many products are labor-intensive. But producers do not have to start with such a distant market. There are three general product categories to be explored in looking for rural business opportunities: higher value agriculture and livestock, non-timber forest and other collectible products, and value-added tourism. There are large, growing markets for higher value cash crops such as off-season vegetables, higher value vegetable seeds such as carrots that can be grown better in cooler climates of mountains. Traditional medicinal plant remedies that are commonly found in the hills appear to also have good market potential. Mountain grass brooms have developed a stable market throughout Nepal and some exports. Opportunities for adding value to commodities in the community should also be explored. For example, milk collection and processing (cooling mainly) can provide the opportunity to supply market towns with a variety of milk products (fresh milk, cream, butter, and cheese). Domestication of medicinal plants needs to be further explored so that increasing demand for ayurvedic medicine does not cause communities to entirely deplete the wild sources of leaves and roots. As mentioned before, the market for products particularly suited to women, such as hand made paper, are being expanded by WEAN and its members. Another possible market for increasing local incomes could be value added community tourism.⁵⁷ Several NGOs have experimented with this with some success.⁵⁸ It should be noted that one NGO has managed to recruit 2-3 small groups (10-18) even for this year. Theme tours involve people with common interests that want to share experiences with rural villagers.

There are a few key activities that need to be included in the program strategy to allow for linkages to markets to happen in the Midwest and Far West hills. They are

- Follow the infrastructure (roads and communications),
- Flexible, need-basis planning,
- Product developers who survive from selling in the marketplace and who are gender aware in their product development,
- Follow on TA that is appropriate and gender sensitive,
- Exposure visits to nearby production and markets, and
- Links to other resources (REAP, CIDA, & formal private sector, etc.)

The first activity has already been discussed. Lack of all weather roads merely limits the options of products that can be produced and supplied to that external market. Therefore, any implementation strategy should try to follow the North-South road corridors while also looking for links to the Special Project Objective and REAP "green road" building.

⁵⁷ Eco-tourism, theme treks like the "Mobile Clinic" a group of doctors came up with.

⁵⁸ For example, The Mountain Institute and CCODER.

The second activity follows on the principle of a demand driven development process engineered by local facilitating NGOs like CCODER.

The third activity involves bringing in product developers to assist in the economic opportunities identification process. This is the key to making effective links to markets. Product developers need to be persons who know markets and the business of making products for those markets, and live from creating successful products with their buyers. They can do a rapid appraisal of the many different factors that determine the feasibility of the imagined venture in difficult environments like Nepal's hills. They can determine rapidly whether there is enough of an enabling environment for export market development to occur.⁵⁹ With a good product developer, very little market research needs to be done. That market research comes with the person because she/he knows the cultural esthetic of the market and its demands and nuances well enough to come up with simple solutions rather than more complex ones for that external marketplace (regional market towns, Kathmandu, India, US and/or Europe, for example). By using product developers, USAID will eliminate the need for expensive and prolonged market studies that are often out-dated almost as soon they are written and read. Those same product developers could assist in helping communities map out the industrialization process⁶⁰ as market demand requires it.

The next three activities (follow up technical assistance, exposure visits and links to other development programs⁶¹) depend entirely on the results of product development activity. Follow up technical assistance or training that is appropriate and gender sensitive is driven entirely by the products being ordered by the market. There is no mass production in the hope of massive orders (supply driven marketing). There is only the production of samples and then production to specific orders garnered by the product developer working with their buyers.⁶² It would require identifying sub-sectors to look further into for that product development. Exposure visits would be designed to accelerate the learning process for adopting new production techniques. Links to other development programs would be mainly to benefit from their expertise in particular products, for example high value agriculture best suited for particular climate and soil conditions. Another example would be bringing in engineers from the Institute for Environmental Management to assist in the industrialization process. This phase would begin in the second year of the project and continue for three years or more as markets open up, local skills develop, more producers are brought into the production process, and industrialization begins. Beyond a certain point, the business itself should be able to pay for these technical and other inputs.

⁵⁹ The enabling environment in this instance is a combination of import and export policy that encourages and facilitates exports, access roads built and maintained, transport regulations and facilities that facilitate and protect movement of product from rural sources to export channels without damage and shrinkage loss.

⁶⁰ This process involves the expansion and gradual mechanization that will allow continual productivity increases that will result in ongoing ability to compete and expand markets further, while increasing returns to labor of rural producers. An example is the use of a Bambery mixer to automate the raw material mixing process of hand made paper. With such a machine, producers productivity can be doubled or tripled.

⁶¹ Microcredit also comes in at this point as producers need seed capital to get started in new economic activities.

⁶² GTZ is in fact doing this process right now for the export carpet industry, with two product designers and one quality control expert here to work with carpet companies on upgrading their designs and quality control for the German and European markets.

Given the insecure situation in the hills at present, it might seem inappropriate to consider such options at this time. However, with proper social marketing as the lead in, it is worth investigating. The process could be started by bringing product developers or brokers from market towns or from Kathmandu to assist communities in identifying potential opportunities rather than from overseas. At some point, perhaps when the insurgency is more under control, it will be well worth bringing product developers from outside of Nepal to tap into external markets that have the potential for providing employment, not just for a few hundred but for thousands of Nepalis.⁶³

Local NGOs and or INGOs, such as CCODER, CSD or CARE, with other activities in the area should be considered to be the coordinating or point institutions as they have existing relationships with large numbers of rural poor and have been involved in successful market access and gender sensitive activities.⁶⁴ The product developer's SOWs should include assessing the capability of partner organizations and detailing their technical, training, and organizational needs and those of the producers.

The agribusiness market demand led development process takes much longer to implement and realize returns as the introduction and production cycles are much longer than that for non-farm products. However, USAID/Nepal has ample experience in this area to build on with the two MARD projects and the CBED project focused on high value cash crop development for small-scale farmers in the Midwest and Far West. Each new community will have to assess which markets exist for products they could have enough comparative advantage in producing to make it worth the efforts necessary to get its potential products to market. Technical assistance is brought in as needed and if a community and facilitator agreed that they are not able to do it for themselves. USAID/Nepal may want to allocate some budget for this just in case resources are not available locally and it is deemed to have sufficient potential to merit the additional investment. This activity can be started as soon as possible and run parallel with the non-farm products market led development activities. It is not part of this study to go into the details of that activity, but the same market demand led principles should be applied to it.

b. Technology

As already mentioned in earlier sections, labor and energy-saving technologies such as fuel efficient stoves and water jars for collecting rain for household water consumption, etc. are likely to be needed to free women from the slavery of water and fuel collection for the home. Not having to spend many hours on those tasks will enable poor women to engage in income generating activities and community development activities. The income generating activities will improve their food security while the participation in the community development activities will empower them and upgrade their skills including literacy, business planning, and management. Treadle pumps, biogas, small hydropower generation units and other productivity

⁶³ The handmade carpet industry used to employ 400,000. Now it is back down to employing around 200,000 mostly in medium scale factories in Kathmandu Valley. Recovering external markets has the potential for creating more than 100,000 jobs fairly rapidly, as fast as orders come in for more carpets. That is the objective of the GTZ/PSP-P activity currently underway.

⁶⁴ USAID should look for ways to tap local NGO resources because some NGOs have integrated community development experience combined with microcredit.

enhancing technologies should result in increased incomes if they are effectively managed. Rural poor are living in inaccessible and marginalized areas, in fragile ecological environments and in very weak economic markets. This makes life physically harder to begin with and more challenging to get by, let alone provide their family with a decent quality of life. These factors also make it more expensive to take whatever they do produce out to markets that can afford them. We are not recommending that under this project USAID/Nepal become heavily involved in the short or long term in the development or in broad dissemination efforts related to these technologies. The activities related to these technologies should be opportunistic, tapping into the resources of IDE, ITDG and CRT and INGOs like CARE and Save the Children who have already geared up to produce and/or disseminate them. The community development networks should allow for the effective dissemination of technologies between communities in the project area. Microfinance could possibly be used to finance the purchase of the technologies by individuals or groups. Some technologies, such as biogas, could be a social development project funded in part from the profits of the local SCO together with labor and material inputs of members.

c. Market Center job creation and infrastructure development

Another avenue that USAID may wish to pursue in economic growth in the Midwest and Far West is market center job creation in the market centers to which many people from the hills are migrating either to avoid the insurgency or escape the poverty of subsistence farming. The purpose of this job creation activity would be to mitigate the adverse effects of that migration while enhancing the local economy of the market center town.

The first step in the process would be identifying a sub-sector for which there was unmet market demand. The president of the Carpet Exporters Association of Nepal gave an example that if the GTZ project succeeds and carpet export demand increases beyond current capacity in Kathmandu⁶⁵ producers would be enticed to move production out as far west as Butwal if the initial infrastructure for processing yarn (carding, dying, spinning, washing, weaving) were put there. For approximately \$400,000 of those inputs, as many as ten factories employing 400 workers each (4,000 total) could be serviced. The companies would pay for their own factories. Workers would be paid about Rs500 per yard of carpet woven and produce on average about 5-6 yards per month. Since the factories provide a room and some medical and preschool for workers and their families, workers are able to send from Rs2,000-3,000 per month back to their village. Carpet factories currently import all of their 200,000 workers from the Terai, which means that as much as Rs400 – 600 million is going back to rural villages per month.⁶⁶ The 4,000 jobs created would create at least double that more in other services in Butwal, meaning that as many as 12,000 jobs could be created with that \$400,000 investment. Other industrial development opportunities could arise that USAID might want to explore supporting in market towns in the Midwest and Far West.

Another strategy that USAID might want to consider is support of minimizing the burden of migration on market and regional town infrastructure like water, housing stock, land and

⁶⁵ All production facilities for carpets for export are currently located in Kathmandu Valley, because the infrastructure for supplying inputs of quality yarn and factories are located there.

⁶⁶ Employment in carpet production used to total about 400,000 in 1991-96

streets. The activity could be to employ migrants in the development of market town infrastructure in a planned manner rather than the normal haphazard and unattractive way resettlement commonly occurs with sudden migrations to burgeoning slum settlements. Money for Work for digging sewers, building streets, schools, parks, low income housing, etc. could provide the skills training for external employment for which there is increasing demand while upgrading local infrastructure. This type of activity would, of course, require a more detailed study of the options available in market towns where such migration pressures could end up being a hotbed for insurgency operations. The focus on employment could be on youth, though gender sensitive options should be explored as well. At present the PDDP project is doing something like this in its project areas. USAID might want to investigate the process and associated costs first hand to determine what role it might want to take in market town development in the Midwest and Far West.

V.2.4. Microfinance

Microfinance, both savings and credit, would be an integral part of the multipurpose community development organizations established in the first phase described above. Over a two to four year period, a network of VDC level SCOs would be established at district and regional levels. This would facilitate financial intermediation between VDCs, spread risk, provide a means to access low cost external funding from sources such as RMDC, and provide certain financial management and internal audit functions for the VDC and community level SCOs. In order to accomplish that, it is recommended that USAID support the following activities.

a. Hill Microfinance Model Building requires support and technical assistance in the following areas:

a.1. Support to development of a District level and/or regional Cooperative or Development Bank

This would be to allow for financial intermediation amongst SCOs at the district level as well as be an efficient channel to external funding from RMDC or other favorably priced funding sources that could accelerate economic activity expansion. It is suggested that TA on something like the village bank model of regional finance centers with independent, fully paid-for financial management support services provided in the Pays Dogon⁶⁷ region of Mali might best serve the needs of SCO networks in hill areas of Nepal. This could entail a trip to Mali or a similarly successful MFI closer by, but in a physical environment with enough characteristics in common with Nepal's hill areas in the Midwest and Far West areas. One or, preferably, two Nepalis (one from management and one from operations) of the model building MFI seeing and talking with the people doing the functions can save months of training effort. In addition, either an international consultant or Malian conversant in the process of developing such regional

⁶⁷ Pays Dogon has a harsh physical environment with only trails between villages and not large concentrations of people. There is usually no electricity in any of the villages. And yet the financial support service is able to visit the local village banks, do audits, go over financial reports and discuss plans for external financing on a monthly basis and fees paid by the village banks fully cover cost of those services.

intermediaries and support services groups⁶⁸ would come to Nepal to work with the MF model builder on the support service center. This could bring down the current ongoing subsidies of the NGO considerably.⁶⁹ CCODER's estimates a total cost of \$300,000 based on current expenditures to create a network that would reach up to 16,000 families (with 96,000 members) with a full range of the integrated community development, CBO capacity building, MF and business building services included. Table 5 below presents the breakdown of these costs and the expected results. The total cost comes to just less than \$20,000, spread over four years to reach 700-900 persons directly and approximately 2,800 additional persons indirectly with what will from the 3 year on be self-sustaining MF services, a multipurpose community development center and self-sustaining VDC level microfinance operation. These figures seem very low, but then the costs of the community development and MF operations are subsidized by member volunteer labor and very low cost facilities. The total costs do not include any international technical assistance, study tour travel to learn the self-sustaining technical support services system or any other technical support services for MF model.

That amount includes \$6,250 for the development of an insurance product and other social development activities, so without that the total cost for the development education, institution building and MF development comes to \$12,500 per 600 families, or a total of 3500 persons reached directly and indirectly.

Some cost efficiencies would be gained funding say twenty or thirty of these VDC level community development centers over a period of 4 years since 33% of the total cost is for the development of an insurance product that should only have to be done once. Additional costs of administering a larger scale organization are not fully factored in. So the economies of scale would likely be half the total for the insurance that would not have to be spent. Current capacity is capable of adding 4 VDC level operations per year for the next two years and after that the capacity should double to eight to ten new VDCs per year. That would bring the total families served by the MFI to 26,000 families or 156,000 people directly or indirectly reached with socio-economic development services.

Table 5. CCODER Nepal Activities, Output and Cost Breakdown

Item for District level operations	Year One	Year Two	Year Three	Year Four	Total
A. Number Add'tl Persons Directly Reached	2,400	2,800	4,800	6000	16,000
B. Number Add'l Persons Indirectly reached = A x 6.	14,400	16,800	28,800	36,000	96,000
Total Cost	\$50,000	\$70,000	\$80,000	\$100,000	\$300,000
Development Education	\$30,000	\$30,000	\$40,000	\$50,000	\$150,000
Microfinance	\$15,000	\$20,000	\$20,000	\$25,000	\$70,000

⁶⁸ There possibly are other models besides CVECA in Mali that could be drawn upon for the further development of a self-sustaining model of MF in the hills of Nepal. Certain parallels permit the use of that model as a good example for Nepal.

⁶⁹ These TA costs would be in addition to those detailed in Annex E, Activities, Output and Cost Breakdown provided by CCODER for establishing a district level SCO.

Business Development	\$5,000	\$10,000	\$20,000	\$25,000	\$60,000
Cost/Dir Per	\$20.83	\$17.85	\$16.67	\$16.67	\$17.50
Cost/Indir Per	\$3.47	\$2.97	\$2.77	\$2.77	\$2.92

See Annex E.

Additional inputs that will be needed for full development of a MF model that could service as many as 50,000 – 100,000 clients with savings and credit accounts in a common region would include:

- a computerized MIS system (the main expense will be the software)
- upgrading of the staff development process to expand capacity to meet the backlog of demand for MF services in the hills.
- Startup funding for the district level development bank of less than \$4000 for operating costs while the wholesale loan portfolio is being ramped up and for some basic office equipment.

While we applaud their optimism, we suggest that additional funds be set aside to handle additional the TA that may be needed as the model development progresses. As the MFI reaches beyond 20,000 clients in the network, USAID will want to encourage the MFI to look for ways that the larger portfolio or more mature Community Development Centers might be able to start cross subsidizing some of the development education costs or find ways to reduce or share more of the Phase Two costs of establishing the VDC level cooperative or bank.

Once the district level MF model is in full operation,⁷⁰ USAID might want to consider supporting a major expansion of the model into additional districts depending on demand. Most of the costs that would be covered would be the initial awareness raising and community based organization establishment. An alternative would be to have the MFI submit a bid to the annual IGP competition for this expansion phase. .

a.2. Capacity building for MF training

Another function that USAID may want to support would be capacity building for MF training in best practice MF hill models in Nepal. This would then result in the establishment and capacity building of other MFIs working in Hill areas, which could lead to more rapid expansion of such rural hill MF models. To keep costs to a minimum and given the capable resources available locally, using one of the local training and TA NGOs/companies, such as the Center for Micro Finance (CMF) for this. Charging some fees might be feasible to further keep costs to a minimum. Implementers of the model technology themselves could provide the training themselves, for a fee, that would generate additional income for their cost recovery while keeping overall training costs to a minimum. On site training in a successful MFI has been found to be most effective.

a.3. Microfinance Policy

On the policy front, USAID/Nepal might want to find an informal way to be involved in the MF policy dialogue. The best way perhaps is to have whoever is managing the above MF hill model development activities participate in policy discussions whenever possible. That person

⁷⁰Reportedly within 18-24 months of the start of the project.

would hopefully already be well versed on relevant issues pertaining to the MF policy dialogue. If specific assistance were ever requested, it could be drawn from the funding allocated to a line item "TA services as needed".

V.2. 5 Implementation Modalities

The Mission has several options available to it for funding and implementing the above-suggested activities. To respond to the point in the SOW that suggested that the Mission would like to start implementation in early FY 2003, that would preclude a full open competition contracting process. More appropriate would be to utilize one of the centrally contracted IQCs, such the SEGIR Financial Services or SEGIR Trade and Investment. Short or long term (multi-year) task orders can be let under those IQCs.

It would make sense for USAID/Nepal to try to do a SOW that would include a range of services with an estimated LOE for each and a total LOE to be provided on an "as-needed" basis and perhaps a grant facility for support to local NGO MF model builders. Circumstances in Nepal are too fluid to try to operate on a fixed schedule work plan. Also, the contractor needs the flexibility to be able to use the same approach in working with local partner MFIs and other organizations, to adjust the process to the need and resources at hand. Too often the assistance process is truncated because a SOW was taken as being cast in concrete when written by someone who did not understand well enough the task and so did not keep the process real. It would be a bit contradictory to say that the same principle that we are suggesting be applied in the development of CBOs not be applied to the work that advisors under the project will do with local partners. The team found people very open to that concept in the interviews and their acceptance of that principle was demonstrated as questions were asked that sometimes they could not answer.

Other sources of funding that USAID/Nepal could consider investigating are the USAID/EGAD/MD PRIME Fund, which matches mission funds with Office of Microenterprise Development funds. There is an annual competition for these funds. Another to keep in mind for support to specific local implementers is the Implementation Grant Program(IGP), also of the MD office. There are two annual competitions; one for MF and the other for BDS activities. The disadvantage of these funds may be the conditions that the MD office might want to place on the activities that may not be entirely consistent with the approach that the Mission finds most appropriate.

At this point in time it is hard to commit to working in any particular district of the Midwest and Far West, given the ebbs and flows of the insurgency. Certain NGOs are demonstrating that work can be done even within zones of conflict. An opportunistic attitude needs to be reflected in whatever contract is let. That way the project can be a living example of positive participation that facilitates the development process rather than trying to dictate it. Second, the Special Project Objective is doing an infrastructure assessment in 10 district in the Midwest and Far West. The results of that assessment could provide a better basis for decisions as to which districts to target for this pillar of the economic growth activity.

VI. Next Steps

Based on the above assessment and strategy recommendations, we suggest the following next steps:

1. USAID/Nepal reviews the results of the SPO Infrastructure assessment. This assessment should be reviewed to see where the information complements and fits within the proposed strategy of this assessment.
2. USAID/Nepal reviews the World Bank's Financial Sector Assessment.
3. In order to obtain confirmation of the work that CCODER is doing, USAID/Nepal could send someone to the field to visit CCODER. Given the present situation, the assessment team was not allowed to travel to CCODER.
4. Based on the final report and the outcome of meetings with the USAID/Washington team, the EG Team will decide on which next steps to take on specific activities related their economic growth strategy.
5. USAID/Nepal secures funding allocation from USAID/Washington.
6. SOW for this activity is drawn up and bids called for under appropriate IQC.

ANNEXES

ANNEX A

SCOPE OF WORK

Microfinance Assessment and Recommendations for USAID Support

I. PROJECT SUMMARY AND BACKGROUND:

USAID/Nepal is in the process of designing an economic growth strategy for Nepal. The mission currently does not have any programs specifically designed to address the need to accelerate and broaden economic growth in Nepal. The draft strategy will need to be targeted at one of the primary root causes of the Maoist insurgency, namely the growing inequality of growth that is reflected in declining incomes and employment, particularly in the rural areas. Linkages, therefore, with the recently approved conflict special objective, as well as with a new democracy and governance strategy current being designed, will be of critical importance. Given the Mission's funding projections, the evolving political situation, and the status of the recently approved conflict special objective, the economic growth strategy will be designed to include a program of activities that can achieve meaningful results over a three to four year period, beginning in early FY03.

The microfinance assessment proposed would build on prior knowledge to examine ways in which rural incomes could benefit from the provision of microfinance and accompanying business services, particularly in the previously under-served hill districts. The outcome of the assessment should be an analysis of the potential for a microfinance/business services component to form a pillar of the upcoming economic growth strategy, and if so recommended, how the component should be best focused to achieve maximum results.

II. WORK STATEMENT:

The Mission envisions the work being conducted through a review of documents, including institutional evaluations, ratings and other assessments, and interviews with relevant government and private institutions with roles in microfinance provision or regulation, including but not limited to: the Nepal Rastra Bank, the Agriculture Development Bank of Nepal, government and private Grameen replicators, the Center for Microfinance, the Rural Microfinance Development Center (an apex institution), and NGO- and donor-supported microfinance institutions. Most work will be conducted in Kathmandu, but limited fields visits may be necessary, based on the contractor's findings and recommended approach.

The contractor's analysis should cover the following areas:

- (i) identification of key constraints to delivering effective microfinance services in Nepal (analysis should consider, inter alia, the legal framework, GoN policies and regulations, the institutional environment, existing MFIs' capacity and sustainability, procedural constraints, the insurgency situation, and total availability of capital for lending);
- (ii) complementary needs, such as skills development (e.g., literacy and numeracy training);

- (iii) business development services in accounting, marketing, product development that are critical for the success of microfinance initiatives, or would enhance the impact of a microfinance activity;
- (iv) summarize existing data on credit and savings needs by location (districts in most need) and sectors in which credit is most needed or most appropriate;
- (v) gender issues as related to the distribution/availability of credit and other business services;
- (vi) the most appropriate institutions with which USAID could work in the delivery of microfinance and business development services, and what needs to be done to strengthen the service delivery capabilities of these institutions;
- (vii) proposed implementation mechanisms for a possible microfinance program supported by USAID; and
- (viii) since the overall budget levels are unknown, provide both minimal and desired levels of funding for a sustainable and effective microfinance program, disaggregated by program component (e.g. policy assistance, institutional development and support, complementary microbusiness services).

In addition, the contractor will recommend an implementation process to ensure inclusion of women and the rural poor in any microfinance program to be supported by USAID. Along with this assessment, the contractor should estimate the employment, income or other benefits of a successful microfinance program.

The contractor will review relevant USAID and other donor programs related to microfinance, including means of eliminating any constraints identified, and ensure that any proposed USAID-funded activity builds on and complements these programs, to the extent possible.

III. BENCHMARKS:

It is expected that the team will begin work on or before August 20, 2002. The proposed time schedule is given below, and can be amended by the contractor with USAID/Nepal approval.

August 20, 2002 – Submission of preliminary work plan

September 11, 2002 – Draft assessment completed

September 15, 2002 – Final assessment completed

IV. LEVEL OF EFFORT:

The Mission expects that the team would be comprised of two members, both of whom would be in Nepal for approximately 15 days. One team member should have significant prior

experience in the design and management of microfinance, and one team member should have significant prior experience in the design and management of complementary business services activities. Prior experience in this sector in Nepal is required.

V. LOGISTIC SUPPORT:

The contractor shall be responsible for all logistic support needed to successfully complete the work.

VI. REPORTING REQUIREMENTS:

The team will be expected to submit the following reports for USAID review and approval. All reports should be prepared in English. An oral debriefing for the Mission will be required prior to the team's departure, highlighting the findings in the draft assessment.

1. A preliminary work plan, prior to undertaking the assessment
2. A draft assessment, containing the team's analysis and recommendations based on the work outlined above
3. A final assessment, incorporating USAID's comments

For USAID/Nepal: one hard copy and one electronic copy to:

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Annex B
Microfinance Service Providers in Nepal¹

Name	Locations	Number of Clients/Portfolio	Interest Rates/Fees	Terms/Types of loans/services	Performance Indicators	Funding Sources	Strengths	Weaknesses	Comments
ADB/N Small Farmers Development Program (SFDP) Started in 1975 <i>Not potential partner as program has evolved into SFCL program</i>	217 in 31 districts across country	24,461 client groups with 165,679 members 21% women R926.9 million total loans outstanding	% flat 4% service fee R5 registration fee for credit training	Solidarity groups of 5-7 in self-managed CBO Up to R30,000 per individual up to 12-month loans to small farmers with <R2,500 per capita annual income and/or land holding size 0.5 hectares per family member. 1 st loan max R8,000	On-time repayment rate NA Loans/credit officer - NA Savings R77.7 million	HMG	Broad coverage Many years experience Started SFCL to replace SFDB with potentially sustainable savings credit system	Poor repayment rate Non-sustainable model SPOs never became self-sustaining ADB/N financial and HR limited Problems with migration and different languages Too limited local capacity to support SPO development	Livestock insurance Adult and parenting education program Group management and participatory evaluation program Refresher training to group organizer & women group organizer Health awareness program

¹ This includes only the microfinance activities that the team was able to collect data on. There are other registered MF organizations and activities that are not included.
 Weidemann Associates, Inc.

Annex B

Name	Locations	Number of Clients/Portfolio	Interest Rates/Fees	Terms/Types of loans/services	Performance Indicators	Funding Sources	Strengths	Weaknesses	Comments
ADB/N Small Farmers Coop Ltd (SFCL) piloted 1987-92 Started 1993 <i>Potential partner only if shift to more savings lead & more efficient delivery methodology They would more likely be TA recipient of USAID project</i>	107 in 112 VDCs in 31 districts in terai (18) and hills(13) SFCLs in hills - 38 In terai - 68	64,368 poor HH 55,936 borrowers R880 billion loans women = 37.3% Average # members / SFCL = 598 Ave # borrowers/ SFCL = 427 Savings as % of loans outstanding Average = 11.2%	16% declining balance with ADB/N resources 20% with internal resources pay 5% on savings	Individual loans with group (5-10) guarantee Maximum R15,000 to ultra poor R30,000 to 50,000 per borrower for 2 years with monthly payments. Are working on 2-5 year loan term	70% on-time repayment rate Loan loss rate - NA >99% OSS in 73 <90% OSS in 21 Ave loans/Credit Official = 172 Average loan size = R16.000 PAR = 18.04%	HMG & GTZ Savings = 0% of Loan Portfolio SNV	Devolving functions to coops Incremental spread by local neighbor demand Half the cost of SFDP Working on better linkages with LA Setting up 5 Central Training Institutes for Ag Credit and Development training	Taking a very long time to develop SPOs into SFCLs though this getting faster Inefficient outreach Too high cost to do across entire country Too high delinquency rate to be viable Lack of alternate leadership and management succession Insufficient support from Loan Advisors Insufficient professionalism in entrepreneurship development Some reluctant to include ultra poor Politicization	Livestock insurance Social development (Like SFDP above) Women run have no delinquency and more savings Contract RDC for training Need financial discipline/problem solving seminars Established Small Farmer Dev't Bank 7/01 that lends to 21 SFCLs Plan to establish Fed of SFCL for functions of ADB/N - regulation & supervision <u>It takes longer to include women in program</u>

Annex B

Name	Locations	Number of Clients/ Portfolio	Interest Rates/ Fees	Terms/ Types of loans/ services	Performance Indicators	Funding Sources	Strengths	Weaknesses	Comments
<p>Madhya Paschimanchal Grameen Bikas Bank</p> <p>Started in 1996</p> <p>137 staff – 72 field staff</p> <p>63.2% owned by NRB 16.5% by HMG/N 5% each by four CBs (RBB, NBL, NABILB, NSBIB)</p> <p><i>Potential partner after privatization as TA recipient because have no methodology appropriate for Hill areas and no resources to expand into Hills</i></p>	<p>22 branches in 4 terai districts</p> <p>(Had to close 4 branches for several months due to Maoist activities)</p> <p>Propose going to 2 more districts but funding not available</p>	<p>3741 groups with 18770 members</p> <p>Borrowers – 16,281</p> <p>R129.4 billion loans outstanding</p> <p>Savings – R40.8 million</p>	<p>16% declining balance</p> <p>pay 7% on savings</p> <p>3% management fee on Managed Funds</p> <p>20% on new project loan product</p>	<p>Grameen Bank methodology - Groups of 5 grouped in - Centers - 2-10 groups each - weekly meetings. - minimal forced savings (<10%)</p> <p>General Loan up to a maximum of R12,000 for 1 year, Seasonal Loan up to R5,000 also for one year, and Latrine loan up to R3,000 for one year. In Year 1- max. one person can borrow - R8,000 (minimum is R1,000). Year 2 max total borrowings is R20,000, Year 3 and beyond maximum is R30,000 between all types of loans. Also group project loans for tube wells</p> <p>New Project loan up to R75,000 for max 2 years with collateral (land &/or Building)</p>	<p>General loan 34% ag, 65% trade/service <1% ME</p> <p>95% on time repayment</p> <p>Cost recovery N.A.</p> <p>Average loans/Credit Officer =</p> <p>Average portfolio/CO = B300,000</p> <p>Staff/CO = 2.2</p> <p>Operating Cost = 44% of loan amount.</p>	<p>Sale of Shares</p> <p>HMG</p> <p>Savings</p>	<p>High repayment rate</p> <p>Staff experience – very low staff turnover</p> <p>Centers of closed branches coming to Central office every 15 days to make payments</p> <p>Have computerized MIS in central office, which saved them when branch records are destroyed by Maoists Had full records in Central office</p>	<p>Interest rate too low.</p> <p>Operating costs are higher than interest rate margin.</p> <p>Only functioning in Terai, not in hills</p> <p>Link to HMG exposes Bank to greater risk.</p> <p>Average # of groups per center too low to be efficient</p> <p>No staff incentive to be more efficient</p>	<p>Shortage of financial resources due to low cost recovery</p> <p>Need to increase operating efficiency and/or increase interest rate/fees.</p> <p>Government prevents increasing interest rate/fees.</p> <p>Growth being stopped by fiscal and security problems</p> <p>Hand tube well distribution - 900</p>

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Name	Locations	Number of Clients/Portfolio	Interest Rates/Fees	Terms/Types of loans/services	Performance Indicators	Funding Sources	Strengths	Weaknesses	Comments
Centre for Community Development and Research (CCODER) <i>High potential partner for implementing integrated community development model</i>	Gorkha, Lamjung, Tanahun, Nuwakot, Palpa and Tehrathum	11,601		Development education, social mobilisation and economic and social development (community banking and income generation)	98 % on-time repayment rate	Misereor, Germany; PELC Foundation USA; DED; CIDR, France	Leadership Able to deliver cost effective MF services in in hill areas <i>Able to work in and around conflict zones</i> A coherent community socio-economic development model Full set of staff and community facilitators training materials Efficient use of resources	HR systems need further upgrading for further & more rapid expansion Inadequate MIS system platform – already slowing down No model for Development education and other non-financial BDS to be self-sustaining	The organisation grew out of setting up Gorkha Ayurved Company. It is currently the only, or one of few NGOs, operating in conflict prone Gorkha.

Annex B

Name	Locations	Number of Clients/ Portfolio	Interest Rates/ Fees	Terms/ Types of loans/ services	Performance Indicators	Funding Sources	Strengths	Weaknesses	Comments
Center for Self-help Development NGO Started 1991 Self-help Banking started 1993 Self-help Banking Bank started in 2000 <i>Potential partner if given sustainable Hill model methodology</i>	28 branch offices in 9 districts 229 VDCs Makwam -pur district Jumla (CBED collaboration)	37, 624 Members R800 Mil disbursed in 2000/01 R179 mil loans outstanding Savings balance R58 mil	20% declining no other fees	In terai Grameen replication Hart bazaar required in hills for adequate concentration of clients Lower loan limits in Makwampur – started at R2,000 Awareness raising	99.98% repayment rate Apparent OSS >100%	Various international and local donors, contracts (CBED), training service fees Savings	Looking at markets for IGA and MEs and anticipating negative as well as positive impacts of new roads Managing rapid growth without losing portfolio quality	No self-sustaining model for hill areas yet Uses integrated approach of community development with savings and credit which is time consuming and therefore costly	Economic opportunities in hills very limited. Need better access to markets In hills start with Comm Dev't Prog – non-formal educ, start savings CB-SCO, raising of development consciousness, donor supported program for disadvantaged & women Need to anticipate IGA displacement of roads Hand tube well distribution – 988 Leadership development training – 625 ALC beneficiaries – 4,416

Annex B

Name	Locations	Number of Clients/Portfolio	Interest Rates/Fees	Terms/Types of loans/services	Performance Indicators	Funding Sources	Strengths	Weaknesses	Comments
<p>DEPROSC Development Bank Ltd.</p> <p>NGO started 1995</p> <p>Bank licensed in July 2001</p> <p>47 staff</p> <p><i>Could be potential partner, but would need to adapt sustainable Hill model methodology and would have to upgrade Development Bank capital base to go into new districts</i></p>	<p>7 branches in 4 districts Rautahat (4), Bara, Parsa, and Sarlahi</p> <p>88 VDCs</p>	<p>1807 groups</p> <p>8536 members</p> <p>6110 active clients</p> <p>R30.2 million MF loans outstanding</p> <p>R15.4 Dev't finance loans outstanding</p> <p>R45.6 total loans outstanding</p> <p>R8.6 million Savings</p> <p>100% women</p>	<p>18% declining balance</p> <p>2% loan loss provision</p> <p>Savings – 7-8% Interest</p>	<p>Grameen adaptation – (only 4 principles) "MIWEG" (MF for Women Empowerment and Employment Generation)</p> <p>Initial loan size maximum R5,000 Maximum loan R15,000 Monthly loan repayment with two month grace period - 12 months no collateral Livestock loan – initial R10,000 max – R15,000 1 year no collateral Irrigation Loan – community shallow tube well irrigation for 5 years Seasonal loan - max R7500 6 months</p> <p>weekly/fortnightly center meetings</p> <p>5% required savings loan guarantee fund Min R20/week group savings, personal savings product</p> <p>Livestock insurance Client life insurance</p>	<p>Members per CO = 284</p> <p>100% repay rate</p> <p>MF - OSS 70%</p> <p>Overall profit of R1 million in 2001-2002</p>	<p>ADB/N, NBL, Nabil Bank Ltd DEPROSC – Nepal CEAPRED (NGO), Everest Bank, NRB CGISP loan</p>	<p>Management – recognized advantage of Dev't Bank</p> <p>Accessed funding from commercial banks and ADB/N</p> <p>Acknowledges limitations of methodologies in hill areas</p> <p>Focuses exclusively on women and targets poorer segment</p> <p>Can accept deposits from non-members</p>		<p>Target of 25,000 clients by 2005</p> <p>Link lending services with other education, skill enhancement, rights training, marketing network, etc. for credit plus programme</p> <p>All staff take 6 month DD Bank field level training to be eligible for appointment</p>

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Name	Locations	Number of Clients/ Portfolio	Interest Rates/ Fees	Terms/ Types of loans/ services	Performance Indicators	Funding Sources	Strengths	Weaknesses	Comments
<p>Nirdhan Foundation</p> <p>Started 1992</p> <p>Nirdhan Utthan Bank Ltd.</p> <p>Started 2000</p> <p>Staff 203</p> <p><i>Would need to adopt sustainable Hill model and have to upgrade Development Bank capital base to be able to extend into additional districts</i></p>	<p>26 branch offices in 7 districts</p> <p>218 VDCs all in terai regions</p> <p>Central office in Bhairahawa</p>	<p>Active clients – 35,388</p> <p>Borrowers – 29,589</p> <p>R211 million loans outstanding of which R37 million non-group ME loans</p> <p>R61.6 total savings</p>	<p>Recently reduced interest rate from 25% to 20% declining balance (reduced staff to compensate)</p>	<p>Grameen replication</p> <p>Groups of 5</p>	<p>PAR 9.88%</p> <p>Operating costs = 8% of loans made</p> <p>OSS = 103%</p>	<p>CGAP \$1 million over 4 years (2000-2004) for MIS and other organizational upgrades</p> <p>USAID/ EGAD IGP with SCF/US \$600,000 for three years</p>	<p>Profitable</p> <p>Manage staff productivity</p> <p>Analytical about viability of moving into more dispersed population areas</p>	<p>Borrower and portfolio growth slowed in 2001-2002</p>	<p>Possibly will extend to Palpa hills</p> <p>Problems with Maoists around 5 branches in Chitwan and 2 in Rupandehi Now OK because HMG declared emergency</p> <p>Out of 190 centers – 45 not functioning – will reopen when terrorism stops</p> <p>2 branches fully computerized</p> <p>Will try working with CBO model with SCF in Banke CBOs need external supervision and need linkages to mainstream economy</p> <p>Large # of CBOs but no large CBOs and do not reach poor</p> <p>Start own CBOs because too hard to change existing ones</p> <p>Need to produce marketable surplus and access for MF to work in remote areas Need BDS skills dev't</p>

Annex B

Name	Locations	Number of Clients/Portfolio	Interest Rates/Fees	Terms/Types of loans/services	Performance Indicators	Funding Sources	Strengths	Weaknesses	Comments
<p>Center For Micro-finance</p> <p>Formed 1998 By CECI</p> <p>5 field staff + 2 volunteers</p> <p>14 shareholders</p> <p>Member of SEEP and INAFI networks</p> <p><i>Potential partner for research, impact assessment, MFI management training</i></p>	<p>Kathmandu</p> <p>Terai</p>	<p>Mahila Jagwan - Women's Awakening 50-70 SCOs</p> <p>Several donors</p> <p>(NOT a member organization)</p>	N.A.	<p>Capacity building of MFIs through research and training</p> <p>Consultancy to donors</p> <p>IMPACT - action research</p> <p>Various project evaluations</p> <p>Some informal networking of MFIs nationally and at regional level</p> <p>Study of MF Hill models</p> <p>HIV/AIDS awareness training for NGOs to MFIs (UNDP)</p> <p>Business planning for BDS activities</p>	<p>Have full set of training materials for MFI capacity building for range of MF models</p>	<p>Ford Foundation (IMPACT) 2000 - 2003</p> <p>formerly USAID through CECI</p> <p>Donor research contracts</p> <p>Canadian Coop Assoc 4 years \$269,000</p> <p>CGAP 2 years grant for Micro Insurance Product design 2002-2004</p> <p>GTZ, SDC, KMTC</p>	<p>For-profit company with not-for-profit purposes</p> <p>Opportunistic about getting contracts to stay in business</p> <p>Have full set of training materials for MFI capacity building for range of MF models</p> <p>Working with larger MFIs on insurance product development</p>	<p>For-profit company has to pay taxes</p> <p>Doing non-MF apex functions in some contract work</p>	<p>Need for study showing link between WEP and economic development</p> <p>Collaborating with IFSB in Food for Work</p> <p>Think more Hill MF models not needed</p> <p>Need for MFI capacity building – e.g. WEP with modification to make more cost effective and with better MFI strengthening component</p> <p>Need to focus on women but also involve men – recommend a balanced approach</p> <p>Linking MFI groups to other ME's on broad scale for marketing</p> <p>Need better marketing channels for ME products</p>

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Name	Locations	Number of Clients/Portfolio	Interest Rates/Fees	Terms/Types of loans/services	Performance Indicators	Funding Sources	Strengths	Weaknesses	Comments
Rural Micro-finance Development Center (RMDC) <i>Key partner for source of funding for capital expansion of MFI networks</i>	Kathmandu Target where MFIs are currently active	Approved R204 million of 17 MFIs (including NGOs, Dev't Banks and coops) Onlending to 163,000 in 34 districts Intention is to focus on lending mainly to women below poverty line	Dropped to 6% from 12% for wholesale funds for up to 5 years	Wholesale lender, training and advocacy for Non-bank MFIs. (Use CSD and other MF DB for trainers) with minimal cost sharing	Lending to only a few MF development banks	ADB \$20 million	Has lots of money to lend Has official mandate to be the wholesale lender to MFIs Most lending selection criteria follow MF "best practices" Paid-up capital of R80 million	Has not worked out how to increase its outreach Criteria for borrowing MFIs to qualify for loans has room for arbitraries Criteria for wholesale lending could exclude viable potential MFI borrowers Board does not include anyone expert in MF	Most selection criteria for MFI lending is valid Has been criticized because it will not lend to non-self-sustaining MFIs but it is a lending institution that needs to have loans repaid Are training staff of 10 NGOs in MF for Kathmandu Valley There is an assumption that experience in NRB and/or in commercial banking qualifies Board members for oversight of a MF facility and service

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Name	Locations	Number of Clients/Portfolio	Interest Rates/Fees	Terms/Types of loans/services	Performance Indicators	Funding Sources	Strengths	Weaknesses	Comments
<p>PACT-Women's Empowerment Program (WEP) – Village Banking component</p> <p>Staff – 9 in Kathmandu</p> <p>3 in field</p> <p>27 field facilitators</p> <p>1996-2001</p> <p><i>Potential partner for VB training and MIS for tracking impacts</i></p> <p><i>Possible vehicle for promoting CVECA type technical support to networks of Village Banks</i></p> <p>Weidmann Associates, Inc.</p>	<p>21 districts mostly in Terai, 5 in West region</p> <p>(currently only in 2 districts)</p>	<p>130,000 (indirectly)</p> <p>100% women</p>	<p>2% per month flat paid up front for 16 week cycle with weekly mandatory meetings</p> <p>charge fine for late payers</p> <p>charge for printing of forms</p>	<p>Savings –weekly enforced</p> <p>Loans up to R10,000 per individual for 16 weeks equal installment repayments</p> <p>No formal group guarantees</p>	<p>1,500 informal VBs formed out of 4,500 groups trained</p> <p>99% repayment but on-time figures not available (4% of groups experienced some late repayment)</p>		<p>Simple, standard model with complete materials in appropriate format and presentation that poor women can use to build local financial services</p> <p>Savings lead keeps expansion at locally manageable rate</p> <p>No external financing minimizes startup costs</p> <p>Women lead and managed</p> <p>PACT has well developed computerized MIS for tracking impacts</p>	<p>No system for linking VBs with each other</p> <p>Model limits number of participants per VB to 30 because of limits in local management capability</p> <p>Model only implemented in Terai</p>	<p>Recommend: keep economic development small & simple</p> <p>need to categorize economic status of women</p> <p>build on whatever resources and skills are there - women have many ideas</p> <p>need intermediaries for ME marketing but don't have donors pay salaries in market chain</p> <p>don't just focus on women, but also youth</p> <p>Observed that women started valuing education more and started saving for children's education</p> <p>Do not see lack of money as major constraint to rural development</p> <p>See need for external market driven MEs and group enterprises</p>

ANNEX C

Non-Financial or Business Development Service Providers

Name	Locations	No. of Clients	Types of Services	Funding Sources	Strengths	Weaknesses	Comments
Public							
Department of Cottage and Small Industry (DCSI) CSID Nepalgunj 17 staff plus hire outside trainers <i>Possible source of technical trainers</i>	27 districts mainly in urban Terai towns	In Nepalgunj 371 students 170 followup 2200 registered 53 exposure visits	Skill development and entrepreneurship development training (1 week to 3 month courses and follow-up, registration, renewal and regulation, credit	HMG Nepal	Change oriented leadership Field presence A wide variety of manuals and packages in place	Bureaucratic Identity crisis between provider and facilitator HRD capacity weak Highly subsidized services Services not linked to market demand Impact of programmes not encouraging	DCSI – established in 1948 - and CSIDB were institutions created in a closed economy. They require restructuring and rationalisation of their functions and roles. The nearly 700 or so employees in all 75 districts have little impact to show on business indicators. Could be seen as outlets for basic business education. with potential displacement of private suppliers to be looked into.
Cottage and Small Industries Development Board (CSIDB)	48 districts mainly in the hills and mountains		Skill Development and entrepreneurship development), feasibility studies, trade fairs, regulatory activities and credit MS business registration	HMG Nepal	Field presence A wide variety of manuals and packages in place	Bureaucratic Identity crisis between provider and facilitator HRD capacity weak Weak financial status Services not linked to market demand Impact of programmes not encouraging	Established as part of the cottage and small industry (CSI) loan of the World Bank in 1979. It carries out tasks nearly identical to the DCSI. Only the assignment of districts is changed on a periodic basis.

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Non-Financial or Business Development Service Providers

Name	Locations	No. of Clients	Types of Services	Funding Sources	Strengths	Weaknesses	Comments
Industrial Enterprise Development Institute (IEDI) <i>Possible partner for entrepreneurship and business skills training</i>	Nepalgunj, Butwal/Bhairahawa, Pohara, Narayanghat, Itahari	In Nepalgunj ME Creation TOT - 25 Bus Plan - 55 EMT - 67 EGP - 14 EMDT - 134 Consulting services - 22	18-20 different ST programs in entrepreneurship and management development training, research on enterprise development, training of trainer courses and other BDS specialised activities	HMG/Nepal, Contracts from donors/projects and client fees	Pioneer organisation on entrepreneurship in Nepal Change oriented leadership Flexible legal structure Considerable physical and human assets 5 branch offices Wide mandate	Inability to innovate and respond to market needs Lack of clarity on role – an umbrella facilitating organisation or a service provider Bureaucratic structure Minimal client fees – need to rework their policy on this	This institution, established in 1996, is the successor to the GTZ supported Small Business Promotion Project which pioneered the CEFE methodology. GTZ is currently supporting a restructuring mission of Deloitte to enable IEDI to function in a more market oriented fashion. IEDI is also the implementor of the REAP project supported by SNV in the mid and far west.
Council for Technical Education and Vocational Training (CTEVT)	Kathmandu with technical schools in Karnali, Kathmandu, Siraha, Dhankuta, Lalitpur, Dolakha, Nepalgunj, Seti, Rapti, Dhaulagiri and Bhaktapur		National level policy and regulatory organisation for the TEVT sector including 8 regional technical schools		Flexible legal set-up	Absence of a coordinating mechanism Lack of reliable labour market information Poor linkages with service providers	www.ctevt.org.np Established in 1989, this organisation has a wide mandate but insufficient resources – both human and capital to fulfil them.
Mixed Public / Private Institutions or Projects							
Small and Medium Enterprise Development Project (SMEDP) Implemented by FNCCI	Nationwide as per demand		Training/Workshop, Information, consultancy		Flexible programmes Lean structure Cost sharing of partners	Sporadic events Training and workshop oriented	This project was supported by the Friedrich Naumann Foundation for a few years till 2001 but this involvement has ended.

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Non-Financial or Business Development Service Providers

Name	Locations	No. of Clients	Types of Services	Funding Sources	Strengths	Weaknesses	Comments
<p>Agro Enterprise Centre (AEC)</p> <p>Implemented by FNCCI</p> <p><i>Partner for ag market and technical information and trade networking</i></p>			Creation and strengthening of private agro enterprises, market driven agro enterprise development	In past USAID	<p>Pioneer in the field of agroenterprises.</p> <p>Competent professionals</p> <p>Neutral position (not tied to a ministry)</p>	<p>Not charging fees to users</p> <p>Have not worked out viable business model for service delivery except for trade fairs</p>	<p>www.fncci-aec.org.np</p> <p>This was set-up under the USAID funded Agriculture Technology Development Project in 1991.</p> <p>This could be a potential partner for USAID</p> <p>A good website on agricultural prices has been developed.</p> <p>www.agripricenepal.com</p>
<p>Institute of Environmental Management (IEM)</p> <p><i>Potential partner for engineering TA for scaling up ME production into industry</i></p>	Nationwide but focussed in urban centres in the Terai		Training and consultancy on cleaner production technology, waste water treatment, energy efficiency and air quality management	DANIDA and client fees	<p>HR capacity</p> <p>Lean project</p> <p>Tackling environment through productivity angle</p>	<p>High subsidy</p> <p>Placing top experts in the field on retainer basis has a distortionary effect</p> <p>Willing but unable to charge commercial rates for services</p>	
<p>Training for Employment (TfE)</p> <p>Implemented by Alliance Nepal</p>	Nationwide based on demand	NA	Institutional and HRD support to training providers	SDC	Demand basis		<p>Established in 2000.</p> <p>In part remittance generation oriented</p>

ANNEX C

Non-Financial or Business Development Service Providers

Name	Locations	No. of Clients	Types of Services	Funding Sources	Strengths	Weaknesses	Comments
Chambers/ Associations							
Federation of Nepalese Chambers of Commerce and Industry (FNCCI) <i>Should be Informal partner for policy advocacy, business chain linkages and networking, and trade promotion</i>	69 districts (86 chambers), 50 commodity associations, 429 public and private enterprises and 9 bi-national chambers		Information, advocacy and business services through special projects like SMEDP, Industrial Forum, TIPS, Agro Enterprise Centre (AEC)	Membership fees, project support from EU, USAID, ILO and other income generating activities	Apex organisation of the private sector Wide membership Credibility in advocacy – representation in most public-private discussions	Politicised from the 1990s Capacity to execute promotional programmes like SMEDP and AEC directly Capacity for issue based advocacy low	<u>www.fncci.org</u> Established in 1965 from a bottom up process of the coming together of district chambers and associations. The political nature of the organisation was clear when a faction formed the Confederation of Nepalese Industries (CNI) in 2002

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Non-Financial or Business Development Service Providers

Name	Locations	No. of Clients	Types of Services	Funding Sources	Strengths	Weaknesses	Comments
<p>Federation of Nepalese Cottage and Small Industries (FNCSI)</p> <p><i>Informal partner for sourcing additional production and business</i></p>	68 districts (women sub-committees in 41 districts)		Seminars/ workshops, trade fairs, information and advocacy and training	Membership and special project assistance e.g. from DED and DANIDA/IEM	Wide coverage	<p>Structurally weak as the federating process was top-down</p> <p>Low HR capacity at all levels</p> <p>Low financial resources</p>	Established in 1990, the FNCSI has been perceived to be a chamber advocating a reversal of the open economy and imposition of protection regimes for CSIs.
<p>Asia Network for Sustainable Agriculture and Biodiversity</p> <p><i>Very good source for biodiversity and sustainable non-timber forest products and eco-tourism info</i></p>	7 districts in Kamali and Mechi	NA	Community forestry planning & implementation, enterprise development and marketing support	SNV and other resources	<p>NTPF development information</p> <p>Biodiversity management options information</p> <p>Well established regional research on ecotourism and bio-diversity</p> <p>Extensive sustainable Non-timber forest products information</p>	Offices/database in Kathmandu so Internet necessary to access most information	A regional network that shares information among 10 countries in South and SE Asia

ANNEX C

Non-Financial or Business Development Service Providers

Name	Locations	No. of Clients	Types of Services	Funding Sources	Strengths	Weaknesses	Comments
NGOs							
<p>Centre for Community Development and Research (CCODER)</p> <p><i>High potential partner for implementing integrated community development model</i></p>	Gorkha, Lamjung, Tanahun, Nuwakot, Palpa and Tehrathum	11,601	Development education, social mobilisation and economic and social development (community banking and income generation)	Misereor, Germany; PELC Foundation USA; DED; CIDR, France	<p>Leadership</p> <p>Proven experience in CD work in hill areas & areas in and around the conflict</p> <p>A coherent community socio-economic development model</p> <p>Full set of staff and community facilitators training materials</p> <p>Efficient use of resources</p>	<p>HR systems need further upgrading for further & more rapid expansion</p> <p>Inadequate MIS system platform – already slowing down</p> <p>No model for Development education and other non-financial BDS to be self-sustaining</p>	<p>The organisation also operates community banking. It was also behind the setting up of the Gorkha Ayurved Company. It is currently the only, or one of few NGOs, operating in conflict prone Gorkha.</p> <p>CCODER is a potential partner for USAID</p>
<p>Centre for Self-Help Development (CSD)</p> <p><i>Potential partner for implementation of integrated community development in second stage</i></p>	Mostly Teria but also in Nuwakot and Jumla	37,500	Institution building at the local level, community development projects, Training and workshops, research, Self-help Banking Programme,	CECI-MARD, CECI CBED, GTZ Churia Project, RDP	<p>Leadership</p> <p>Proven in effective community economic development</p>	<p>A coherent model is not yet formulated for hill areas</p>	<p>The organisation also runs a development bank that targets lower end poor</p>

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Non-Financial or Business Development Service Providers

Name	Locations	No. of Clients	Types of Services	Funding Sources	Strengths	Weaknesses	Comments
Development Project Service Centre Nepal (DEPROSC/N) <i>Potential implementing partner in second stage after model better developed</i>	Field Offices in Rasuwa, Battar, Nuwakot, Lamjung, Dadeldhura, Garuda, Gaur, Parsa, Rangeli, Barabise and Jumla		Capacity building, community development, microfinance, income generation, natural resource management and research	Various donors/projects including ADRA Nepal, GTZ, UNDP, USAID (AEC), Plan International, PACT, CECI MARD	Strong leadership Proven experience in community economic development	A coherent model is not yet formulated for hill areas	The organisation also runs a development bank providing Grameen replication financial services the Terai.
International Development Enterprises (IDE) <i>Potential partner for dissemination of treadle pump technology</i>	14 hill districts of eastern, western, mid-western and far-western Nepal	NA	Mass marketing of low-cost treadle pumps, low-cost drip irrigation system, promotion of drip and micro-sprinkler irrigation	Possible IGP grant from USAID/EGAD/MD	Low cost proven portable treadle pump technology from ApproTec in Kenya Field experience	in early stages of implementation	Treadle pump project attempts to build both supply and consumer markets
PACT Nepal <i>Potential partner for women's empowerment, functional literacy, numeracy and basic business skill training</i>	21 districts (now only 2), including Banke, Bardiya, Kanchanpur and Kailali in the Mid-west and Far West	130,000 100% women	Women's empowerment through: Functional literacy and numeracy Savings led village banking model - no external account	USAID, World Bank, others	Training of Trainers expertise Effective training materials for poor women in: Literacy; Numeracy; Basic Business Skills; and Village Banking Local staff minimize costs	No sustainable follow system to literacy / numeracy training developed No sustainable follow-up to VBing development, so most groups left isolated and too small scale to fully develop Only delivered in Terai	Implemented the Women Empowerment Project supported by USAID Very broad outreach achieved through Training of trainer of other NGOs. Localized staffing also ensures better local language and cultural and social issue awareness

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Non-Financial or Business Development Service Providers

Name	Locations	No. of Clients	Types of Services	Funding Sources	Strengths	Weaknesses	Comments
Women Entrepreneurs Association of Nepal <i>Potential partner for product development, women entrepreneur development and trade linkages</i>	Kathamandu and 3 outside districts including Nepalgunj	1150	Enterprise creation, skills development, training, management training, product development, savings and credit activities and marketing support	Membership, donor project support, member product sales and other income generating activities	Women lead, women focused		Established in 1987

ANNEX D

Donor Private Sector Activities (including Microfinance & Microenterprise)

Name	Program Name	Types of Activities	Area(s) Served	Period of Program	Funding Amount	Comments
Asian Development Bank	Corporate and Financial Governance Programme	Institutional strengthening of the securities board, privatisation of the stock exchange, establishment of a central depository system, capacity building of the company registrar's office, establishment of a national judicial academy and dispute resolution mechanism	NA	2000-	US\$7.3 million	www.adb.org/nepal
Asian Development Bank	Rural Microfinance Programme	On-lending fund for RMDC and T/A to NRB on microfinance	NA	1998-2004	\$20m fund for on-lending	www.adb.org/nepal Very little of these funds are being on-lent to MFIs because RMDC is applying strict qualification criteria on financial and institutional viability
World Bank	Financial Sector Technical Assistance Project	NRB Reform and Privatisation of NBL and RBB, corporate governance, regulation and competition policy	NA	In the pipeline	US\$16 million	www.worldbank.org
World Bank	Financial Sector Reform Project	Loan tied to the above TA	NA	In the pipeline	US\$50 million	www.worldbank.org
World Bank	Rural Infrastructure Project	Supporting rural roads through maintenance, design, logistical support and TA	Kapilvastu, Rupandehi, Nawalparasi, Syangja, Palpa, Kaski, Dhading, Sankhuwasabha	1999-2003	US\$5	Collaborating with GTZ in Sankhuwasabha on the "green road" technology for wider adoption. www.worldbank.org
BMZ -Ministry of Economic Cooperation Germany	GTZ-Rural Development Programme	Rural development activities including rural infrastructure, microfinance & microenterprise, promotion of self-help institutions of the poor and strengthening local self-governance	Gorkha, Lamjung, Sankhuwasabha	Current phase August 2000 to March 2004	NA	GTZ also supports activities in Siraha, Saptari & Udaypur under Churia project & almost all districts in the mid-west and far-west through FFW activities with FAO. The "Green Road" technology was developed in this programme

Name	Program Name	Types of Activities	Area(s) Served	Period of Program	Funding Amount	Comments
BMZ	GTZ-NGO Fund Programme	Support to Self-help groups/initiatives and NGO support including microenterprise promotion	Initial interventions in Parbat and Kapilvastu, now 4 focussed and 8 non-focussed districts	1995-2005 current phase 2000 - 2003	NA	www.gtz.de
BMZ	GTZ-Private Sector Promotion Project (PSP)	Business development services, strengthening 15 business membership organisations and promotional activities in carpets, tea and tourism	Nationwide but concentrated in Kathmandu and urban Terai towns	On-going 3 year phase till April 2004 possible extension till 2007	NA	www.gtz.de
BMZ	GTZ-Rural Finance Nepal (RUFIN)	Strengthening of SFCLs, replication of the model, review and improve process of transfer to SFCLs and support to ADB/N	Nationwide	2001-2004	NA	www.gtz.de
CIDA	CECI – Community Based Economic Development (CBED)	Focus on institution building to contribute to livelihood improvements	55 VDCs and 2 municipalities in Dadeldhura, Baitadi and Jumla	2003 – 2010	US\$5-6 million	The project partners are CEAPRED in Baitadi, Jumla, CSD in Jumla and DEPROSC in Dadeldhura. CECI has requested USAID for a US\$1 million grant to extend activities to areas covered by the MARD project (Surkhet and Dailekh) www.ceciasia.com
DFID	Rural Access Programme (RAP)	"Transport Plus" activities. Combining "green" roads, trails and bridges with programmes to improve the poor's access to economic opportunities and developing local level capacities	Bhojpur, Khotang, Sankhuwasabha Dailekh, Accham and Doti	1999 – 2004	GBP 19 million	www.dfid.gov.uk
DFID	CARE Nepal – Livelihood and Forestry Prog		Rukum, Rolpa, Salyan, Pyuthan and Dang	Planned	NA	Information to be sought on this. www.carenepal.org

Name	Program Name	Types of Activities	Area(s) Served	Period of Program	Funding Amount	Comments
DFID	CARE Nepal Accham Livelihoods Security Project	Food security, health, governance, drinking water and enhanced economic opportunities	Accham District (12 VDCs)	March 2000 – March 2005	NA	www.carenepal.org
SDC	Swisscontact Small Industries Promotion Programme (SIP-P)	Business development services, support to women entrepreneurs, development and innovation of new service products	Nationwide but concentrated in urban towns outside Kathmandu	On-going 5 year phase till 2004 with a possible next phase	CHF 5 million	www.swisscontact.ch Decided after 2 years to not do further work through business membership organizations (BMOs) Working on a new, as yet untested model of service delivery
SDC	Swisscontact - Training Institute for Technical Instruction (TITI)	Infrastructure support to TITI, testing programmes, OD and HRD support	Kathmandu TITI office and other areas	1991-2003	CHF 15 million	www.swisscontact.ch
SDC	Alliance Nepal - Training for Employment (TfE)	Quality improvement of technical training and linking entrepreneurs with service providers	Kathmandu and urban centres	2000-2002	CHF 1.5 million	SDC is looking into new areas for intervention including microfinance and vocational training through mobile low cost methods like the SKILL project of Helvetas
SNV	Pro-Poor Sustainable Tourism	Advisory services to Nepal Tourism Board, facilitation of district tourist plans and information systems, enterprise development activities related to tourism	Dolpa, Humla, Mugu and Jumla		NA	www.snv.nl
SNV	Community Based Forest Enterprises	Establishment of a central MIS for NTFP, training in marketing and management and conducting feasibility studies for exports	Humla		NA	Implemented with the Asia Network for Sustainable Agriculture and Bio-resources (ANSAB) www.snv.nl
SNV	Rural Enterprise Assistance Programme	Creating and strengthening networks of enterprise service providers, capacity building of service providers, integrated support services, market linkages and policy inputs	Dolpa, Mugu, Humla & Jumla in Karnali & Ilam, Panchthar and Taplejung in Mechi	2002-2005	Euro 702,000	Implemented by the Industrial Enterprise Development Institute (IEDI). Modality of networking and coordination seems interesting www.snv.nl

Name	Program Name	Types of Activities	Area(s) Served	Period of Program	Funding Amount	Comments
SNV	CARE Nepal – Bajhang Poverty Reduction Project	Governance, health, agriculture, natural resources and education	Bajhang District (47 VDCs)	July 1999 – June 2004	NA	With financial support from CARE USA www.carenepal.org
UNDP	Microenterprise Development Programme (MEDEP)	Marketing, Training, Gender, MIS and M&E system development, microfinance, appropriate rural technology and product development	Nawalparasi, Nuwakot, Parbat, Baitadi, Dhanusa, Sunsari, Tehrathum, Dadeldhura, Dang and Pyuthan	1998 - 2003	US\$2.9 million	Apparently expensive model that seems to assume that target public needs every kind of assistance in order to succeed in business. Relies heavily on activities of other agencies and so there may be significant double counting in results achieved. www.medep.org.np
UNDP/NORAD	Participatory District Development Programme (PDDP)	Village development through social mobilisation, public-private partnership, support to micro-macro policies and HRD	5 Districts in the far west, 6 districts in the mid-west, 14 districts in the west and 4 districts in the central region	1995 – 2002 (September)	US\$9.2m UNDP & US\$3.03 NORAD	UNDP has another programme in 30 districts called Local Governance Programme (LGP) that follows the same methodology www.pddp.org.np
UNDP	Rural Urban Partnership Programme (RUP)	Enterprise related training, technology dissemination, credit for private initiatives and seed grants for community activities	32 Rural market centres around Dhankuta, Biratnagar, Heatuda, Bharatpur, Byas, Pohara, Tansen, Butwal, Tulsipur Tribhuvannagar Nepalgunj and Birendranagar	January 2000 to December 2003	NA	www.undp.org.np Focus is on urban markets and links to rural production sources. Outreach into rural areas in Nepalgunj area appeared not to reach hills to any significant degree.
USAID	CARE Nepal – Remote Area Basic Needs Project	Strengthening district planning, agriculture and forestry development, water and irrigation and health	Bajura (17 VDCs)	1997 - 2002	NA	Financial support from DANIDA, CARE Denmark and CARE USA www.carenepal.org
USAID/OMD	IDE	Treadle pump production & marketing	NA	2003 - 2005	NA	Contract in process of being finalized

ANNEX E
CCODER-Nepal

Activities, Output and Cost Breakdown

Regional-CDC = VDC Level

Average 15 CDCs

Coverage: Members 700-900*

Families: 600

Total Population affected indirectly: 3500

* After 12-18 months will have slightly more than one member per household, 700 members. After 5 years, there are 900+ members.

	Activities	Output	Time	Cost in Rupees	Result in 5 years
1.	First Phase		[18 months]		
1.1	Pre-DEP <ul style="list-style-type: none"> ▪ Entry: Non-formal meetings ▪ Village leader workshop & 10 minute mobilization ▪ DEP Teachers Training (20 participants x12 days xRs. 250) 	Integration Community mobilization Seed for development	6 months	5,000 200,000 60,000	156,000 hrs donation
1.2	DEP: <ul style="list-style-type: none"> ▪ DEP class running Teachers salary+Materials+ Supervisor Rs. 9,000x15 classes 	CDC formation Individual plan Institutional plan	3 months	135,000	
1.3	Post DEP <ul style="list-style-type: none"> ▪ R-CDC formation (a true people's organization) Supervisor+materials+CSC building ▪ CODEB's preparation Training (Bank management committee/ Manager) ▪ Opening of the bank including installation 	R-CDC and it's Secretariate Registration Community Service Center (CSC) building CODEB average capital R1,500,000 (Hot money)	9 months	250,000 25,000 25,000	True people's organization [Institutional Development]
	Sub-total			700,000	
2.	Second Phase:		[12 months]		
2.1	Institutional Development (Annual Workshop)				
2.2	Economic Development <ul style="list-style-type: none"> ▪ Operation of CODEB, 6/12 support ▪ I.G. ▪ Market network 	Functioning CODEB			Well functioning CODEB with Capital above Rs. 2,000,000
2.3	Social Development Primary Health Care Center	[Economic Development]		300,000	
3.	Third Phase:		[12-30 months]		
3.1	Community Health Insurance	Consolidation Health Insurance			Well functioning H.I. Plan
3.2	Infrastructure/Environment	Comfortable village			
3.3	Human Resource Development	[Social Development]		500,000	[Model VDC]
	Total		42-48 months	R1,500,000	

Period: 3-5 yrs. Cost NRs. 1,500,000. Neat & clean, well managed, self-reliant model VDC
[Investment: NRs. 428/family member]

Center for Community Development and Research (CCODER) – an integrated approach to rural socio-economic development

This local NGO was started in 1990 out of the work of the French NGO Center for International Development and Research (CIDR). It grew out of Gorkha Ayurvedic, a medicinal herbs processing and marketing company set up on the principle of how to bring more money into rural villages. CCODER was established because its founder, Govinda Dhital realized that they needed to broaden the range of economic and other activities beyond Gorkha Ayurvedic's focus if they were to achieve the goal of improved incomes in rural villages. They started in Gorkha District and now are working in 6 districts in the West and East.¹ Their methodology contains three components: Development Education, Economic Development and Social Development. They work through Community Development Centers (CDCs), one per village that are later networked into a Regional CDC (R-CDC). They are presently working on establishing District level banks that will take on some of the administrative, CDC internal audits and channeling outside funding to R-CDCs. Eventually the plan on a national level financial organization.

CCODER starts work with a community association with 25-50 members. At least 80% of the households in a community must have at least one person as a member of the CDC. They do not prescribe whether the member will be the husband or wife, but as it works out, both often end up participating and there is normally a good mix of men and women members in each CDC. There are 10 – 20 CDCs per VDC, or an average of 15 CDCs with an average of 40 members. CDCs take an average of 6 months to form. CCODER trains Village Leaders in group mobilization and trains local facilitators to do most of the work in the groups and in the development education curriculum. They begin the process of integration and mobilization and plant the seeds of development by getting the people to start saving on a regular basis. When that training is done, they then conduct the development education program (DEP). That consists of 15 classes of 5 hours each that cover CDC formation, Individual plans, and Institutional plan. They use a questioning process as the entry point of the project. Where are they at present? Where do they want to go? How can they reach there? – with an action plan. They go over the concepts of education, organization and socio-economic development. Those 75 hours of classes are done over a 3-month period. They inculcate the idea that collateral consists of monetary savings, volunteerism, and active participation in the CDC monthly General Assemblies. They have a passbook for their volunteerism that is used to track the "ten Minutes A Day" that they agree to contribute of their time (1 hour /week) to community projects.

In Phase Two they focus on economic development, which consists of establishing VDC level community banking, income generation activities and market networks. After the CDCs are networked into a Regional CDC CCODER assists them to form a Community Development Bank (CODEB), which is registered as a community development cooperative, a primary cooperative. The CODEB has one employee, the Manager, who is paid Rs3,000-4,000 per month. CCODER at present subsidizes this amount for from 6 to 12 months until interest and fee income from operations covers that and other costs. Simultaneously CCODER via the CDCs works on helping members identify income generation activities (IGAs - otherwise known as microenterprises, though sometimes they are group enterprises). Individual loan proposals are developed for amounts not exceeding 3 to 5 times the amount of savings the person has made. After approval by the CDC, they are submitted to the R-CDC for approval and disbursement. The CDC takes full responsibility for ensuring that the loan is repaid. On-time repayment is reported to be 99%. Savings and volunteer time and General Assembly (GA) participation are accepted as collateral. District level banks will be owned by the R-CDCs, each purchasing R100,000 of shares for the initial capital and will perform whole bank functions.

CCODER, based on knowledge of markets and analysis of local economics, orients members to three IGA areas; higher value agriculture and livestock, cultivation and processing of medicinal herbs,

¹ Gorkha, Palpa, Lamjung, Nuwakot, Terathum

and community managed tourism.² CCODER tries to work with government resources on the agriculture and livestock training, but only as they are organizing operations at the district level does it appear that they might be able to mobilize resources through proper government channels. Otherwise they are forced to hire technical resources for their trainings. One example of a group enterprise market linkage is a 5000 liter milk collection cooling tank that enables them to process and market a variety of milk products from Nuwakot to Kathmandu on a daily and weekly basis.

The third component of CCODER work in a community is the social development. The volunteer time savings (1 hour per week) is used for these activities, which tend towards better hygiene with water resource management and latrines, neat and cleanliness of the village, its trails and houses, and maintenance of community facilities such as irrigation systems, tube wells, etc. At present CCODER provides some matching funds for community development projects with the CDC providing volunteer labor and materials collection.

One point that is worth mentioning about CCODER's work is that they have managed to continue working without interruption in Gorkha while all other economic development programs have discontinued operations there. In fact, when CCODR organized a 'mobile clinic' trek with 18 US doctors, the Maoists actually cooperated in ensuring its success. Another such trek is planned for October 2002.

The results that CCODER aspires to and has achieved are: a village that is neat and clean, with improved trails, water resource management, all houses have latrines and most villagers have increased their savings and incomes.

² The later of these is limited to a few groups per year, but is building up. There are theme treks such as 'mobile clinic of doctors from the US,

ANNEX F

List of Documents Reviewed

1. Nepal Agriculture Sector Performance Review. ADB TA No. 3536-NEP. ANZDEC Limited, New Zealand and Consolidated Management Services Nepal (P) Limited, March 2002
2. Microenterprise Development in Nepal: Achievements of the 1990's and opportunities ahead for USAID Nepal. Lene Hansen, USAID Nepal. 1999
3. Impact Evaluation of PACT's Women's Empowerment Program in Nepal. Jeffrey Ashe & Lisa Parrott. October 2001
4. Summary of Financial Sector Issues – From the Draft World Bank Nepal Financial Sector Study. February 2002
5. Industrial Policy 2002, HMG Nepal Ministry of Industry, Commerce and Supplies. March 2002
6. Industrial Policy Review of HMG Nepal. HMG/Nepal Ministry of Industry, Commerce and Supplies and SDC Small Industries Promotion Project. March 2002
7. Gulmi-Arghakhanchi Rural Development Project Phase II (GARDP II). Final Draft Report. July 2002
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11. Private Sector Development Plan: A framework on sector support to micro and small enterprise development – 2003 to 2008. SNV Nepal – PSD Sector. June 2002
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14. CTEVT Profile. The Council for Technical Education and Vocational Training. Kathmandu 1994

15. Occupational Skills and Enterprise Development OSED A Conceptual Framework 2001-2005. Swiss Agency for Development and Cooperation Kathmandu
16. The Business Environment and Manufacturing Performance in Nepal. Biggs T, Nasir J, Pandey K, Zhao L, World Bank Regional Program for Enterprise Development and Federation of Nepalese Chambers of Commerce December 2000
17. Practical insights of Business Development Services July 18th 2002– Prceedings. Lotus Holdings Pvt Ltd.
18. Performance Assessment of BizPort. Lotus Holdings Pvt Ltd July 30, 2002
19. Experiences of Grameen Bank Financial System in Nepal, Nirdhan Utthan Bank Limited, April 9, 2002
20. Report on Mid-Term Evaluation Workshop of Productivity Improvement Through Cleaner Production. A Pilot Demonstration Programme for Cottage and Small Industries. Institute of Environmental Management, July 2002
21. Scope of Work for an Action Plan on Women's Economic Empowerment in Nepal 2002
22. Draft of Desk Top Research on Relevant Work Done to Develop Appropriate MF Models that Can Be Offered to Poor People in the Hills of Nepal. Center for Microfinance (CMF) Kathmandu May 24, 2002
23. A Report on the Proceedings of the National Seminar on the Savings Services. CECI Nepal Lalitpur February 5, 2000
24. Women's Empowerment through Microfinance? The Case of the Micro-Credit Project for Women. Occassional Paper No. 2 CECI/CMF March 1999
25. The New Agro-Enterprise Center: Charitng a Course Toward Commercial-Agricultureal Growth and Expansion – Final Report of USAID Review Team March 1, 2002.
26. A Glimpse of Village Development Programme. Local Governance Programme (LGP)
27. Small Farmers Cooperative Limited: A microfinance model in Nepal. Purushottam Shrestha, Agricultural Development Bank of Nepal.
28. Rural Enterprise Assistance Programme (REAP). August 2002-August 2005. IEDI and SNV. June 2002.

29. Integrating MEDP Modality in the Mainstream National Poverty Alleviation Programme. MEDEP. May 2002.
30. Nepal Development Forum Economic Update 2002, The World Bank January 30, 2002

Organisational Profiles/Brochures

- SNV Nepal: Annual Report
- Lotus Holdings:
- Rural Microfinance Development Corporation (RMDC)
- PACT Nepal
- Rural Access Programme (RAP)
- HMG/N and GTZ Rural Development Programme (RDP)
- GTZ - NGO Fund Project
- HMG/UNDP Participatory District Development Programme (PDDP)
- Institute for Environmental Management (IEM)
- Mid-Western Grameen Bikas Bank
- HMG/UNDP Rural Urban Partnership Programme (RUPP)
- HMG/UNDP Micro Enterprise Development Promotion Programme (MEDEP)
- Development Project Service Center Nepal (DEPROSC)
- DEPROSC Development Bank Ltd. An Introduction
- Swisscontact Small Industries Promotion Project (SIP-P of SDC)
- CTEVT Profile. Council for Technical Education and Vocational Training
- Center for Self-help Development (CSD) Annual Report 2000/2001

ANNEX G

Organisations & People Visited

Organization	Name/Position
1. USAID	Joseph C. Williams, Program and Planning Officer Cheryl Martin, Assistant Program Officer Lala Faiz, Assistant Program Officer Sribindu Bajracharya, Program Specialist Andrew Pryce, SPO Director
2. Centre for Microfinance (CMF)	Ms. Namrata Sharma, Managing Director Bishnu P. Shrestha, Deputy Managing Director
3. PACT	Ms. Usha Jha, Program Director
4. GTZ-PSP (Private Sector Promotion Project)	Jim Tomecko, GTZ Team Leader Ashutosh Tiwari, Business Development Manager
5. GTZ-RDP	Ms. Sushma Bajracharya, Deputy Coordinator Subhakar Baidya, Senior Coordinator
6. UNDP-MEDEP	Dr. Lakshman Pun, National Programme Director A.P. Gautam, District Programme Manager, Baitadi Santosh Acharya, District Programme Manager, Dhanusa
7. UNDP-PDDP	Sanjaya Adhikary, National Programme Manager Ms. Seema Sharma Rajouria, Communication Publication Officer
8. Swisscontact SIP-P (SDC)	Leon Houdret, Programme Manager Navin Dahal Programme Officer
9. SNV	John Hummel, Private Sector Development Manager Eelco Baan, Micro & Small Enterprise Development Specialist Srijana Rana, BDS Adviser
10. Rural Access Programme (RAP) DFID-UK	John Cunningham, Social & Livelihood Development Advisor Bijaya Singh, EPIs & Livelihood Specialist
11. Independent consultant (former PS of MCIS and developer of the LGP)	Dr. Bholu N. Chalise
12. ICIMOD	Dr. Binayak Bhadra, Director of Programmes Dr. Narpal S. Jodha
13 CECI (Canadian Centre for International Studies & Cooperation)	Ms. Kabita Bhattarai, Country Director Ms. Katy Phillips, BDS Advisor
14. Rural Microfinance Development Center (RMDC)	Shankar Man Shrestha, CEO
15. DEPROSC Development Bank Development Project Service Center	Pitamber Acharya, Executive Director Dr. Vrigu Duwadi, Sr. Programme Coordinator
16. Nirdhan & Nirdhan Utthan Bank Ltd.	Dr. Harihar Dev Pant, Chairman & Executive Director
17. CSD (Center for Self-help Development)	Mukunda B.Bistra, Executive Director
18 (CCODER) Center for Community Development & Resesarch	Govinda Dhital, President
19. Industrial Enterprise Development Insitute (IEDI)	Dr. Chiranjibi Nepal, Executive Director Bishwa Karki, Marketing Manager

ANNEX G

Organisations & People Visited

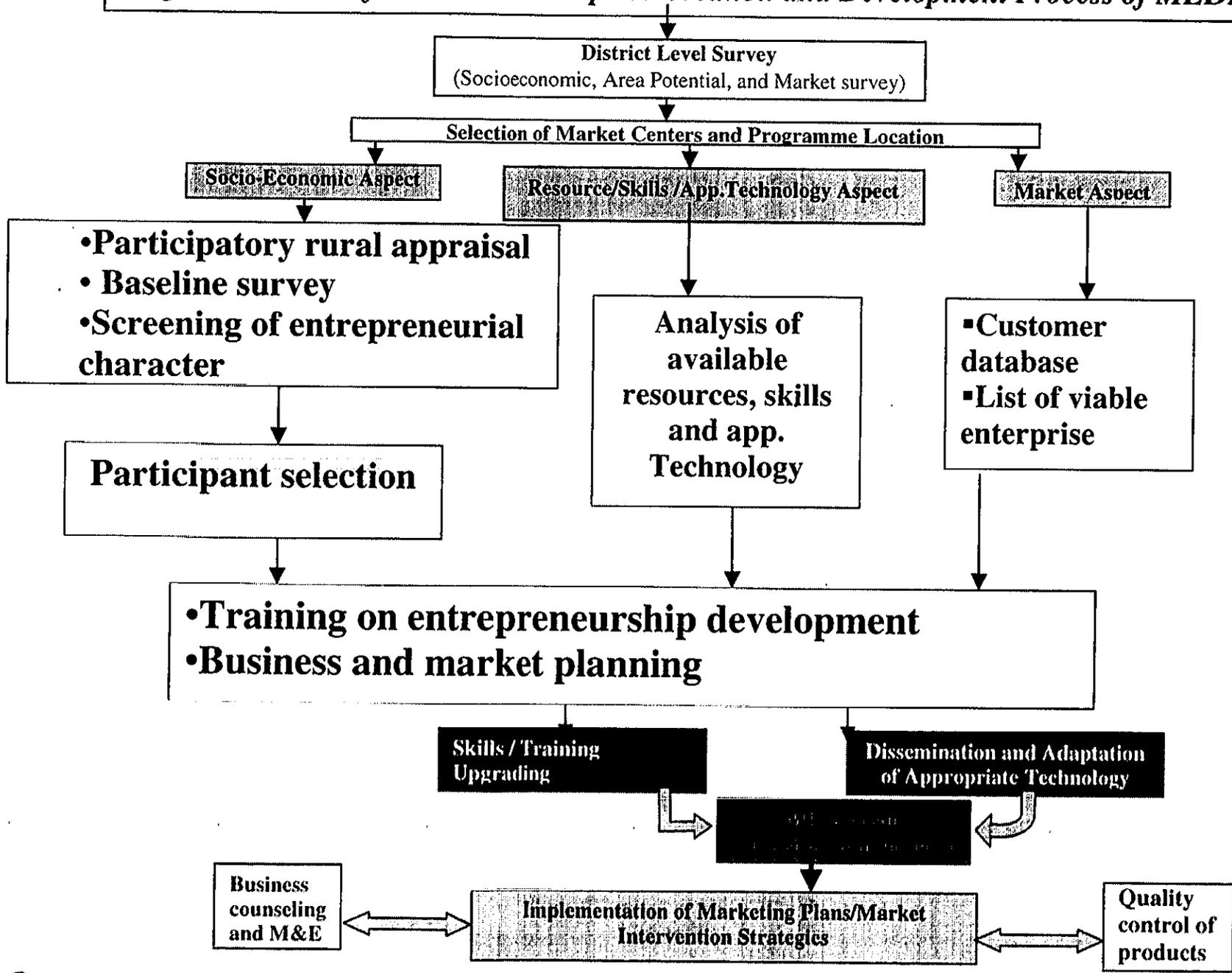
	Dilip Thapa, Coordinator REAP programme
20. Institute for Environmental Management (of ESPS)	Poshan Bahadur K C, Training & Institutional Development Advisor
21. Agro Enterprise Center (AEC)	Dr. Dev Bhakta Shakya, CEO
22. SAMANATA	Dr. Arzu Rana-Deuba, President
23. The Mountain Institute	Nandita Jain, Director of Programs
24. DCSI/IEDI Workshop	Leela Mani Paudyal, Director General, DCSI Dr. Chirinjivi Nepal, Executive Director, IEDI Basu Dev Giri, President, FNCSI Ms. Shanti Chadda, President, WEAN Binod K. Bhattarai, Member-Secretary, Employment Promotion Commission Balaram Rajbhandari, Secretary, Nepal Chamber of Commerce Govinda Dev Pandey, Executive Director, SMEDP Srijana Rana, BDS Adviser, SNV Nepal Dhruva Dhungel, Director, CTEVT Dr. Shreeram Lamichhane, CERID Kabya Niroula, IEDI Dinesh Shrestha, FNCCI Ms. Nirmala Thapa, Training for Employment Project Batuk Nath Dhungana, CSIDB
25. Nepal Rastra Bank	Ram Babu Pant Deputy Governor Ganesh Kumar Shrestha, Executive Director Non-Bank Regulation Department Tulasi p. Uprety, Executive Director, Non-Bank Inspection & Supervision Dept. Lok Bahadur Khadka, Director NBI&SD
26. Agriculture Development Bank of Nepal ADB/N	Purushottam Shrestha, Division Chief Micro Finance Division
27. FNCCI	Badri Prasad Ojha, Director General
28. FNCSI	Basu Dev Giri, President Central Office
29. Nepal Carpet Exporter's Association	Kavindra Nath Thakur, President
30. Lotus Holdings Pvt. Ltd.	Rajiv Pradhan, CEO
31. Ministry of Finance	
Field Trip Nepalgunj	
32. IEDI – Nepalgunj	Iswari Prasad Sharna, Branch Manager Raj Bahansa Choudary, Field Officer
33. Cottage & Small Industry Department – Nepalgunj	Krishna Dev Partap, Deputy Manager
34. Grameen Bistra Bank	Chief of Administration, Chief of Accounting, Field Facilitator
35. Chamber of Commerce & Industry of Nepalgunj	General Manager
36. WEAN Nepalgunj	
37. Fancy Bag Industry	Rajiv shop manager (brother of owner)
38. Rural-Urban Partnership Programme (RUPP – UNDP)	

ANNEX G

Organisations & People Visited

39. Rural Economic & Social Improvement Service Center	Purna Lal Chuke, Executive Director Lata Sharma, Programme Coordinator
40. Bheri Technical Training Center	Deputy Director
41. ILO – Strategies and Tools against Social Exclusion and Poverty (STEP)	Ismène Shalpers; Associate Expert Micro-Insurance

Logical Network of the Micro-Enterprise Creation and Development Process of MEDEP



8-1

ANNEX I. Summary of the Product Development Cycle

Phase One - 12 to 16 weeks: Product developer(s) visits targeted geographic areas and groups, identifies immediate opportunities, makes product samples to specifications, returns to the home market, and finds buyers/importers that place an order for a certain number of products or product lines.¹ The product developer identifies the training and organizational skills and technology needed to develop the products for the existing order. The product developer will also determine if there are existing export organizations and the necessary infrastructure to take products from rural areas to export. Recent trade liberalization including the exoneration from import and export duties for NGOs should make this possible in Nepal. The in-country assessment usually takes three people about two weeks.

Phase Two three to nine months: The product developer(s) works with the targeted/identified local partners (NGOs, MFIs, exporters, training organizations, etc.) to get the production and other elements of the exporting process established, and the first order done and delivered on time. A problematic constraint to market access in Nepal is the lack of roads. But if the above recommendation is followed, then the first communities identified for production would be at least fairly close to a road. Dealing with communities further away may restrict the initial products to non-perishable items. It may also mean that targeted areas are those in which USAID or other potential partner activities are building green roads.

Phase Three - two to three years: The infrastructure for the ongoing market linking system is fully established and localized.

Phase Four - two to eight years: The industrialization phase can start at any time once a relationship with an expanding market has been established. The planning for this phase will overlap with *Phase Three* as a projection for the possible productivity and product quality enhancements should be sought as soon as feasible. The industrialization process is not necessarily a linear one. Productivity and product enhancements can happen in many different areas. Some will involve mechanization of certain functions in the production process from processing of raw materials to final finishing and packaging. Others might involve bringing previously independent and scattered producers to a common production location. A covered space or enclosed facility might be a step to reduce weather as a factor in production. Another might be to introduce a better technology for preparing standardized pieces of the final product. Another might be developing assembly jigs to eliminate variations in products of low tolerance to variances in final dimensions or fitting or functioning. Any mechanization or organization introduced to enhance productivity and product quality in any way is part of the industrialization process. One thing we can be assured of in a market economy, we can be sure that someone else will try to produce a similar product, if not the same one at a lower price. One thing to remember in the industrialization process, if we are marketing "handmade" products, we must go as far as we can in our mechanization or industrialization without rendering the final product not handmade.