# CHAPTER I

# INTRODUCTION

## 1.1 Background of the Study

For a developing economy, poverty has been one of the major challenges in its economy. The banks and financial institutions in the formal sector have been playing a vital role in the country's economic development by providing finance to those who lack resources to initiate business activities. However, the coverage of their services has mostly been limited to the urban areas as they see more potential to expand their business and ensure higher returns. Most of the rural poor do not have access to this facility. They are dependent mostly in farming which is subsistence and, most of the time, seasonal in nature. To fulfill their financial need they seek the informal sources, who often exploit them to make their condition worse. Even if the banking service is being provided, the complexity in completing with a number of formalities compels them to go to the *Sahus and Mahajans, the indigenous moneylenders*. For uplifting the economic and social life of these people, it is imperative that they be engaged in income generating activities, easily and at fair rate of interest. This led to the development of the concept of micro-financing.

Microfinance is new concept developed with a view to providing financing service to the poor people living in the rural area deprived of modern banking service through schemes especially designed to meet the people of poor community. The poor have usually been viewed by the conventional banking system as 'non-bankable' because a) they can offer no collateral or security on a loan b) they are a bad risk with regard to repayment and, c) the size of loans they require is too small for a bank to handle profitability. Microfinance includes both saving and credit activities of small scale, besides other community-based activities for the improvement of standard of living of deprived sector in the society.

The history of microfinance in Nepal dates back to 2010 B.S. with the setting up of cooperatives which began saving and micro-credit services to its members. The

Cooperative Bank was established in 2019 B.S., but was later on merged with the Agricultural Development Bank in 2024 B.S. Realizing the necessity of micro-finance service to the deprived sector, Nepal's central bank (NRB) introduced priority sector lending (PSL) primarily in the name of "small sector" as directed credit in 2031. Accordingly, commercial banks were mandatorily required to invest certain portion of their loans in priority sector, i.e. agriculture, industry and service sector. Later on Intensive Banking Program (IBP) and CSI Project and Lead Bank Scheme were also launched under PSL. As a component of the PSL, the deprived sector lending was started from 2047. Apart from this there are 9720 cooperatives out of which there are 3392 saving and credit cooperatives (including l6 cooperatives licensed by NRB) by Ashad 2064. Similarly, 47 financial intermediary NGOs have been licensed by NRB. Besides, dhukutis (a form of trust) are also in operation particularly in rural areas as a peculiar form of micro-finance. In Nepal, currently there are 9 Grameen Banking Replicators (GBRs) represented by nine micro finance development banks and four non-government organizations (NGO).

The socio-economic status of these people in Nepal, which constitute a large portion of the population, is pitiable. As is evident, the overall development of the country is not possible if the economic condition of these people is not improved. In this context, the Government of Nepal has given special emphasis to reduce poverty in its development plans from the very beginning. The Tenth Five Year Plan (2059/60-2063/64) has given top priority to this aspect. Apart from this, a number of programs and projects have also been conducted towards this direction. A number of donors have also participated in Nepal's efforts to reduce poverty.

In Nepal there has been encouraging efforts towards availing microfinance services to the poorest of the poor through institutional arrangements, for the past few years. They include non-government organizations (NGOs), cooperatives and microfinance developments banks (MFDBs). As these institutions cannot function without funding arrangements, attempts have also been made towards setting up wholesale institutions. The internal resources mobilized by the institutions may not be sufficient to meet the growing demand of finance. Hence the MFIs need to receive funds from wholesale institutions. The wholesale model is one of the various models of microfinance in Nepal. Presently, there are three institutions involved in this model. They are: Sana

Kisan Bikas Bank (SKBB), the Rural Self-Reliance Fund (RSRF) and the Rural Microfinance Development Centre (RMDC). Among the three institutions, the RMDC is the apex wholesale microfinance institution having large exposure. This study aims at having an insight into the role played by Rural Microfinance Development Centre (RMDC) as an apex wholesale MFI, which came into operation on Marga 20, 2056.

## 1.2 Statement of the problem

Nepal is a developing country where nearly 31 percent of the total population lives below absolute poverty. About 86 percent of the population lives in rural areas. Most people depend on agriculture which contributes about 40 percent of the national income. As one of the least developed countries (LDCs), most people, particularly living in villages are very poor. There is little or no opportunity for employment so that people can earn for their livelihood. They have very little access to formal credit to get them engaged in income-generating activities. The poor and deprived are exploited by local landlords and indigenous moneylenders. Ironically, despite the development and expansion of financial system in the country compared to the past, the access to credit for the poorest of the poor is insufficient. As per the Rural Credit Survey of 2049/50 conducted by Nepal Rastra Bank, only 20 percent of the rural poor have access to institutional credit. Hence most of these people have no alternative, but to rely on local moneylenders who charge exorbitant rate of interest, take their home and land as collateral and at many times confiscate them upon failure to repay the loan on time.

As mentioned earlier, the most effective tool for reducing, if not eliminating poverty is microfinance services. According to experts, about 2.1 million people living below poverty line need to be accessed with such services. However, it is estimated that only 7, 00,000 people (one third) have access to such microfinance services (As taken from a survey of micro finance in South Asia by MIX, Washington DC, January 2006). Hence, about two-third of the needy is still deprived of microfinance services.

On the above context, it is essential that the financial services be accessed to the maximum number of people of deprived sector. How such services can be accessed is also important. Undoubtedly, a wholesale microfinance institution can play vital role in providing finance to the financial intermediaries serving particularly in rural areas. How such institutions can play such role effectively, whether it is capable for that and what are the impact on the financial and managerial capacity of the participating retail institution, apart from effect of such services on the part of the general public at large. Similarly, what are the weaknesses of such institutions and how they can be minimized? How they can contribute much in accessing as much finance as possible? These are some of the questions that need to be answered. In this context, this research will try to ascertain the answers to such questions with particular reference to the RMDC as the wholesale micro-financing institution in Nepal.

## 1.3 Objective of the study

An attempt has been made to evaluate the operation and activities of RMDC as a wholesale institution licensed by the central bank. The objectives of this paper can be summarized as follows:

- To look into the operation, activities and achievement of RMDC.
- To have an insight into the modes of disbursing the whole loan to its Partner Organizations (POs).
- To evaluate the impact of microfinance services provided through RMDC to the poorest of the poor.
- To suggest ways to bring further improvement in the operations of RMDC

## 1.4 Significance of the Study

MFIs in Nepal have been successful in increasing outreach and maintaining healthy levels of returns because of extremely low cost structures. Considering that a large portion of demand for microfinance services is still unmet, there is a significant opportunity for MFIs to further increase the number of clients served. For this purpose, there is necessity of wholesale micro-finance institutions like the RMDC that can cater to the growing demand of such services particularly for rural people that are economically and socially deprived, that constitute large portion of total population.

It is evident that the wholesale financial institutions, which are limited in number, have played an important role in supporting the retail institutions financially. In this context, the RMDC aims at supporting its partner organisations not only in providing wholesale finance, but also supporting them through technical assistance like capacity building and training. As such this research study will evaluate the performance of RMDC. It will help ascertain the ways to improve the quality and quantity of service delivery. It also helps to evaluate its partner organizations which received wholesale loan from RMDC for on-lending to the people of low-income group.

## 1.5 Focus of the Study

Though there are currently three wholesale institutions in the financial system, the focus of the study has been the RMDC which is promoted by the government, the central bank and a number of banks and financial institutions. This institution is also financially supported by the Asian Development Bank. The study focuses on financial performance of RMDC of last five years, managerial capacity of RMDC, activities on training and capacity building for its partner organizations, brief highlight of the performance of partner organizations, and overall impact of wholesale financing by RMDC.

## 1.6 Methodology

For the successful completion of this study, secondary data has been used. The sources of secondary data, facts and figures consist of RMDC and its partner organizations, central bank and microfinance related institutions.

In view of the nature of the objective of the study, descriptive as well as analytical research design will be adopted. Wherever applicable, graphical/tabular presentations will be made to analyze the issue.

## 1.7 Organization of the study

The whole study will be divided into five chapters as follows:

The First Chapter deals with introductory part of the study. This includes background of the study and the statement of the problem. It also covers the objective, focus, methodology, organization and limitation of the study.

The Second Chapter deals with the review of literature. It includes conceptual review, principles and best practices of micro finance, history of micro finance institutions, profile of RMDC, government policy on micro finance, central bank's initiatives and policies towards micro finance. It also consists of legal and regulatory frameworks for

MFDBs, micro finance models in Nepal, review of articles/studies, thesis, dissertation.

The Third Chapter explains the research methodology used in the study. It includes research design, population and sampling, sources of data and method of data analysis.

The Fourth Chapter deals with the vital aspect of the study, that is, the presentation and analysis of data, based upon which findings are made.

The Fifth Chapter contains conclusion, summary and recommendations for improvement in accessing microfinance services to the poorest of the poor, along with management of wholesale lending based on the findings of the study.

## 1.8 Limitation of the Study

There are certain limitations of this study. They can be summarized as follows:

- Firstly, out of three wholesale institutions for financing microfinance institutions, i.e., the RMDC, Sana Kisan Bikas Bank and the Rural Self-reliance Fund, the RMDC has been selected for the purpose of study. No comparison among these institutions has been made.
- Secondly, it covers the financial performance of RMDC for the past five fiscal years only
- Thirdly, personal visits to the partner organizations of RMDC have not been made as they are located in different parts of the country. Respective data are derived from annual reports of RMDC.
- Lastly, the impact of wholesale loan on partner organization has been assessed on the basis of interviews study conducted by RMDC itself etc. It was not possible to interview the each partner organization who received loan from RMDC, as they are from the rural areas.

# CHAPTER II

# REVIEW OF LITERATURE

This Chapter highlights on the existing literature and research related to the present study with a view to finding out what had already been explained and how the present research adds to the dimension. Although the study is related to an apex wholesale funding microfinance development bank, it would certainly add value if the vital aspects of micro-finance sector are discussed to a certain detail. For this purpose, various literature, articles, relevant legal framework, central bank regulations and documents, publications of the concerned institutions, study reports published domestically and internationally have been studied. As such, the following areas that are closely related to the topic in question are discussed briefly.

- Conceptual Review
- Principles and best practices of microfinance
- History of microfinance
- Profile of RMDC as wholesale financing institution
- Government policies on microfinance
- Central bank's initiatives and policies towards microfinance
- Legal and regulatory framework.
- Models of microfinance in Nepal,
- A few studies carried out in recent times,

Each of the above area is discussed in the following paragraphs.

## 2.1 Conceptual Review

Today microfinance is an area of global interest. It has been recognized as an effective means of minimizing poverty particularly in developing countries. This has further been reiterated with the award of 2006 Nobel Peace Prize recently to Professor

Muhammad Yunus of Bangladesh for his pioneering role in uplifting the socio-economic standard of the poorest of the poor through Grameen Banking system. Yunus introduced this unique type of microfinance as a unique experiment in the mid-seventies. Microfinance includes features like credit on group guarantee without collateral, saving, literacy, and community services like health and sanitation. The Grameen Banking model has now been spread over more than hundred countries of the world.

Micro-credit has been defined by NRB as an amount upto Rs 40,000 without collateral disbursed to deprived sector for income-generating activities and upto Rs l00,000 in case of micro-enterprise with collateral. Asian Development Bank defines finance as "a provision of a broad range of financial services such as deposits, loan, money transfers and insurance to small enterprises and households." Likewise, World Bank defines it as "the provision of financial services to low income clients, including self employees. It includes both financial and social intermediation. It is not simply banking, it is a development tool."

From the above definitions, it is clear that micro finance aims at providing financial service to the needy people of the rural society, encourages saving, and also contributes in improving their standard of living. Following features of micro-finance can be pointed out:

- Micro-finance also known as rural finance refers both saving and credit activities of small scale, besides other community-based activities.
- The term 'Micro credit' synonym with agriculture credit, rural credit.
- Illiterate and poor friendly system-simple and easy.
- Targeted to the poor.
- Focused on women of the poor households.
- Mostly collateral-free lending: therefore, no need of collateral evaluation, auctioning and other legal complications.
- Different form of Security-Group guarantees (joint liability of groups and compulsory savings as substitute for collateral).
- Informal appraisal of borrowers/investments.
- Small loan size for working capital or consumption.

- © Repayment of loan.
- © Flexibility in the use of loan money.
- © High staff productivity in terms of clients' service.
- © High financial discipline among clients.
- © Cohesion and solidarity among group members.
- © Doorstep service (no borrowing cost other than interest)
- © Low costs loan disbursement and recovery.
- © Larger repeat loans based on past loan performance.
- © Targeted to the poor.
- © Poor are bankable-poor can save, borrow, utilize and pay back.
- © Women as target group-most sincere to the bank and to the family.
- © Costly due to non-financial services as well as small loan size.
- © Substantiality of program, institution is vital for growth.
- © Subsidy is not considered well for long-term.
- © Training for both skills and fiscal discipline.
- © Interest rate higher as compared to other credit.

## 2.2 Principles and Best Practices of Microfinance

The CGAP of the World Bank has outlined the following key principles of microfinance (Key Principles of Micro-finance, CGAP, World Bank, Washington DC, USA.).

1. **The poor need a variety of financial services, not just loans.** Just like everyone else, poor people need a wide range of financial services that are convenient, flexible, and reasonably priced. Depending on their circumstances, poor people need not only credit, but also savings, cash transfers, and insurance.
2. **Microfinance is a powerful instrument against poverty.** Access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children's health and education.

3. **Microfinance means building financial systems that serve the poor.** Poor people constitute the vast majority of the population in most developing countries. Yet, an overwhelming number of the poor continue to lack access to basic financial services. In many countries, microfinance continues to be seen as a marginal sector and primarily a development concern for donors, governments, and socially-responsible investors. In order to achieve its full potential of reaching a large number of the poor, microfinance should become an integral part of the financial sector.
4. **Financial sustainability is necessary to reach significant numbers of poor people.** Most poor people are not able to access financial services because of the lack of strong retail financial intermediaries. Building financially sustainable institutions is not an end in itself. It is the only way to reach significant scale and impact far beyond what donor agencies can fund. Sustainability is the ability of microfinance provider to cover all of its costs.
5. **Microfinance is about building permanent local financial institutions.** Building financial systems for the poor means building sound domestic financial intermediaries that can provide financial services to poor people on a permanent basis. Such institutions should be able to mobilize and recycle domestic savings, extend credit, and provide a range of services.
6. **Micro credit is not always the answer.** Micro-credit is not appropriate for everyone or every situation. The destitute and hungry that have no income or means of repayment need other forms of support before they can make use of loans. In many cases, small grants, infrastructure improvements, employment and training programs, and other non-financial services may be more appropriate tools for poverty alleviation. Wherever possible, such non-financial services should be coupled with building savings.
7. **Interest rate ceilings can damage poor people's access to financial services.** It costs much more to make many small loans than a few large loans. Unless micro-lenders can charge interest rates that ware well above average bank loan rates, they cannot cover their costs, and their growth and sustainability will be limited by the scarce and uncertain supply of subsidized funding. Micro lenders should not pass on operational inefficiencies to clients in the form of prices that are far higher than the need to be.

8. **The government's role is as an enabler, not as a direct provider of financial services.** National governments play an important role in setting a supportive policy environment that stimulates the development of financial services while protecting poor people's savings. The key things that government can do for microfinance are to maintain macroeconomic stability, avoid interest-rate caps, and refrain from distorting the market with unsustainable stability, high-delinquency loan programs. Governments can also support financial services for the poor by improving the business environment for entrepreneurs, clamping down on corruption, and improving access to markets and infrastructure.
9. **Donor subsidies should complement, not compete with private sector capital.** Donors should use appropriate grant, loan and equity instruments on a temporary basis to build the institutional capacity of financial of financial providers, develop supporting infrastructure and support experimental services and products. To be effective, donor funding must seek to integrate financial services for the poor into local financial markets; apply specialist expertise to the design and implementation of projects; require that financial institutions and other partners meet minimum performance standards as a condition for continued support; and plan for exit from the outset.
10. **The lack of institutional and human capacity is the key constraint.** Microfinance is a specialized filed that combines banking with social goals and capacity need to be build at all levels, from financial institutions through the regulatory and supervisory bodies and information systems, to government development entities and donor agencies.
11. **The importance of financial and outreach transparency.** Accurate, standardized, and comparable information on the financial and social performance of financial institutions providing services to the poor is imperative. Bank supervisors and regulators, donors, investors, and more importantly, the poor who are clients of microfinance need this information to adequately assess risk and returns.

## 2.3 History of Microfinance in Nepal

Microfinance is the category of financial services offered to lower-income people, where the unit size of the transaction is usually small ("micro"), typically lower than the average GDP per capita, although the exact definition varies by country. Starting in the 1970s, well known pioneers, such as Grameen Bank in Bangladesh and ACCION in Latin America, demonstrated that poor people can be creditworthy. With the untiring efforts of micro-credit practitioners for over 30 years in developing countries, micro-credit has received a global recognition today not only as a powerful instrument for poverty reduction and empowerment of women, but also a promising sector of financing for the banks, financial organizations and NGOs. Today, microfinance covers the full range of financial services-credit, savings, remittances, insurance, and leasing.

Formal microfinance emerged in Nepal in 1956 as cooperatives began to provide savings and micro-credit services to their members. Recognizing the larger need for microfinance services, the government soon became actively involved in promoting the sector. In 1974, Nepal Rastra Bank directed the then two state-owned commercial banks to invest at least five percent of their total deposits in small scale finance. Shortly after, the Agriculture Development Bank of Nepal launched the Small Farmers Development Project, which was the first to introduce the concept of group guarantee as an alternative to physical collateral in Nepal. During the 1990s, the number of microfinance providers operating in the country increased dramatically as local NGOs and microfinance development banks entered the market.

Presently, there are mainly three major types of microfinance institutions in Nepal: savings
and credit cooperatives, NGOs and microfinance development banks. Rather than providing direct financial services, these institutions facilitate the formation of small groups that generate internal resources through member savings and use the funds to make loans to members. NGOs occasionally provide seed money to the groups, but that is the extent of their financial support. The groups often disintegrate when the NGO programs that promoted them come to an end and cease to provide necessary training and technical assistance. Some however, are able to become sustainable and generally transform into savings and credit cooperatives. A small set of NGOs, forty-seven in all, are registered as financial intermediary NGOs and provide microfinance services to clients. Out of 70 development banks operating in operation, twelve of then are micro finance development banks. Of the 12 retail microfinance development

banks, five were initially promoted by the government in each of the development regions in Nepal, while the remaining was promoted by private individuals or institutions. The names and location of MFDBs are as follows:

- Eastern Grameen Bikas Bank Ltd., (Bittiya Sanstha), Biratnagar
- Far-Western Grameen Bikas Bank Ltd., (Bittiya Sanstha), Dhangadi
- Western Grameen Bikas Bank(Bittiya Sanstha), Butwal
- Mid-Western Grameen Bikas Bank Ltd., (Bittiya Sanstha), Nepalgunj
- Mid-Region Grameen Bikas Bank Ltd., (Bittiya Sanstha),Janakpur
- Nirdhan Utthan Bank Ltd., (Bittiya Sanstha), Bhairahawa
- Rural Microfinance Development Centre, Kathmandu
- Deprosc Development Bank Ltd.., (Bittiya Sanstha), Bharatpur
- Chhimek Bikas Bank Ltd., (Bittiya Sanstha), Hetauda
- Swabalamban Bikas Bank Ltd., (Bittiya Sanstha), Janakpur
- Sana Kisan Bikas Bank Ltd., (Bittiya Sanstha), Kathmandu
- NERUDE Bittiya Sanstha, Biratnagar

All microfinance institutions in Nepal provide credit and two types of savings services-mandatory and voluntary savings. Mandatory savings are collected as a condition for membership or access to credit. Most microfinance development banks offer between four and ten standardized loan products whereby clients move from cycle to cycle with increased loan amounts in every subsequent cycle. In the case of cooperatives and financial intermediary NGOs, the practice is also to start from smaller loans and move on to higher amounts, but loan products are generally not standardized. Micro finance development banks and cooperatives have recently introduced micro-insurance services, and a handful of microfinance institutions have started providing money transfer services as well.

## 2.4 Profile of Rural Micro finance Development Centre (RMDC)

The main topic of the thesis is focused on the performance of RMDC as a wholesale development bank; hence it will be relevant to include the profile of RMDC describing operation and activities of the same. As discussed in the preceding Chapter, there is growing demand of rural finance in Nepal, while the access to the same could not be met sufficiently. Although a number of microfinance institutions - formal, semiformal and informal - are operating indifferent parts of the country, they have not been able to run successfully in the absence of sufficient fund. To bridge this gap, the Rural Microfinance Development Centre Ltd (RMDC) was established as a wholesale microfinance institution in October l998 with the direct initiative of the central bank. Initially created for wholesale lending to the rural development banks and the two private rural microfinance development banks (CSD, Nirdhan), RMDC had to open to a larger clientele after coming into direct competition with commercial banks over the years. As such the Centre has been operating as an apex microfinance organization providing mainly, wholesale lending to retail microfinance institutions (MFIs). The MFIs receiving such facility consists of, microfinance development banks, savings and credit cooperatives (SACCOs) and financial intermediary NGOs (FINGOs) that provide microfinance services to the poor, the marginalized and the deprived people with main focus on women living below the poverty line. Apart from wholesale lending, the RMDC also supports these institutional strengthening and capacity building of member institutions.

RMDC came into operation in 2056.08.20. It is licensed, regulated and supervised by the by the central bank (Nepal Rastra Bank). Primarily it was registered as a public limited company under the Company Act with a mandate to function as a development bank as per the erstwhile Development Bank Act. Currently it operates within the framework of Bank and Financial Institutions Act, 2063 (BAFIA). It was set up as wholesale lender for retail microfinance institutions which are providing microfinance services to the poor, the marginalized and the deprived people with main focus on women living below the poverty line. Accordingly, the Centre's activities include: wholesale credit to and institution building of MFIs, training support to ultimate borrowers and database of MFIs. The partner organizations of RMDC include rural development banks, cooperatives and non-government organizations.

Some notable contributions of the Centre are as follows (Annual Report 2004-05 of Rural Microfinance Development Centre Ltd.)

- Role of an incubation centre for the microfinance industry. Most of its partner organizations have been developed from the scratch with technical and financial supports of RMDC.
- Institutional capacities of existing MFIs have been enhanced.
- FINGOs could have access to wholesale credit fund as per their need.

- Organizational capabilities and occupational skills of a large number of microfinance clients have been enhanced.
- The number of trained manpower in MFIs has increased.
- Partner organizations have become more professional than before.

RMDC was set up under the Rural Finance Project with the technical and financial assistance of the Asian Development Bank (ADB). By the end of F.Y. 2063/64, the number of its partner organizations (POs) has reached 58 in 47 districts. The POs include microfinance development banks, cooperatives and non-government organizations (NGOs). Out of the total loan approved amount of Rs. 23,287 lakh to 58 MFIs, RMDC has disbursed Rs., 1,94,37 lakh till the end of fiscal year 2063/64. The installment dues of all the loans had repaid on time by POS. Similarly, Rs. 11,350 lakh had remained as outstanding loans. The details of RMDC loan portfolio and the POs are presented in Annexure I. Apart from lending activities, the Centre helps its POs (including Gramin Banking replicators) in supporting institutional strengthening and capacity building. To sum up, the RMDC has played a pivotal role in the field of microfinance during a period of six years of its operation. Remarkably, the PSL is being phased out. This will lead to less supply of micro-credit services to the rural poor.

In the initial years, RMDC was financially supported by the Asian Development Bank (ADB). It was registered in under the Company Act 1996 with a mandate to operate as a development bank within the framework of the erstwhile Development Bank Act 1995. Currently, it is operating under the Bank and Financial Act.

### 2.4.1 Vision, Mission, and Goal

RMDC has set a vision to establish itself as a successful apex institution of microfinance that is financially viable and sustainable, operationally efficient and capable to establish a sound financial system that can cater to the needs of the majority of the deprived and disadvantaged families and thereby help contribute to the building up of poverty free self-reliant society in the country.

Similarly, the Centre has envisaged a mission is to reach a large number of the poor and deprived families in Nepal with appropriate microfinance services and capacity building supports to help them realize the huge potentials for self-development that are not tapped so far.

Having served more than 500 thousand poor families during the past seven years of its operation, RMDC has set a target of reaching 800,000 poor families with quality credit facilities through about 100 partner organizations by the end of 2008.

### 2.4.2 Objectives of RMDC

The main objective of RMDC is to improve the socio-economic condition of majority of the poor, the landless through increasing their access to institutional microfinance services for productive undertakings and employment. In this connection, the specific objectives of RMDC can be listed as follows:

- Provide wholesale funds to potential and viable microfinance institutions MFIs) for on-lending to the ultimate borrowers for undertaking their productive activities.
- Help build and strengthen the institutional capacity of (POs) in their efforts at providing access to resources for the poor.
- Promote financially viable and sustainable MFIs by providing necessary financial and technical supports to potential institutions.
- Develop and enforce appropriate accounting, auditing, and performance and reporting standards in all MFIs throughout the country.
- Assist the central bank and the government in formulating and establishing a policy and legal environment conducive for the promotion and the development of the microfinance industry in the country.
- Support or undertake studies and research works on aspects of appropriate and sound practices and products of microfinance.
- Assist POs to enhance their professional knowledge and sills on microfinance.
- Support, promote, develop, and identify employment opportunities and micro enterprises for the poor, the landless and the asset-less families, particularly the women.
- Play an effective role as an efficient financial intermediary to channel international and domestic resources to the grass-root institutions and to the poor.

### 2.4.3 Ownership Pattern, Equity and Funding

Currently, the authorized capital of RMDC is Rs 6400 lakh; issued capital is Rs 3200 lakh and paid-up capital of Rs 2500 lakh. Previously, the authorized capital of RMDC was NRs. 1600 lakh and the issued as well as the paid-up capital is NRs. 800 lakh. Its promoters and shareholders include: the Nepal Rastra Bank (the central bank), 13 commercial banks, 5 Regional Grameen Bikas Banks, the Deposit and Credit Guarantee Corporation Nirdhan Utthan Bank. The 13 commercial banks and the NRB hold 88.44 percent and 8.42 percent of the total paid-up capital of RMDC respectively. The promoters of RMDC and their respective shareholding pattern are given in the following Table.

**Table No. 1 – Promoter Shareholders of RMDC**

| S.N. | Promoters | Amount (Rs. in '000) | % of Total Share Capital |
|---|---|---|---|
| **1** | Nepal Rastra Bank | 2,10,45 | 8.42 |
| **2** | Nepal Investment Bank | 2,50,00 | 10.00 |
| **3** | Nabil Bank Ltd. | 3,75,00 | 15.00 |
| **4** | Nepal Bank Ltd. | 2,16,85 | 7.49 |
| **5** | Standard Chartered Bank Nepal Ltd. | 3,85,90 | 15.44 |
| **6** | Nepal SBI Bank Ltd. | 1,88,95 | 7.56 |
| **7** | Himalayan Bank Ltd. | 3,75,00 | 15.00 |
| **8** | Nepal Credit & Commerce Bank Ltd. | 51,95 | 2.08 |
| **9** | Rastriya Banijya Bank | 64,95 | 2.60 |
| **10** | Bank of Kathmandu Ltd. | 51,95 | 2.08 |
| **11** | Nepal Bangladesh Ltd. | 45,31 | 1.81 |
| **12** | Everest Bank Ltd. | 31,20 | 1.25 |
| **13** | Nepal Industrial & Commercial Bank Ltd. | 1,62,41 | 6.50 |
| **14** | Lumbini Bank Ltd. | 11,54 | 0.46 |
| **15** | Purbanchal Grameen Bikas Bank Ltd. | 8,00 | 0.32 |
| **16** | Madhyamanchal Grameen Bikas Bank Ltd. | 11,54 | 0.46 |
| **17** | Paschimanchal Grameen Bikas Bank Ltd. | 23,00 | 0.92 |
| **18** | Madhya Paschimanchal Grameen Bikas Bank Ltd. | 11,54 | 0.46 |
| **19** | Sudhur Paschimanchal Grameen Bikas Bank Ltd. | 8,00 | 0.32 |
| **20** | Deposit and Credit Guarantee Corporation | 10,00 | 0.40 |
| **21** | Nirdhan Utthan Bank | 8,00 | 0.32 |
| | **Total** | 25,00 | 100.00 |

RMDC received a loan of US$20 million from the ADB for on-lending to the target clientele and for extending institutional capacity building supports to MFIs and their clients under the Rural Microfinance Project RMP). The Project had been terminated on June 30, 2007. RMDC has still access to a loan of US$ 5.2 million fund under the ADB funded Community Livestock Development Project (CLDP) of which the Centre has been designated as the executing agency. Besides, it has received a grant of US$ 550,000 under the "Japan Fund for Poverty Reduction" (JFPR) Project. Apart from this the RMDC is also eligible to obtain the Deprived Sector Credit from the commercial banks as per the recent directives of the central bank, that could be a major source of fund for its regular lending program in the days to come.

### 2.4.4 Management

RMDC's management consists of three bodies, viz, the general body, the Board of Directors and the Audit Committee to run its managerial and financial affairs in a smooth, transparent and accountable manner. In this connection, the Centre fully adheres with the prevailing legal framework, which includes the BAFIA and the internal rules, regulations and bye-laws. They are described briefly. Similarly, the General Body, consist of 21 member promoters. It gives overall policy guidelines and directives for the efficient functioning of RMDC.

Currently the Board of Directors (BoD) of RMDC comprises five representatives from member banks. They include one representative from the Nepal Rastra Bank and four from the commercial banks representing other shareholders (Annex II). The BoD is the apex policy making body. It pursues and carries out the objectives of the Centre. The Chairman of the Board is elected from among the board members. The term of the BoD is four years.

As per the NRB Directive No. 6, an Audit Committee, under the coordination of a non-executive Director, has been constituted. The meeting allowances paid to the members of the Audit Committee is at par with the members of the Board of Directors. The main function of the Audit Committee is to analyse the internal and external audit reports. It also issues directives to the management on relevant issues and reports on policy matters to the Board along with recommendations and suggestions. The Audit Committee has been a very contributive body in maintaining financial discipline and internal control system within the Centre.

The day-to-day affair of RMDC is carried out by the Chief Executive Officer (CEO), who also heads the management. The CEO is assisted by a team of experienced and professional staff to carry out its activities in smooth manner. Remarkably, RMDC has maintained relatively low number of staff to attain cost effectiveness.

Remarkably, the Rural Microfinance Project carried out by RMDC had been awarded for exemplary contribution to improved project performance by the Asian Development Bank in 2001, 2002, 2004 and 2005.

### 2.4.5 Wholesale Credit to MFIs

RMDC has set clear-cut procedure on providing wholesale credit to MFIs for on-lending to the ultimate borrowers for viable off-farm and on-farm economic activities. Eligible MFIs are required to apply for loan with RMDC for loans by filling up loan application form (Annex IV). They are required to submit business plans and organizational documents including certificate of registration, governance and management structure, status of human resources, financial position reports, statements and other documents. Apart from this, they are required to submit their updated institutional profile to RMDC in stipulated form as shown in Annex V. Besides, RMDC has supported 160 institutions with various training activities. The details of institutions receiving such support are given in Annex VI. Such support has enhanced the capacity of the Pos to a remarkable extent. The status of Pos operations showing district covered, number of members, loan activities, etc is presented in Annex VII. The loan size, loan term and repayment schedule and determined and negotiated between RMDC and the borrower based on the business plan and institutional capacity of the latter.

### 2.4.6 RMDC'S Eligibility Criteria for Lending

RMDC has made its eligibility criteria more liberal as compared to the past for allowing a larger number of MFIs to avail wholesale credit. Institutions willing to borrow from the Centre should fulfil the following criteria. Accordingly, the MFI willing to obtain fund should have:

**i.** registered under an appropriate act and received a license for microfinance operation.

**ii.** minimum of one year experience in operating microfinance activities.

**iii.** savings balance at least as follows:

- 5 % of the loan outstanding in the 1st year,
- 10 % in the 2nd year,
- 15% in the 3rd year, and
- 20% in the 4th year and onward.

**iv.** attained minimum 90% loan recovery rate.

**v.** committed and dynamic executive committee.

**vi.** active and professional management.

**vii.** appropriate management information system.

**viii.** an appropriate business plan.

**ix.** adopted modern accounting system.

**x.** appropriate policies and procedures for implementing credit program, and its monitoring and evaluation.

**xi.** at least 50% active borrowers.

**xii.** at least 25% female borrowers.

**xiii.** minimum Rs. 250,000 financial resources.

**xiv.** minimum net-worth of Rs. 100,000.

**xv.** a trend towards self-sufficiency as per the last three years' financial position, and

**xvi.** audited its financial statements in time.

### 2.4.7 Features of RMDC's Credit Program

- Wholesale loan funds to all type of institutions-NGOs, savings and credit cooperatives or microfinance development banks (including rural development banks) for on-lending to their clients for productive activities.
- Annual interest rate on loans to MFIs was 6.5% in the FY 2003/04.
- Partner organization (PO) to repay its first loan within 1.5 years. The repayment period for the second loan to an MFI could be extended to 3 years and for the subsequent loans up to 5 years based on the previous repayment record of the MFI. First 6 months are considered as a grace period and

thereafter loan is to be paid in quarterly and half-yearly instalments. However, interest payments are to be made quarterly.

- Free from imposition on its POs regarding modality of operation and setting interest rate. But is suggests them to adopt the best practices and set an appropriate interest rate so as to meet operational and financial costs, and attain financial viability and sustainability over a reasonable period of time.

### 2.4.8 RMDC's Operational Approaches For Creation And Promotion Of New MFIs

**i.** Potential institutions (NGOs, cooperatives, banks) are identified looking at their profile, commitment for microfinance and experience.

**ii.** An exposure visit program is organized for executive committee members of the potential organization to allow them to study and observe best practices of microfinance.

**iii.** After the visit, the participating members of 8-10 organizations are invited to take part in a 3-day interactions program, which includes presentation of field visits from participants, discussions on major issues, essentials of microfinance and steps of implementing microfinance programs, and sessions on viability and sustainability of MFIs, setting appropriate interest rate, etc.

**iv.** One or two field staff of the MFI is provided with 2-month long on-site practical training on operational systems in one of the field offices of a successful MFI.

**v.** The interested MFIs' officials are trained on PRA/PWR methodologies, which they can use to assess problems and potentialities for implementing microfinance programs, and to identify poor households in their program area.

**vi.** A few officials of the MFIs are trained and provided with on-site guidance on preparing their institutions' 3-year business plans.

**vii.** MFIs are given on-site counselling on establishing appropriate operating systems (e.g. accounting, MIS, reporting, program monitoring and supervision, internal control mechanism, etc.) and conducting effective pre-group training.

**viii.** Regular on-site monitoring and supervision to the borrowing MFIs are undertaken in every 2-3 months.

**ix.** Monthly off-site monitoring of the borrowing MFIs are undertaken based on the monthly reports (containing outreach, portfolio, trial balance, and productivity data) received from them.

**x.** Special on-site technical assistance is given to an MFI as per its need and demand.

## 2.5 Government Policy on Microfinance

- In the beginning of the Tenth Plan (2002-2007) Nepal had 38 % of the total population (24 million) in the below poverty level, where people are living with less than Rs 4404/- equivalent to US$59 as annual income.
- Plan had a single target of "Poverty Reduction", where micro-finance has also been recognized as one important tool to achieve this target. Encouraged by the successful implementation of microfinance programs, the l0th plan had incorporated microfinance as a major tool to overcome its objective of poverty reduction. As such, the Plan has set out a number of policies and strategies. One remarkable aspect of this policy with regard to accessing financial services to the poor was the target of disbursing rural credit to the tune of Rs l0l billion during the Plan period. Out of the fund set aside, 50 percent is targeted to be disbursed through MFIs.
- Nepal Government Budget speech of various fiscal years has spelled out the announcement of a "National Micro Finance Policy" and the formulation of "Micro Finance Act" within FY 2005-06.
- The "National Micro Finance Policy" drafted by NRB, submitted to Nepal Government, is in the process of implementation.

## 2.6 Central Bank's Initiatives and Policies Towards Micro-finance

Nepal Rastra Bank has been playing a pivotal role in the promotion of micro-finance in Nepal from its very inception. The bank earmarked certain portion out of its net profit annually. The accumulated amount was transferred to the Cooperative Bank in 2019. Introduction of directed credit as stated earlier, formulation of banking branch policy for expanding banking services in rural sector, promotion of five rural development banks and one wholesale lending institution, licensing, regulation and supervision of MFIs, refinance policy can be cited as few examples of the central bank's initiatives towards promoting microfinance in Nepal. The main objectives and functions of Nepal Rastra Bank as mentioned in its Charter are: to promote banking and financial sector stability and liquidity; to regulate, inspect, supervise and monitor banking and financial system, and to promote public confidence by safeguarding the overall banking and financial system in the country. Similarly, the core functions of NRB includes to issue license to commercial banks and financial institutions to carry on banking and financial business; to regulate, inspect, supervise and monitor such transactions. The role of the central bank in terms of regulating and can be elaborated in the following points:

- Provision in Monetary Policy, Budget Speech and Financial Sector Reform Program.
- Introduction of Directive Credit: Priority Sector Lending (1974) followed by Deprived Sector Credit in 1990
- Promotion of supporting institutions: DICGC, APROSC.
- Setting up of separating department: Micro-finance Dept (previously Development Finance), BFIR Dept for regulation and FISD for supervision of MFIs.
- Direct involvement in various MF projects, PCRW, MCPW, TLDP, WTPAP, etc.
- Major equity participation in GBBBs and RMDC.
- Executing body for RSRF.
- Licensing Saving and Credit Coops for limited banking transaction.
- Licensing NGOs as financial intermediary.
- Refinance policy.
- Conducive and liberal licensing policies/regulations to MF sector development.
- Restructuring of GBBs (a five year plan to be completed by July 2007).
- Phasing out of PSL to be completed by mid-July 2007.
- BFIs licensed, regulated and supervised by NRB as at Ashad 2064 (Mid-July 2007):

**Table No. 2 – Number of BFIs at Ashad 2064**

| | |
|---|---|
| Commercial banks | 23 |
| Development Banks | 58 |
| Finance Companies | 79 |
| Micro-finance development banks | 12 |
| FINGOs | 47 |
| Saving and credit cooperatives | 16 |
| **Total** | **235** |

Out of 235 BFIs, the number of MFIs comprise of 75. The MFIs includes 5 Gramin banks, 7 micro-finance development banks, 47 FINGOs and 16 Cooperatives. The micro-finance development banks include two wholesale banks, namely, the RMDC and the SKBB.

## 2.7 Legal and Regulatory Framework for MFDBs

There are a number of laws that govern microfinance institutions, which refer to microfinance development banks, cooperatives, financial intermediary non-government organisations. These institutions at present are government by the following Acts:

- Nepal Rastra Bank Act, 2058
- Company Act 2063
- Bank and Financial Institutions Act 2063
- Societies Registration Act
- Cooperative Act, 2048
- Financial Intermediation Act, 2055

Financial Intermediary Act, 1998 (first amendment 2002) facilitates FINGOs for carrying out limited financial intermediation like small savings, micro-credit and agent banking. Previously, before the promulgation of the Bank and Financial Institutions Act 2063 there were separate legislations for commercial banks, development banks and finance companies. Provisions were made in those Acts as to operating micro-financing services. Currently, the Bank and Financial Institutions Act 2063 has the provisions for carrying out these services by A category institutions (commercial banks), B category institutions (development banks), and C category institutions (finance companies). Similarly, Clause 47 (4) of the Act has specified D category institutions licensed by NRB as micro-finance development bank. Clause 48 has categorically specified the operations that cannot be carried out by a licensed by NRB.

NRB has defined micro credit for an amount up to Rs. 60,000 per project and up to Rs. 1,50,000 for micro-enterprise loan. As the major microfinance service provides of Nepal, covering nearly 50 percent outreach, having presence in 47 districts, microfinance development banks are well regulated and supervised by the central banks for their financial soundness and sustainability from the very beginning. There used to be a separate regulation for MFDBs in the past. However, with the enforcement of the BAFIA all the BFIs licensed by the NRB had come into a single umbrella. Accordingly, a unified directive applicable to all BFIs including MFDBs is in place. NRB has given top priority for issuing license to MFDBs to be operated in rural areas. The regulatory frameworks for MFDBs, which are much more liberal as compared to other BFIs, are as follows:

- Minimum Paid-up capital requirement for establishing a MFDB, based on area of operation:
    - National level: Rs. 100 million
    - Regional level: Rs. 60 million
    - 4-10 districts (up to l5 districts including additional 5 hilly regions): Rs 20 million
    - 1-3 districts: Rs 10 million
- Submitting Feasibility Study while applying for setting up a MFDB has been waived. Submitting of the Business Plan is sufficient. Similarly, submission of one year's financial statement in case of institutional investor is sufficient.
- Limit of pre-operating expenses fixed as 2 percent of the paid-up capital
- Limit for promoters' stake
    - Minimum No. of promoters – l5
    - Shareholding pattern: minimum 51 percent and maximum of 70 percent by promoters, at least 30 percent to be floated to the public

shareholders (including maximum of 5 percent share to employees of the respective bank)
    - Public issue be made within 2 years of operation
- Provision for foreign stake holding
    - Open only to foreign institutional investors, no foreign individuals are allowed
    - Minimum of 20 percent and maximum of 85 percent holding
    - In the case of holding less than 50 percent share, the provision for allotting 30 percent share should be floated to public
    - In the case of holding more than 50 percent share, a minimum of l5 percent share should be floated to the public (out of which maximum of 5 percent share to the employees of respective bank can be allotted)
- Limit of individual (firm, family, group, houses, company falling in the same group) shareholding: 25 percent
- Fit and proper test for appointment of promoter, CEO, director of the MFDB stipulated in the licensing policy
- Capital Fund and Core Capital adequacy requirements: 8 percent and 4 percent of risk weighted asset respectively.
- Loan classification and loan loss provision: Good, Substandard, Doubtful and Bad. Loan loss provision of 1 percent, 25 percent, 50 percent and 100 percent respectively
- Limit of micro-credit and micro-enterprise loan: Rs 60,000 and Rs 1,50,000 per project respectively
- Limit of micro-enterprise loan: 25 percent of the total loan portfolio
- Can carry out inward remittance by obtaining prior approval
- CRR: Minimum 0.5 percent of saving and borrowing
- Liquidity: Minimum 2.5 percent of deposit (from members only) liabilities
- Limit of financial resource mobilization: 30 times of core capital (can accept deposit only from members)
- Determining of interest on flat rate allowed; publishing of interest rate in newspapers not necessary
- Shares invested in MFDBs by commercial banks treated as loan disbursed on deprived sector

- Director of licensed BFI allowed to serve as Patron or Advisor of a MFDB
- More than one director from a single family, firm or group allowed in the Board
- Autonomy in opening, closing, transferring or merging of branches within the stipulated area by the MFDB without NRB approval
- CAMELS rating not mandatory in supervision of MFDBs

As a move towards availing the micro-credit facility in the context of phasing out of the priority sector lending from 2007, development banks have also been directed to disburse at least l percent of their total loan portfolio from mid-July 2007. The regulation as to allocating deprived sector credit by the commercial banks is already in place.

Apart from the above, the Monetary Policy for F.Y. 2064/65 has envisaged various programs on micro-finance to extend such facilities to the needy. A few prominent among them are as follows: the followed program on micro-finance.

- Provision of mandatory disbursement of deprived sector credit as 3 percent of the total loan portfolio by commercial banks. Such provision to be made in the case of development banks and financial institutions also from FY 2064/65, with a view to access fund to MFIs.
- The limit of micro-finance credit (single borrower limit) extended to Rs 60,000 for general loan without collateral and Rs 150,000 for micro-enterprise loan backed by physical collateral, from Rs 40,000 and Rs 1,00,000 respectively.
- The requirement to maintain an additional 20 percent loan loss provision for loans disbursed by MFIs without collateral has been waived.
- Formulation of micro-finance policy covering microfinance institutions like cooperatives, NGOs on the basis of mapping of the status of such institutions.
- Formation of a specialized regulatory and supervisory institution for MFIs
- The draft "Rural Self-Reliance Fund Act designed to convert NRB operated RSRF into a wholesale financial institution will be amended and submitted to the GoN for enactment.

- A line of credit will be made available to those cooperatives that have been borrowing from RSRF with an objective of extending micro-credit facility to the deprived and poor families living in the far-remote areas of the country.
- Micro-credit development banks can expand their areas of operation by one more additional adjoining district with an incremental paid-up capital of Rs 25 Lakh. This provision is intended to expand the financial services in rural areas.
- A production credit arrangement will be made for the farmers obtaining renewable energy (solar energy, biogas, micro-hydropower, etc) credit from the RSRF through cooperatives.
- Although the CGISP has been phased out on July 31, 2007 the credit disbursement will be continued through RSRF to install shallow tube well.
- A separate fund is necessary to make share investment in MFIs which will increase their leverage of borrowing from BFIs. Necessary provisions will be made whereby interested national and international organisations and companies can contribute money to the fund.
- Encouragement in re-establishing replaced bank branches
- The share in the Western and the Eastern Rural Development Banks have already been sold to the private sector, with a view to comply with the NRB Act 2058. NRB's share ownership in the Central Rural Development Bank will be divested to the private sector in 2064/65. Further due diligence audit (DDA) of other rural development banks will be carried out in the process of their privatisation.
- With a view to expand financial services in rural and backward areas, a financial institution can be opened in those areas with a paid-up capital of Rs 1 Crore.

## 2.8 Microfinance Models in Nepal

At present, there are seven models of micro finance in the organized sector known as formal sector's micro finance model. They are as follows:

1. **Grameen Model:** As per this model a small group of 5 people is formed and loans are advanced under group guarantee and without any collateral. Rural Micro Finance Institutions are actively involved in this model. Amongst rural financial institutions, 5 Grameen Banks, established as a regional rural

development bank in 5 development regions of the country and operating on the Grameen system of Bangladesh, are the largest MF operators in Nepal. This concept was introduced in 1992. These banks are operating in 47 districts covering 744 VDCs. By mid July 2007, the loan disbursement by these gramin banks has reached Rs. 16,18,40 lakh to 17,46,64 women borrowers (of which Rs 1,77,10 lakh stand as outstanding amount), covering 36,860 group through 5223 centres. Besides, there are seven micro finance development banks in private sector, operating as per the Grameen Banking model. They are operating in 46 districts covering more than 1200 VDCs. These banks have disbursed a micro credit of Rs. 9,94,30 lakh of which Rs 4,00,96 lakh stand as outstanding loan by the same period.

2. **Small Farmers Co-operative Model (SFCL):** SFCL is newly developed financing concept on co-operative, initiated by Agricultural Development Bank of Nepal (ADB/N). SFCL model is converged from of the 3 decade-old Small Farmer Development Project of the bank under the policy adopted by ADB/N. To meet the wholesale credit requirement of SFCLs for on lending to small farmers, ADB/N has also set-up an organization called Small Farmers' Development Bank (SFDB). The main objective of the SFCL transformation was to make such institutions a viable and sustainable MFI that would be managed and administered by the members themselves. SFCL model has been honored internationally by many international agencies like IFAD and CGAP. By mid July 2006, these cooperatives have disbursed a sum of Rs. 100 lakh to its members.

3. **FINGOs Model:** This is the latest development in micro-finance practices. It is believed that more than 10,000 unregistered NGOs are operating in the country either in micro-finance or in social and community based development. FINGO Act is the first ever formulated law for the NGOs operating in micro-finance sector. So far, 47 FINGOs are licensed by NRB while 53 are associated with RSRF.

4. **Priority Sector and Deprived Sector Credit Model:** Commercial Banks, both public as well as private have been involved in micro finance since 1974

through the mandatory credit requirement as put by the NRB. This mandatory requirement is called Priority Sector Lending (PSL). As a part of PSL, the Deprived Sector Credit Program was introduced in 1991. Both schemes, PSL and DSC have provision of direct and indirect financing facilities. The priority sector lending modality is regarded as the central bank's commitment in rural finance- finance for the rural development. Since mid July 2007, the PSL had been completely phased out. However, the deprived sector lending is still mandatory for the commercial banks. Additionally, provision has been made for mandatory investment of at least 1 % of the total loan portfolio by the development banks effective from mid July 2007 in view of the phasing out of the priority sector lending.

5. **Savings and Credit Co-operatives Model:** Co-operative model of financing has long history in Nepal. This is a member-based organization, registered with the objectives of self-help development among members. As of Mid-July 2007, there are 9,720 co-operatives registered with the Department of Co-operatives of which 3392 are savings and credit co-operatives. Such cooperatives provide micro-finance services to their members for running various income-generating activities. The Co-operative Act 1998 governs co-operative societies. Out of 3392 saving and credit cooperatives, 16 are licensed by NRB while 252 are associated with RSRF.

6. **Donor Supported Micro-Credit Programs** (Project-based)**:** In addition to the above mentioned micro finance models, there are six major donor-funded micro-credit programs:
   i) **Production Credit for Rural Women (PCRW):** The first micro-credit project known as PCRW was initiated in 1982 and completed in 1997 under two phases in 35 districts. The PCRW, supported by IFAD was carried out by NBL, RBB, and ADB/N in 35 districts.
   ii) **Micro-Credit Project for Women (MCPW):** This project was started in 1993 as a supplementary to PCRW, with ADB-Manila loan assistance in 42 districts by NBL and RBB. It was completed on June 30, 2002.

iii) **Poverty Alleviation Project in Western Terai (PAPWT):** Funded by IFAD in 1997 the project was carried out by five partner institutions in 8 districts. It was completed on December 2004. A total of 21,000 families have been benefited with this project.

iv) **Third Livestock Development Project (TLDP):** To improve the quality of livestock and its production along with other livestock related development, TLDP was initiated in the year 1997 and completed in 2004. This project was carried out by 19 institutions comprising of commercial banks, development banks, Grameen banks, cooperatives and NGOs in 19 districts. A total of 9773 families have been benefited with this project.

v) **Community Ground Water Irrigation Sector Project (CGISP):** With the basic objective of increasing agriculture productivity of marginal and small farmers through community-based sallow-tube well irrigation system, Nepal Government has introduced CGISP in 12 districts of eastern and central Terai in March 1999. There are 8 partner institutions involved in this project. They comprise of NBL, Grameen banks and cooperatives. It is estimated that 21,262 families had been benefited with this project.

vi) **Rural Micro-finance Project (RMP):** Funded by the Asian Development Bank, this project facilitated the establishment of RMDC as a wholesale financing institution.

7. **Wholesale Micro-financing Model:** The basic objective of creating wholesale institution is to make MFIs easier and continued access to cheaper fund. Wholesaling in micro-finance began with the establishment of Rural Self-Reliance Fund (RSRF) in 1991. The RSRF, having a fund of nearly Rs 35 Crore (Rs 9 Crore as seed capital from the government and Rs 25.34 Crore earmarked out of the net profit of Nepal Rastra Bank) has disbursed wholesale loan of Rs. 16,15 lakh to 53 NGOs and 252 cooperatives spread over 49 districts by Poush 2064. Later in 2000 RMDC, under the Rural Micro-finance Project (RMP) came into existence with the initiative of the central bank to cater the credit need of MFIs for on-lending purposes. RMDC has disbursed loan of Rs. 1,94,37 lakh by mid-July 2007 to 58 partner institutions. In the year 2002, another wholesaling micro-finance institution called Sana Kisan Bikas Bank (SKBB) also established to supply wholesale credit to SFCLs. As

of 2063 Asar (mid-July 2006), a total of 1,17,094 members (18,365 number of small farmers group) are associated with 228 SFCLs in the country. About 139 SFCLs have already been associated with SKBB for on-lending to the small farmers. The SKBB has disbursed a sum of Rs. 1,46,10 lakh by 2064 Chaitra (mid-April 2007. Additionally, the National Cooperative Development Bank had also been registered in 2003 as a wholesale institution for cooperatives.

## 2.9 Review of articles and studies

1. **Santosh Acharya** in his article published on "Spotlight" (10 Sep 1999) presents the SWOT Analysis on Micro Credit Project for Women (MCPW) in Dang District. MCPW is the second women focused credit program launched by the government. The main objective of MCPW is to uplift socio-economic status of marginalized women by facilitating them with small-scale credit, to carry out income generation activities. This article tries to analyse Strength, Weakness, Opportunity and Threat of MCPW in mid-western district of Dang.

**Strength:** It has played an impressive role to make women realize their potential as the borrowers of credit Majority of women reported that they have noticed some positive changes in the behaviour of their husbands or male members of the family due to the reason that women are given respect by the government by offering them loan without offering physical collateral. In the case of beneficiaries organized by Human Welfare and Protection Centre (HWEPC), a local NGO, in Narayanpur V.D.C., women were found to be disciplined with the group spirit and very conscious to repay the loan in time.

**Weaknesses:** The majority of borrowers do not know what the MCPW means and had no idea about MCPW's objective "Socio-Economic empowerment of women". The majority of borrowers do not know the repayment schedule, the interest rate charged and some of them even do not know what is repaid and what is due. The sample taken from HWEPC, Chetana Club, and Nepal Mahila Samudayik Sewa Kendra showed that about 30 percent women did not belong to real target beneficiaries. NGOs seem to be concentrated mainly in the administrative procedures of loan administration.

**Opportunities:** Majority of women (about 90 percent) seemed to be well supported and encouraged by their husbands and this is one of the great opportunities for women. Majority of people living in rural areas still depend upon from informal sectors such as land lords, businessmen, moneylenders. The rural poor are highly exploited by such lenders. So, program like MCPW possesses high chance to grow in terms of the outreach in the rural areas of Nepal.

**Threats:** Very low status of skill training in the case of women organized by NGOs is the major threat challenging in the high productivity performance by women. Very poor insurance facilities can be major threat discouraging women not to carry out livestock production as their activity. Majority of women do not know about the premium of insurance whether it is charged annually or whether it covers the total period until loan is repaid. Although the NGOs were highly encouraged at the beginning of MCPW program but at present they seem to be loosing interest.

The research can be concluded that although there is good progress in terms of social empowerment there is still a lot to be done to consolidate economic progress and to ensure economic empowerment of the majority of poor women.

**2. Lila Prakash Sitaula** in his paper entitled "The Supervisory Framework for Microfinance in Nepal" (2000) has presented financial performance of Eastern Rural Development Bank (ERDB). The objectives highlights, Policies and procedures of ERDB, Operation of ERDB, Performance of ERDB, Success and Constraints of MFIs (ERDB)

**Findings:** ERDB is one of the successful replicas in Nepal in terms of outreach of operation and program. As of mid-July 1999 ERDB was providing services to 39,132 active borrowers by 38 branch offices and 7 area offices whereas the total number of members was 39,717 federated in 1,158 centre and 8,426 groups. During the period of 1$^{st}$ 7 years, the total loan disbursement and repayment was USD 19.67 million and USD 16.48 million respectively. During that period, the total group fund saving was USD 1.13 million and operation income and expenses was recorded USD 568 thousand and USD 676 thousand respectively. The repayment rate of this bank is 98 percent approximately which is very high.

There have been tremendous opportunities in the Terai. The ERDB also has to face some constraints like government intervention in decision making process and politicization of the program, complex working procedures from establishment to disbursement, lack of enough resources.

**Conclusion:** The ERDB has always been inspired by the guiding principle of Grameen that the poverty existing in the country can be alleviated with the mobilization, in an organized manner and with the inputs of capital, of the productive human resources in the deprived society. Furthermore, it is very difficult to adopt the proper regulations and supervision approach and methodology for MFIs because of their unique characteristics. However, an appropriate regulatory environment is absolutely necessary condition for creating a conducive and healthy micro finance practices.

**3. Micro-Finance Information Exchange Inc. (MIX)** has conducted a survey of microfinance in South Asia (2006). The research was initiated and funded by the World Bank and by the Consultative Group to Assist the Poor (CGAP). This report looks at MFI performance in six South Asian countries including Nepal.

**Objective:**

- Performance analysis of microfinance institutions in South Asian region.
- To highlight the work of the national networks and the challenges that they face in supporting transparency in their local environments.

**The Methodology** used in this study includes:

- Date collected by local microfinance institutions and surveyed the local transparency environment.
- Sample from 125 institutions from across South Asia and is compared with the rest of the MIX Market's public database on nearly 600 microfinance services providers worldwide.
- Industry reporting standards to survey institutional performance in South-Asia and to highlight drivers of that performance.

**Findings:** The Nepalese microfinance sector has reached one third of estimated demand for microfinance services and has built on external borrowings and client deposits to fund a steadily growing loan portfolio. Despite its high leverage, the sector continues to fall short of demand, micro finance supply grew significantly over the last decade and reached nearly 7,00,000 clients by 2003. Of the overall 7,00,000 clients reached by the sector, the institutions in the sample served 190,000 clients representing one third of total outreach in Nepal. The sample MFIs managed over USD 17 million in loans outstanding, covering almost one third of the USD 62 million in total loans outstanding. Most MFIs cover costs before taxes irrespective of institutional type. There is very little variation in operational self-sufficiency which is over 100 percent for all MFIs but one-CBB (97 percent). Nepalese MFIs serve fewer borrowers than the average South Asian MFI-152 compared to 219 but their productivity exceeds that of other regions.

As a developing country with difficult topography and a large portion of people living below the poverty line, it has always been a matter of serious concern for the government as well as the donors to uplift the social and economic standard of these people. For this purpose financial services have to be accessed to these sectors. Hence there had been few research and surveys in the past to find out the position of access to microfinance from time to time. The first survey of such kind being the Agriculture Credit Survey in l969/70 by NRB. It was followed by the second and third ones in l976/77 and l991/92 respectively. Apart from these, other institutions and NGOs also conducted such research in limited extent for their own purpose. The survey results prompted the policy makers of the government and the central bank to formulate programs, plans and policies relating to microfinance and MFIs over the years. The concept of wholesale MFIs like RSR, RMDC and SKBB also emerged as a result of the studies in the past.

**4.** Nobel laureate and founder of Bangladesh's Grameen Bank, Muhammad Yunus has stressed on social business to purge poverty. In his words, "Instead of spending money sponsoring football and cricket matches and concerts, public relations activities or charities in the name of social responsibilities, companies can actually help change the world n freeing it up from poverty by investing in social businesses that will run like proper businesses with a social cause. By simply putting away part of the proceeds, the large corporate could provide social services to the people that won't harm their growth. In turn, this will help the societies move ahead." The Grameen Bank with repayment rate of 99 percent, has disbursed microcredit to the tune of US$ 5.1 billion to 5.3 million borrowers. (The Himalayan Times, Perspectives, April 20, 2008)

**5. Surveys by NRB**

The Nepal Rastra Bank had conducted three surveys as to finding out the position of access to rural finance. In this connection, the first Agriculture Credit Survey conducted in 1969/70 showed that only l8 percent rural people received credit. Similarly, the second Agriculture Credit Review Survey l976/77 came out with 24 percent on the same. It is also noteworthy that the Rural Credit Survey l991/92 conducted by Nepal Rastra Bank showed that only 20 percent households received credit facility from formal sector, while 6 percent received credit both from formal and informal sector. Hence conclusion can be drawn that large number of rural people still rely on informal sector, i.e. moneylenders, friends and relatives despite the fact hat there has been substantial increase of formal financial institutions. It is evident that these institutions, mostly located in urban areas, have not been able to reach the poor to a substantial extent.

**6. Study by World Bank**

A survey on Access to Financial Services in Nepal was carried out by World Bank in 2006/07. The study led by Ms Aurora Ferrari completed the survey. For this purpose, l800 households across 60 districts were taken as sample. The sample was stratified into three main category namely locations (urban or rural), administrative region (five) east, mid, west, mid-west and far west) and agro-climatic region (Terai, Hills and Mountains). The conclusion of the study can be listed as follows:

- Despite the presence of large number of banks and financial institutions, financial services in Nepal have been limited for many people in many parts of Nepal and in recent years declining despite government efforts. In other words, a large portion of deprived sector does not have access to financial services.
- Banks serve mainly urban areas and the wealthiest

- Microfinance development banks and Gramin banks serve rural poor (not the poorest)
- FINGOs and cooperatives main provides for everybody in rural areas and large provider for the country
- Competition from informal sector for lending is fierce even for wealthiest households with bank accounts.
- Financial access to poor and backward regions is a challenge for the financial system even though it is expanding over the years.
- Red tape in acquiring financial services keeps consumers away from banks. Formal sector is too slow, bureaucratic and requires extraordinarily high level of collateral
- While the banks serve mainly the urban areas, rural area and poor section of the society largely depends upon informal sources of financing.
- Only 26 percent Nepalese has bank accounts
- 27 percent of the Nepalese population have access to commercial banks, 24 percent in other financial institutions, 28 percent in informal sector, while 20 percent do not have access to finance at all(Aurora Ferrari with Guillemette Jaffrin and Sabin Raj Shrestha, Access to Financial Services in Nepal, March 19, 2007).

The conclusions of the World Bank's study was criticised by some bankers on the ground that the sample selected for study did not represent true picture on access to finance. They also criticise the finding that collateral is needed to get rural finance, since the microfinance development banks provide microcredit on group guarantee, without any collateral(Nepal Samacharpatra, 2063.12.10)

## 2.10 Review of Thesis/Dissertation

**1. Role of NGOs in Micro-Credit program issues of reaching the poor women and sustainability of these organizations. (A case study of the MCPW in Nepal) -Sangita Thapa (2001)**

This study tries to analyse on socio-economic empowerment of the MCPW women beneficiaries. It examines the central goal of the MCPW that has to develop the NGOs into" an alternative financial system that will provide affordable and accessible financial services to disadvantaged women in a sustainable manner. It also critically examines overall impact of project on socio-economic empowerment of the most under privileged women in the country.

From the study it is concluded that MCPW project and especially its NGO component is a major break-through in Nepal. It is not only an initiative from which new models of micro credit delivery will stem but also a unique opportunity to test new models of co-operation between the NGO sector and the government. Poor women are difficult to reach but not impossible. Policy environment and regulatory system should be conducive. Access to credit is proved as a powerful tool to raise income for the poor. NGO could be an effective mechanism reaching the vast majority of the poor people. Effective monitoring and supervision mechanism is necessary to establish. Regarding the NGOs sustainability the study revealed that considering the limited institutional capacities of local NGOs they are not sufficiently strengthened to operate as Financial Intermediary. They lack skill and abilities in credit management activities. More over, the financial services sector can be very unforgiving to even the most professional managers. For organization such as NGOs that are rooted in values of social justice and equity, the successful management of savings and credit programs can be very difficult.

**2. Financial Performance of Micro-finance institutions and the women economic empowerment in Nepal. (A case study of Mahila Prayash Bachat Tatha Rindh Sahakari Sanstha Ltd. And Panchakanya Mahila Bikas Bachat Tatha Rina Sahakari Sanstha Ltd.) -Smriti Kharel (2008)**

This research study deals with the case study of MPBRS, Dhumbarahi and PMBRS, Baluwatar. It analyzes the financial performance of these two MFIs, to access the female entrepreneurship, to access the empowerment of women in the selected program and its impact on the life style of the members. From the study it is found that MPBRS financial performance is better in comparison to PMBRS. But the membership percentage is in increasing order for both MFIs and that's a good sign. Also, there has been increasing trend of women to involve in business. Confidence level of members of both the MFIs has increased and as a result they are able to develop their communication skills, do something for their livelihood and as a result there's a upliftment in their socio-economic status. Thus, micro finance is a powerful tool for poverty alleviation and empowerment of women. MPBRS and PMBRS both move towards it.

**3. The role of Grameen Bikas Bank in alleviation of poverty ( A case study of Purbanchal Grameen Bikas Bank) – Bijay Ram Acharya(2000)**

The research was taken up to find out the changes in financial condition of women before and after participation in the program of Grameen Bikas Bank, to analyze the financial position of PGBB over the period of 5 years. And from the study it was concluded that borrowed loan significantly diverted the rural women from traditional sector to non-traditional sector. Income level of borrower has been raised, satisfactory increment in self-employment, motivation of people towards bank is positive. Women become conscious in their socio-economic status and hence, there have been positive changes in their life style.

**4. Impact of micro finance on women empowerment (A case study of micro finance project of Dhaulagiri Zone) – Arpan Poudel (2007)**

This research study deal with what kind of socio-economic impact does micro finance programs have on rural women of Dhaulagiri zone through Nepal Educational and Social Development Organization (NESDO), a popular NGO in Parvat. It also analyzes the political impact of MF project on rural women in operational areas of NESDO. From the study it is shown that micro finance programs are creating positive impacts on rural women and as a result women are encouraged, forced and facilitated to become self-dependent. They have been quite active and trying to set their own status, taking part in various social as well as family decisional aspects. Thus, microfinance program is a desirable and effective tool to empower the women on rural areas.

# Chapter III

# RESEARCH METHODOLOGY

## 3.1 Introduction

Appropriate research methodology is required for any type of research work. "Research methodology refers to the various sequential steps to be adopted by a researcher in studying a problem with certain objectives in view." (Kothari C. R., Research Methodology: Method and Technique, p 10)

In other words, research methodology describes methods and processes applied in the entire part of the study. One of the major objectives of this study is to analyze, examine, highlight and interpret the financial as well as statistical tools to analyze the data in order to reach a conclusion. Financial analysis helps the judgment about the operating performance of financial position while trends of position can be ascertained through the use of statistical data presented through diagrams and other tools.

In the earlier chapters, background on development of microfinance in Nepal and the role of RMDC as a wholesale financing institution have been highlighted. Similarly, the review of literature with possible reviews of relevant books, articles, thesis and research findings have also been discussed. This has equipped the researcher with the inputs necessary for the study and helped to select the appropriate research methodology to support the study in realistic terms with sound empirical analysis.

This chapter deals with the research design, nature and sources of data, data collection procedure and tools and technique of analysis. The study follows the research methodology as described below.

## 3.2 Research Design

A research design is the arrangement of conditions for collection and analysis of data that aims to combine relevance to the objective of research with simplicity. Research design is the plan, structure and strategy of investigation conceived so as to obtain answers to research questions. Research design includes definite procedures and technique which guide to sufficient way for analyzing and evaluating the study. To achieve the objective of this study, descriptive and analytical research design has been used.

Some financial and **statistical tool** has also been applied to examine facts and descriptive techniques have been adopted to evaluate the performance of RMDC as an apex wholesale lending institution for micro-finance institutions. For this purpose only the ratios that are relevant and that serves the purpose of the study has been used.

## 3.3 Sources of Information and Data

The study is conducted mainly on the basis of the secondary data. The data required for the analysis are directly obtained from financial statements and annual reports of RMDC. Supplementary data and information are collected from number of institutions and regulating authorities like NRB, budget speeches of Nepal government and brochures on microfinance institutions.

It is worthwhile to mention that though a financial institution, the RMDC does not mobilize any kind of deposits, neither from the public, nor from its member organisations. In fact, public deposit collection has not been allowed so far to the MFDBs. As a wholesale institution for financing the MFIs, it mobilizes funds from its equity, borrowings, grants, etc. So for computing purpose, the deposit side has been ignored.

All the secondary data are compiled, processed and tabulated in time series basis. Formal and informal talks with the concerned authorities of the bank were also helpful to obtain the additional information of the related problem. Due to lack of time and resources, the partner organisations of RMDC which consist of 58 located in various parts of the country could not be visited. However, sufficient data on those organisations for analysis purpose was available.

Likewise, data and information are collected from the economic journals, periodicals, bulletins, magazines and other published reports and documents from various sources.

## 3.4 Populations and Sample

There are more than one wholesale institution for microfinance in Nepal, i.e., Rural Self Reliance Fund, Small Farmer Development Bank and the RMDC. However, RMDC has been selected as the sample for the purpose of this research study since it is the apex institution with wide coverage of services. In view of the nature of the study, comparative performance has been analysed for the period of five years. No comparison with other institutions has been made.

## 3.5 Method of Analysis

Financial statement of RMDC over the period of five years has been analyzed. Financial statement analysis is a process of evaluating the relationship between components/parts of financial statement to obtain a better understanding of firm's position and performance. It is designed to determine the relative strength and weakness of a company whether the firm is financially sound and profitable and whether its position is improving or deteriorating over the time. Apart from this, management aspects of RMDC has also been analysed for the purpose of evaluating the strength of the management.

In this study, various financial, accounting and statistical tool have been applied to achieve the objective of the study. The analysis of data will be done according to the pattern of data available. The financial tools have been used with respect to the directives issued by the central bank is studied. The hidden facts put forth by financial statements will be analyzed using financial tools such as ratio analysis as shown below:

## 3.6 Ratio Analysis

"Ratio analysis is a part of the whole process of analysis of financial statements of any business or industrial concern especially to take output and credit decisions" (Kothari, K.C. "Quantitative Techniques",1984). Ratio analysis is a technique of analysis and interpretation of financial statement. Thus, ratio analysis is used to compare a firm's financial performance and status to that of other firm's or to itself overtime. The qualitative judgment regarding financial performance of a firm can be done with the help of ratio analysis.

Even though there are many ratios, only those ratios which are related to the performance of RMDC have been covered in this study. "Ratio analysis is one of the most frequently used tools to evaluate the financial health, operating result and growth. Financial ratios by themselves do not indicate position of the institution. A standard or norms is needed against which to judge them". It is powerful tool of financial analysis." A ratio is defined as the indicated quotient of two mathematical expressions and as relationship between two or more things" (Webster's New Collegiate Dictionary, 1975, P.958). To achieve results for the study of this research paper, various ratios have been studied. They are briefly described in the following paragraphs

### 3.6.1 Liquidity Ratios

Liquidity ratios are used to judge the ability of bank and financial institution to meet its short-term liabilities that are likely to mature in this short period. From them, much insight can be obtained into present cash solvency of the bank and its ability to remain solvent in the event of adversities. It is a means for measurement of speed with a bank's assets can be converted into cash to meet deposit withdrawal and other current obligations. "Liquidity is the ability to meet anticipated and contingent cash needs. Cash needs arise from deposit withdrawals; liability maturity and loan disbursals (new loans and the draw down of outstanding lending commitments). Cash needs are met by increase in deposit and borrowing, loan repayment, investment maturity and the sale of assets"( Scott David, Assets and Liabilities Management, Banking Institutions in the Development Markets, Vol 1, p-140)

Banks and financial institutions need liquidity to meet loan demand and deposit withdraws. Liquidity is needed also for the purpose of meeting cash reserve ratio (CRR) and statutory liquidity ratio requirements prescribed by the Central bank. The following ratios are calculated under the liquidity ratios:

#### 3.6.1.1 Cash and Bank Balance to Borrowing Ratio

This ratio is applied to measure whether bank and cash balance is sufficient to cover unexpected demand made by borrower in the event of unforeseen reasons. Cash and bank balance includes cash in hand, cash at bank, foreign currencies held with the bank and other cash items held in different financial institutions. Similarly, total borrowing includes borrowings from banks and financial institutions. It is calculated by dividing cash and bank balance by total borrowings.

$$\text{Cash and bank balance to borrowing ratio} = \frac{\text{Cash and bank balance}}{\textit{Borrowing}}$$

Higher ratio shows higher liquidity and ability to cover borrowings and vice-versa.

### 3.6.2 Activity/Turnover/Utilization Ratio:

Activity ratios are concerned with measuring the efficiency in assets management. Some time, these ratios are called efficiency ratios or assets utilization or turnover ratio. Because they indicate the speed with which assets are converted or turned over into sales.

Activity ratios are employed to evaluate the efficiency which the firm manages and utilizes its assets. The ratio indicates whether the funds employed have been used efficiently in the business activity or not. Following ratio is used under activity ratio:

#### 3.6.2.1 Loans and Advances to Total Borrowing Ratio

This ratio shows whether the banks and financial institutions are efficient to utilize the borrowings from various sources for the purpose of profit generation on the loans and advance thus provided. In other words, this ratio states to what extent the firms are able to utilize the depositor’s fund to earn profit by loans and advances.

Generally higher ratio reflects higher efficiency in utilizing borrowings and vice-versa. This ratio can be computed by dividing the total amounts of loans and advance by borrowings.

$$\text{Loans and advance to total borrowing ratio} = \frac{\textit{Loans and advance}}{\textit{Total borrowings}}$$

Here, loans and advance refers to the total amount of loan and advance disbursed to partner organizations.

### 3.6.3 Leverage/Capital Structure Ratio:

The long-term creditors would judge the soundness of a firm on the basis of long-term financial strength measured in terms of its ability to pay the interest regularly as well as repaying the instalment of the principal on due dates. It represents the long- term solvency of a firm. According to this, long-term creditors calculate what portion constitutes the equity and borrowed finds in total capital of a firm. This ratio can be calculated from the balance sheet of a firm. Creditors are hesitant in supporting the firm if equity/owner's portion is less than the borrowed fund in capital structure of a firm. This ratio highlights the long-term financial health, debt servicing capacity and strength and weakness of the firm. There are different ratios, which justify the long-term financial solvency of a firm. The related leverage ratios are:

### 3.6.3.1 Debt to Net Worth Ratio:

This ratio reflects the relationship between borrowed funds and owner's capital. It refers to the relative proportion of debt and equity in financing the assets of a firm. The relationship between outsider's claims and owner's capital can be shown in different funds invested by the owners. So, it is the test of the financial strength of the Company. It can be computed by dividing total debt by total equity.

$$\text{Total debts to equity ratio} = \frac{Total\ debt}{Total\ equity\ (NetWorth)}$$

A total debt refers to all deposits, bills payable, borrowing from other bank and other liabilities. Total equity refers to paid up capital, reserve and surplus and undistributed profit.

Simply high debt to equity ratio is not considered to be favourable for the firm. Because creditors have more claim on the company. They should be paid interest as principal at due time by the firm. So if a firm raises excess debt, company's cash out flow exceeds the cash inflow. If the firm is for some time unable to pay interest, the creditors can take legal action on the firm, due to which the firm may reach liquidation.

On the other hand, very low debt equity ratio is also unfavourable from the shareholders' point of view; Shareholders want excess use of debt in the firm with low rate of interest but high return from that debt. When the return is high than the cost, the shareholder will be benefited. So an appropriate mix of capital structure is needed to employ by a firm so that the wealth of the shareholders can be maximized.

### 3.6.3.2 Total Debts to Total Assets Ratio

This ratio reflects the claims of outsiders and owners on the total assets of the firm. It also measures the financial security to the outsiders. It is also like a debt equity ratio. Higher ratio indicates higher financial risk as well as increasing claims of outsiders in total assets. Similarly lower ratio indicates lower financial risk as well as decreasing claim of outsider on the total assets of a firm. This ratio can be computed by dividing total debts by total assets.

$$\text{Total debts to total assets ratio} = \frac{Total\ debts}{Total\ assets}$$

Total debts represent long-term debt and other liabilities whereas total assets represent all the assets of balance sheet.

### 3.6.5 Profitability Ratio

Profitability ratio is one of the main indicators to analyze the financial performance of a firm. It shows the overall efficiency of the business concerns. Profitability ratio measures the degree of success in achieving desired level of the firm. Profitability also indicates public acceptance of the product and shows that the firm can produce competitively. This ratio can be computed on the basis of either sales or investment. Shareholders, government, tax collectors, employees and all concerned with the company are generally concerned with the profitability of the company. This ratio gives the answer to following question.

(a) Does the firm adequate earn the profit?
(b) What rate of return does it represent?
(c) What is the rate of profit for various divisions and segments of the firm?
(d) What is the earning per share?
(e) What amount was paid as dividends?
(f) What is the rate of return to equity holders?

The following ratios are calculation under profitability ratio.

#### 3.6.5.1 Return on Net Worth/Total Equity Ratio

This ratio measures, how much profit is earned by utilizing funds of total equity by the firm. It measures the earning power of the company against owner’s investment (equity). Total shareholders' equity consists of preference share capital, ordinary shareholder equity consisting of equity share capital, share premium, reserve and surplus less accumulated losses. This ratio can be computed as Net profit after taxes (NPAT) divided by average total shareholders' equity.

$$\text{Return on net worth/ Total equity ratio} = \frac{\text{Net profit after tax}}{\text{Net worth / total equity}}$$

Higher ratio indicates the sound management and efficiency of a firm and vice-versa.

### 3.6.5.2 Return on Assets Ratio (ROA)

This ratio is related on net profit after tax and total assets. It evaluates the efficiency of a company in utilization and mobilization of the assets. How efficiently the assets of a firm able to generate more profit are measured by this ratio provides the foundation necessary for a company to deliver a good return on equity. A company without a good return on total assets is almost impossible to generate a satisfactory ROA.

$$\text{Return on total assets ratio X} \frac{\text{Net profit after tax}}{\text{Total assets}}$$

Higher ratio indicates higher efficiency in utilization of asset of the firm and vice-versa.

### 3.6.5.3 Return on Investment (ROI)

ROI measures the capacity of the company to generate profit out of its total investment. It reflects only those attributes of the firm's performance which are actually under the control of the firms operating management. Here return denotes net profit after tax and investment includes investment in government securities and certificate of deposits. It can be computed by:

$$\text{Return on Investment (ROI) X} \frac{\text{Net profit after tax}}{\text{Total Investment}}$$

### 3.6.5.4 Total Interest Earned to Total Assets Ratio

This ratio indicates how much interest mobilizing the assets in the banks has generated. Interest is the main source of income of banks'. Interest is received from generally loans and advance, and investment in securities. This ratio can be computed as interest earned divided by total assets.

$$\text{Total Interest earned to total assets ratio X} \frac{\text{Total Interest earned}}{\text{Total assets}}$$

Higher ratio indicates higher efficiency in the mobilization of resources and ability in interest earning and vice-versa.

### 3.6.5.5 Earning Per Share (EPS)

Apart from the rate of return, the profit ability of a firm, from the point of view of the ordinary shareholders', is the Earning per share (EPS). It measures profit available to the equity holders on per share basis. It is calculated by dividing the profit available to the shareholders by the number of outstanding shares. This profit represents the net profit after tax and preference dividends.

$$\text{Earning per share ratio} = \frac{\text{Profit after tax}}{\text{Total number of shares}}$$

### 3.6.5.6 Net Profit to Total Income Ratio

This ratio measures the amount of net income out of the total income. The total income includes interest income and other operational income. Interest income includes interest from loans, and investment in different securities and certificate of deposits. Other operational income includes service charge and miscellaneous incomes. Likewise, net profit is derived from total income after deducting operational expenses, personnel expenses, loan loss provisions, interest expenses, employee bonus and income tax provision. Higher the ratio, better for the firms.

$$\text{Net Profit to Total Income Ratio} = \frac{\text{Net Profit}}{\text{Total Income}}$$

### 3.6.5.7 Net Profit to Borrowing Ratio

This ratio of measures the degree of net profit after tax earned by using total borrowings various purpose and sectors. This ratio shows how efficiently the management is utilizing its borrowings in profit generating activities. This is an important ratio as the earning is made by the efficient and effective utilization of these borrowings. Higher ratio indicates better utilization of borrowings and vice versa.

$$\text{Net Profit to Borrowing Ratio} = \frac{\text{Net Profit}}{\text{Total Borrowings}}$$

### 3.6.6 Other Ratios

Different types of ratios have been discussed already. Besides, some of the following are to be considered regarding the performance of a firm.

#### 3.6.6.1 Interest Paid to Interest Income

This ratio reveals the proportionate relationship between interest paid on different liabilities and interest income from different sources. Higher ratio indicates higher payment of interest on liabilities in relating to interest income and vice versa.

Interest paid includes interest paid on borrowing and interest income includes the interest from loan, investment on government securities and, money at short call and certificate of deposits. Following formula is used.

$$\text{Interest paid to interest income} = \frac{\text{Interest paid}}{\text{Interest income}}$$

#### 3.6.6.2 Loan Loss Provision Ratio

This ratio describes the proportion of provision for loss to the loan. It is very important for any financial institution to have a good investment in a loan because a poorly administered loan portfolio usually has significant negative impact on the earning and capital of the firms. Provision of loan loss leads to less profit and decreases in the capital. This ratio can be calculated by dividing loan loss provision by total loan advanced.

$$\text{Loan loss ratio} = \frac{\text{Loan loss provision}}{\text{Total loans \& advances}}$$

#### 3.6.6.3 Interest Income from Loans to Loans & Advances Ratio

Interest income from loans to loans and advances ratio measures how much RMDC has been earning against the loans and advances disbursed to its partner organizations. Generally, interest on micro-credit is higher than on normal loan.

$$\text{Income from Loans to Loans and Advances Ratio} = \frac{\text{Interest Income From Loan}}{\text{Loans and Advances}}$$

#### 3.6.6.4 Interest Expenses to Total Borrowings Ratio

As RMDC is the wholesale micro finance lending institution which disburses loan to number of partner organizations (NGO, INGO, Credit and Cooperatives, etc), it needs to borrow sufficient amount of fund from outsiders like commercial banks, international donors etc. It has to pay certain rate of interest on those borrowings. Thus, this ratio measures how much interest on an average RMDC has been paying against the total borrowings. Lower the rate of interest, better and profitable for institution.

$$\text{Interest Expenses to Total Borrowing Ratio} = \frac{\text{Interest Expenses}}{\text{Total Borrowings}}$$

## 3.7 Appraisal of RMDC's Managerial Performance

Apart from the above mentioned ratio analysis, with a view to facilitate the objective of the research paper, the financial and managerial performance of RMDC will be measured with appropriate parameters on time series basis. Accordingly, RMDC's financial and managerial performance as the wholesale lending MFDB will be measured in the following terms.

### 3.7.1 Micro Finance Institution (MFI) and Partner Organization (PO) Staff Training

Under this heading, MFI staff training programs, workshops, seminars conducted and supported by RMDC during the fiscal year 2002/03 to 2006/07 for its partner organization's staff have been briefly highlighted.

### 3.7.2 Micro Finance Institution (MFI) Clients Training

RMDC also offers financial and technical supports to its POs to organize need-based training based programs for the clients in order to strengthen their credit groups and upgrade their income-generating and entrepreneurial skills. Here, clients training programs conducted by RMDC during the fiscal year 2002/03 to 2006/07 have been highlighted.

### 3.7.3 Human Resource (Manpower)

In this part, human resource utilization by RMDC has been studied.

### 3.7.4 Annual Loan Portfolio Growth

Annual Loan Portfolio Growth analysis shows the information about the loan and advances disbursed by RMDC to its partner organizations in the five fiscal years that we have taken for our study. The overall loan performance of RMDC in these five years has been analysed. Loan portfolio shows how much loan has been approved, how much have been disbursed. It also shows what amount of loan has been recovered and what the outstanding loan is. This will also help to evaluate the managerial capacity in spreading its service to as more micro finance institution as possible.

## 3.8 Compliance with NRB Directives and prevailing legal framework:

The directives issued by the central bank are directed towards safe and sound operation of the financial institutions licensed by it. The directives are equally applicable to all institutions – commercial banks, finance companies and MFDBs (including wholesale institutions like RMDC). Apart from this, all financial institutions including the MFDBs like the RMDC, are required to comply with the prevailing legal framework. Hence it is imperative that the regulatory and legal framework is complied fully by the financial institutions.

It is noteworthy that NRB has adopted very liberal policy with regard to MFDBs as compared to other banks and financial institutions since they cater the need of the poor people living in rural areas. MFDBs as member-based institutions have indeed played a very crucial role in enhancing the social and economic life of the rural people. With this point in consideration, the central bank has taken liberal approach in the case of such institutions. Accordingly, MFDBs can be established with low capital base. They are exempted from completing too many formalities in the course of establishment. Investment in the shares of MFDBs has been encouraged. The requirement of maintaining the ratio for Capital adequacy and CRR has been kept low. These are only few examples.

As such, apart from the ratio analysis, the status of compliance with NRB directives as well as legal framework has been analysed in the case of RMDC as well. Such framework has already been mentioned in Chapter II (Review of Literature). To serve the purpose of the research study, an analysis will be made with regard to the level of compliance with the NRB directives as well as with the prevailing regulatory framework, wherever applicable.

### 3.8.1 Paid-up capital requirement

Paid-up capital is the capital subscribed by the promoters and public share holders. It is the strength of the financial institution which indicates the financial strength. This directive of NRB requires banks and financial institution to maintain a minimum capital as prescribed by NRB during a stipulated period of time.

### 3.8.2 Capital Adequacy Ratio

NRB has directed financial institutions to maintain specific minimum core capital and capital fund. Capital adequacy ratio measures the portion of capital fund and core capital in risk weighted assets (RWA). NRB regulation requires that microfinance development banks should maintain the capital fund of minimum 8% of RWA and core capital of minimum 4% of RWA. The formula to calculate core capital and capital fund are as follows:

Core Capital = Paid-up capital + Reserves and Surplus

Capital Fund = Core Capital + Supplementary Capital

### 3.8.3 Holding of Annual General Meeting

Company Act requires that every public limited company should hold Annual General Meeting within 6 months of the expiry of fiscal year. Thus, this act will check if the financial institution has been conducting AGM in time or not

### 3.8.4 Floating of Public Share

A public limited company should issue at least 30% share of paid-up capital for public as per BAFIA. Here, we will see whether RMDC has gone into public issue or not.

### 3.8.5 General Reserve Fund

General Reserve Fund shows capital growth and strength. BAFIA requires financial institution to mandatorily maintain at least 20% out of its net profit in General Reserve Fund every year until it becomes double of paid-up capital. Here, we will check whether the institution has been able to maintain this percentage or not.

### 3.8.6 Cash Reserve Ratio

Cash reserve ratio is the minimum balance to be maintained in NRB account. CRR should be maintained on the basis of total deposits. It is the percentage of NRB balance on total borrowings.  The rate of CRR percentage to be maintained differs from one category financial institutions to another category. 'A' category financial institutions have to maintain 5% of CRR. Likewise, 'B' and 'C' category financial institutions have to maintain 2% of CRR but if they operate current account then the mandatory rate would be 5%. For 'D' category financial institution, CRR to be maintained is 0.5%.

### 3.8.7 Liquidity

Liquidity ratio measures the ability of a firm to meet its short-term obligations and reflect the short term obligations and reflect the short term financial solvency. Thus, adequate liquidity is a must in order to protect its solvency and to honour short-term obligations or liabilities. A 'D' category financial institution is required to maintain 2.5% of total deposits. Liquid assets include cash at vault, investment in government bond/NRB bond, deposits held in 'A' category financial institutions.

## 3.9 Appraisal of RMDC partner organizations

Apart from computing the above ratios, performance of RMDC's partner organisations is also appraised in brief. The data for this purpose has been derived from the various reports of RMDC. In this context, operational and financial efficiency of the partner organisations is measured by the following ratios:

3.9.1 Staff productivity ratio
3.9.2 Productivity ratio
3.9.3 Financial efficiency ratio
3.9.4 Portfolio quality
3.9.5 Profitability
3.9.6 Other performance ratios

# CHAPTER IV

# Data Presentation and Analysis

This Chapter deals with the data, facts and figures relating to various aspects of RMDC that help appraise its performance with regard to the financial and managerial aspects based on he data of FY 2002/3 to FY 2006/7. For this purpose, this Chapter presents the analysis as well as interpretation of relevant data as mentioned in chapter III (Research Methodology). Various financial ratios are calculated for ascertaining the financial performance of a financial institution based on certain indicators. Accordingly, in view of the peculiar nature of RMDC, which is a wholesale, non-deposit taking financing institution for microfinance institutions, related and relevant ratios have been taken for analyzing its strength and weakness. Additionally, this Chapter helps to draw conclusions after detailed analysis on the basis of which proper recommendations for enhancing capacity in wholesale lending and profitability could be prescribed. For this purpose the following analysis are done.

## 4.1 Ratio Analysis

The term 'ratio' refers to the numerical or quantitative relationship between two variables. The ratio analysis is the most powerful tool of the financial analysis and it is used in analyzing the financial information to indicate the operating and financial efficiency and growth of the firm. Relevant ratios can be calculated on the basis of figures derived from the balance sheet (Annex VIII) and profit and loss account (Annex IX). Other calculations have also been made on the basis of which some ratios are calculated (Annex X). Such calculated financial ratios are useful for analyzing and assessing the performance and position of a company. It reflects the relative strength and weakness of financial institution over the years.

As mentioned in the previous Chapter i.e. research methodology, various ratios are calculated to determine the potential for a company's success considering certain relationship between various financial statement items which are relevant indicators of the company's prospects to produce new information that has additional value

### 4.1.1 Liquidity Ratios

It is very important for a FI to be able to meet its obligations as they become due. Failure to meet such obligation timely due to maintaining inadequate liquidity leads to loss of goodwill and creditors' confidence. Liquidity ratio measures the ability to meet its short term obligations and reflect the short term financial solvency. Hence adequate liquidity is a must in order to protect its solvency and to honour short-term obligations or liabilities. Failing to do so may lead to the financial institution's liquidation. Hence to protect the creditor's interest, NRB has directed the banks and financial institutions to maintain adequate Cash Reserve Ratio (CRR) as a component of liquidity. Liquid asset refers to cash at vault, investment in government bonds, NRB bonds and deposits held in 'A' category institutions licensed by NRB. A firm must ensure that it has a sound liquidity position to face the instant claims by its creditors. In other words, a company should ensure the uninterrupted availability of cash to meet the growing demand from creditors upon maturity. Similarly, for deposit taking institutions, maintaining sufficient liquidity is a must to meet the deposit liabilities.

Liquidity ratio is calculated as shown below:

#### 4.1.1.1 Cash and Bank Balance to Borrowing Ratio

Cash and bank balance to borrowing ratio measures the capacity of a financial institution to meet any unexpected demand from the borrowers, in the case of RMDC, partner organizations. Higher ratio shows high liquidity position and ability to cover the borrowings and vice versa. Cash and bank balance includes cash in hand and cash at bank. Similarly, borrowing indicates lending from donors and commercial banks.

The following Table shows cash and bank balance to borrowing ratio of RMDC.

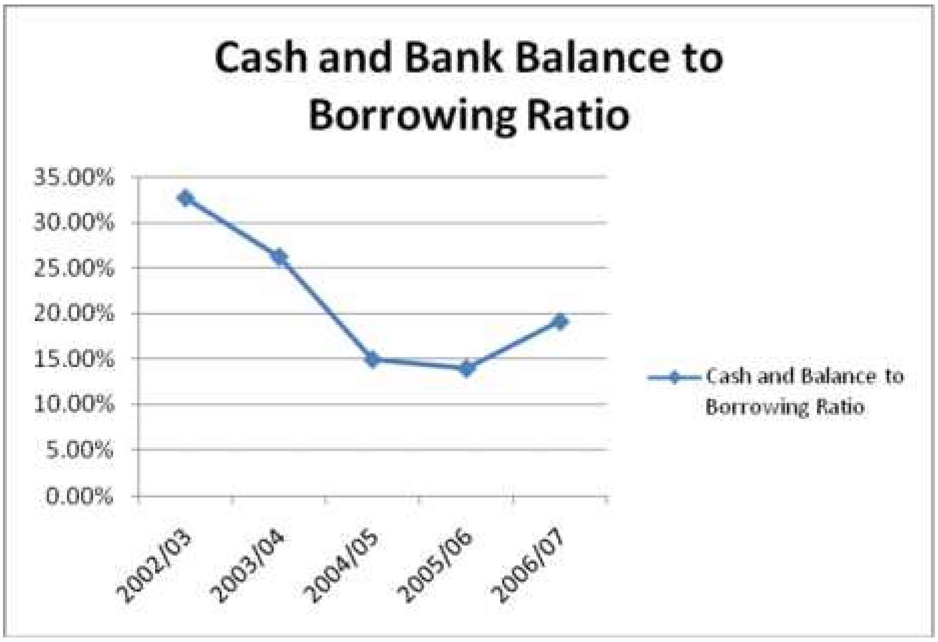
**Table No. 3-Cash and Bank Balance to Borrowing Ratio**

| Cash and Bank Balance to Borrowing Ratio | | | | | (Rs. in Lakhs) |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Cash and Bank Balance (Rs.) | 986.30 | 1,047.04 | 993.72 | 1,256.51 | 2,924.56 |
| Total Borrowings (Rs.) | 3,019.02 | 3,995.76 | 6,670.19 | 9,036.13 | 15,339.51 |
| Ratio (%) | 32.66 | 26.20 | 14.89 | 13.90 | 19.06 |
| Mean Ratio (%) | 21.34 | | | | |

The above Table shows cash and bank balance to borrowing ratio of RMDC for five years which ranges from lowest 13.90% in (2005/06) to highest 32.66% in (2002/03). However, this ratio has declined after 2002/03 in the following years indicating greater use of borrowings. The mean ratio of 21.34% shows the sound liquidity position of RMDC in order to serve the partner organizations. Nevertheless, RMDC seems to be holding greater amount of fund underutilized for right purpose.

The trend of cash and bank balance to borrowing ratio of RMDC has been presented below.

**Figure 1-Cash and Bank Balance to Borrowing Ratio**




### 4.1.2 Activity/Turnover/Utilization Ratio

This ratio measures the efficiency of management in utilizing assets/fund in profit generating field. This ratio is called turnover or efficiency or assets utilization ratio. If available assets are not properly utilized the management fails to increase profit, investment will not generate sufficient production and sales cannot make a returnable profit. In this study efficiency ratios are computed to determine the company's efficiency in utilizing available resources (borrowings). The activity ratio of RMDC computed under this heading are shown and interpreted as follows:

#### 4.1.2.1 Loans and Advances to Total Borrowing Ratio

This ratio reflects the total loan and advances by RMDC as compared to total borrowings. As a wholesale lending institution, the borrowings of RMDC are targeted towards on- lending to its partner organization (POs). With the help of this ratio we can study how far has RMDC been able to utilize its borrowings in disbursing microfinance loan to the targeted groups through its POs. The following Table and chart helps to analyse this ratio.

**Table No.4 – Loans and Advances to Total Borrowing Ratio**

| Loans and Advances to Total Borrowing Ratio (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Loans and Advances (Rs.) | 1,209.06 | 1,334.67 | 3,258.35 | 5,008.54 | 11,350.44 |
| Total Borrowings (Rs.) | 3,019.02 | 3,995.76 | 6,670.19 | 9,036.13 | 15,339.51 |
| Ratio (%) | 40.00 | 33.40 | 48.85 | 55.43 | 73.99 |
| Mean Ratio (%) | 50.33 | | | | |

The loans and advances to total borrowing ratio of RMDC ranges from the lowest 33.40% in (2003/04) to the highest 73.99% (2006/07). The Table shows RMDC's investment in loans and advances out of total borrowings received The mean ratio of 50.33% indicates the portion of the total borrowings being invested in loans and advances to partner organizations.

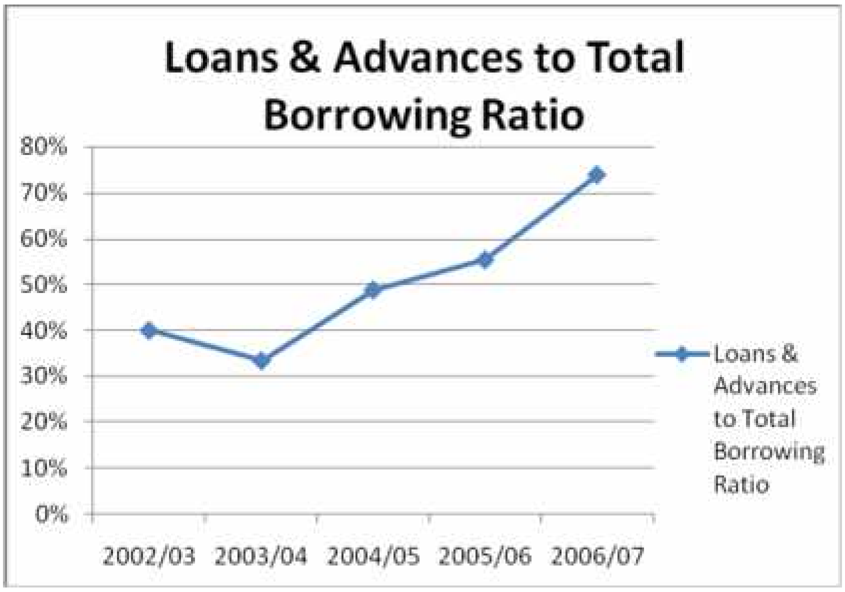
The above Table shows that during the year 2002/03, Rs. 1,209.06 lakh was disbursed which counts to just about 40% of the total borrowings of Rs. 3,019.02 lakh. This figure has risen to almost 74% in the year 2006/07. It is clear that the ratio is in increasing trend. The lowest ratio in five years is 33.40 % in the year 2003/04 which represents lower borrowing portion being used as loans and advances in that year. However, from then afterwards, this ratio has gradually increased to 48.85%, 55.43% and 73.99% respectively in the following years. The basic reason is that the year 2002/03 was just about a couple of years from the establishment of RMDC. There were only 28 partner organizations with around 216,002 members. However this number of POs rose to 40 with 368,848 members in the year 2005/06. Subsequently, with the rise in partner organizations, lending of RMDC also increased. The sharp rise in the lending during the year 2006/07 can be explained from the number of partner organization which rose to 45 and more importantly from the number of members which rose to 503,497.

As is evident, RMDC has been established to provide wholesale loan, we can see that it has been providing significant amount of loans to those partner organizations.

It should be noted that loans and advances are the highest return yielding sector for a financial institution. In this context, lower ratio denotes less investment opportunity.As such, this insititution has been investing in the sector yielding comparatively less return.

The trend of loans and advances to total borrowing ratio of RMDC has been presented below

**Figure No. 2 – Loans and Advances to Total Borrowing Ratio**




### 4.1.3 Leverage/Capital Structure Ratio

This ratio is calculated to judge the long-term financial position of the firm. This ratio indicates mixture of funds provided by the owners and lenders, i.e. in the form of debt and equity. Debt is more risky from firm's point of view. The firm has a legal obligation to pay interest to debt holders, irrespective of the financial position. The firm with low leverage ratio is subject to lower risks and lower return as well.

This ratio highlights the long term financial position, debt servicing capacity as well as strength and weaknesses of the firm. For the purpose o RMDC, the following ratios are examined under these heading:

#### 4.1.3.1 Debt to Net Worth Ratio

This ratio is calculated by dividing total debt by total equity. This ratio measures the proportion of external liability in the total capital of the firm. It is calculated to measure the firm's obligation to creditors in relation to the funds invested by the owners.

In this study, total debt refers to bills payable, borrowing made from other banks and other liabilities. Similarly, total equity refers to paid up capital, reserve and surplus and undistributed profit.

The portion of debt and equity used by a firm affects its cost of capital. Higher equity indicates higher weighted average cost of capital and less risk. Higher debt on the other hand, indicates lower weighted average cost of capital but high risk because if they don't get regular interest they may take actions to liquidate the firm.

The following table shows the ratio of total debt to total equity of RMDC

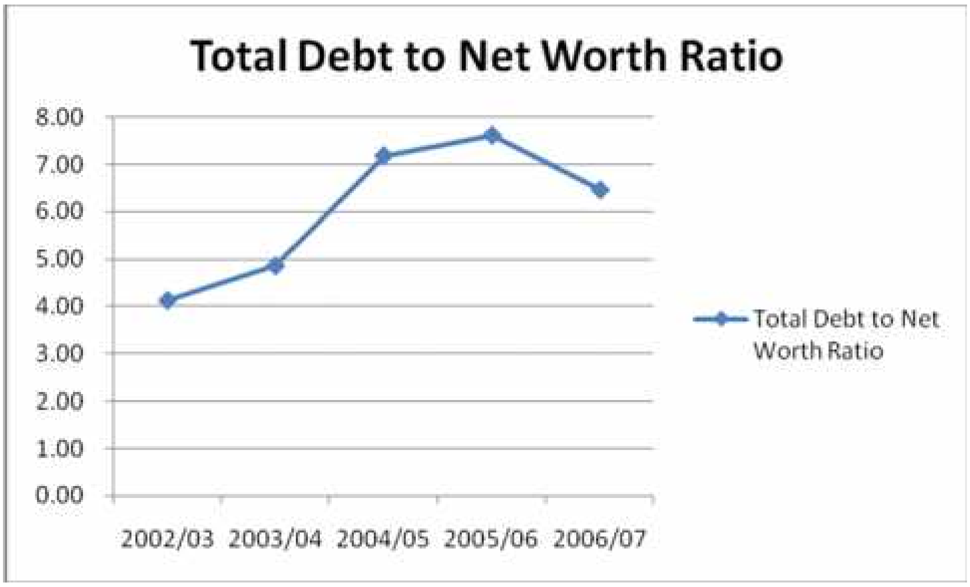
**Table No. 5 – Total Debt to Net Worth Ratio**

| Total Debt to Net Worth Ratio (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Total Debt (Rs.) | 3,981.33 | 4,944.93 | 7,673.80 | 10,237.11 | 18,815.64 |
| Total Equity (Net Worth) (Rs.) | 964.95 | 1,017.38 | 1,068.23 | 1,344.56 | 2,912.83 |
| Ratio (Times) | 4.13 | 4.86 | 7.18 | 7.61 | 6.46 |
| Mean Ratio (Times) | 6.04 | | | | |

The above Table shows that total debt to net worth ratio of RMDC is 4.13 in the year 2002/03 and then it gradually increases to 4.86 in year 2003/04 and keeps on increasing to 7.18 and 7.61 in the next two years. The ratio decreased to 6.46 in the year 2006/07. Overall, this ratio is in increasing trend. This ratio is on higher side because rather than considering the weighted average cost of capital RMDC is mainly concerned with lending to the retail microfinance institutions. If we look at the figures, we can see that the increase in debt is higher than the increase in equity. Therefore, the ratio has increased sharply in the year 2004/05 and 2005/06. This shows the risky position for an institution but in case of RMDC, high debt to net worth ratio will not affect as its creditors are government and bilateral agencies.

The trend of total Debt of Equity Ratio of RMDC has been presented below.

**Figure No. 3 – Total Debt to Net Worth Ratio**




#### 4.1.3.2 Total Debt to Total Assets Ratio

This ratio measures the relationship between financial contribution of outsiders and owners on total assets of the firm. It measures the proportion of debt out of total assets of the firm. In other words, this ratio indicates the percentage of total assets that are financed by debt. So, higher ratio indicates risk of creditors' claim on assets. This ratio is similar as debt to equity ratio. Here, total debt refers to short-term loan; long term loans (borrowing) and, other liabilities and total assets include all the assets that are in the assets side of balance sheet of the firm. The following table shows ratio of total debt to total assets of RMDC.

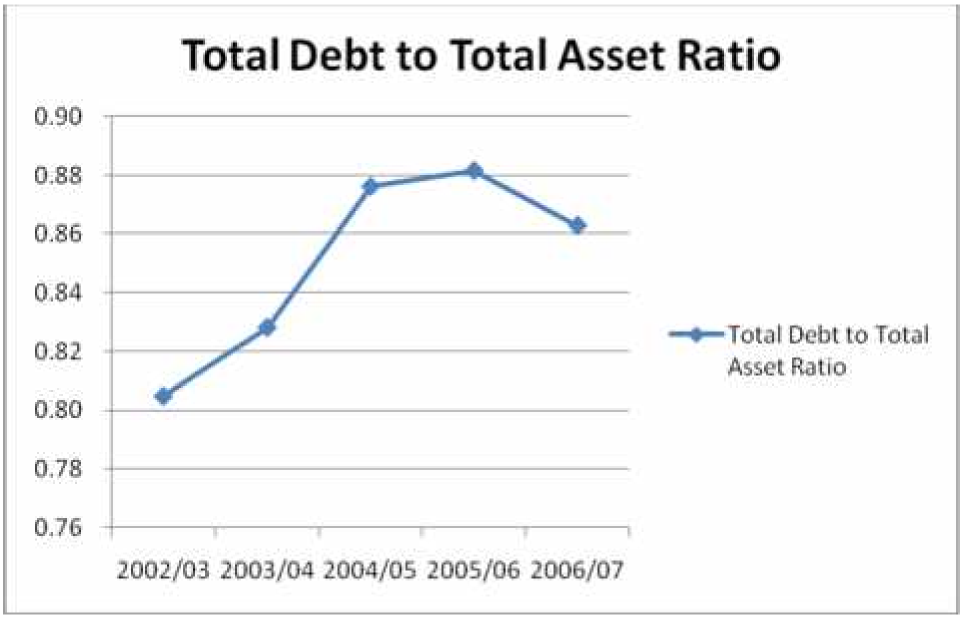
**Table No.6 – Total Debt to Total Asset Ratio**

| Total Debt to Total Asset Ratio (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Total Debt (Rs.) | 3,981.33 | 4,944.93 | 7,673.80 | 10,237.11 | 18,815.64 |
| Total Assets (Rs.) | 4,946.27 | 5,970.31 | 8,758.03 | 11,611.66 | 21,803.47 |
| Ratio | 0.80 | 0.83 | 0.88 | 0.88 | 0.86 |
| Mean Ratio | 0.85 | | | | |

The above Table shows the total debt to total asset ratio of RMDC which ranges from the lowest 0.80 in (2002/03) to 0.88 in (2004/05 and 2005/06). It is also in slightly increasing trend. It can be seen that total debt to total asset ratio is high in each fiscal year taken in our study. The Table also shows that on an average, 85% of the total assets is financed by debt. This ratio is on higher side which would indicate a risky position of a firm in general. More the debt more will be the risk of creditors to claim on asset. However, since RMDC serves as a wholesale lending institution and its creditors are government and bilateral agencies, it is free from such risks.

The trend of total debt to total assets ratio of RMDC has been presented below.

**Figure No. 4 – Total Debt to Total Asset Ratio**




### 4.1.4 Profitability Ratio

Profit is one of the main objectives of any financial institution since it is the key element to survive and grow over the long run. It is a measuring rod of financial performance of any company. This ratio indicates the degree of success in achieving desired profit levels of the working funds. These ratios are of two types: those showing profitability in relation to sales and those showing profitability in relation to investment. In this study profitability ratios are computed by relating to the profit. Following ratios are calculated under this heading.

### 4.1.4.1 Return on Net Worth/Total Equity Ratio

This ratio measures the profit made by financial institution by utilizing owners' equity thereby generating return to satisfy the owners. Higher ratio indicates sound management and efficiency, which in turn is the wealth maximization of the institution.

Here, NPAT refers to net profit after tax from profit and loss a/c and net worth refers to paid up capital, reserve and surplus and undistributed profit. The following Table shows return on equity of RMDC.

**Table No. 7 – Return on Net Worth to Total Equity Ratio**

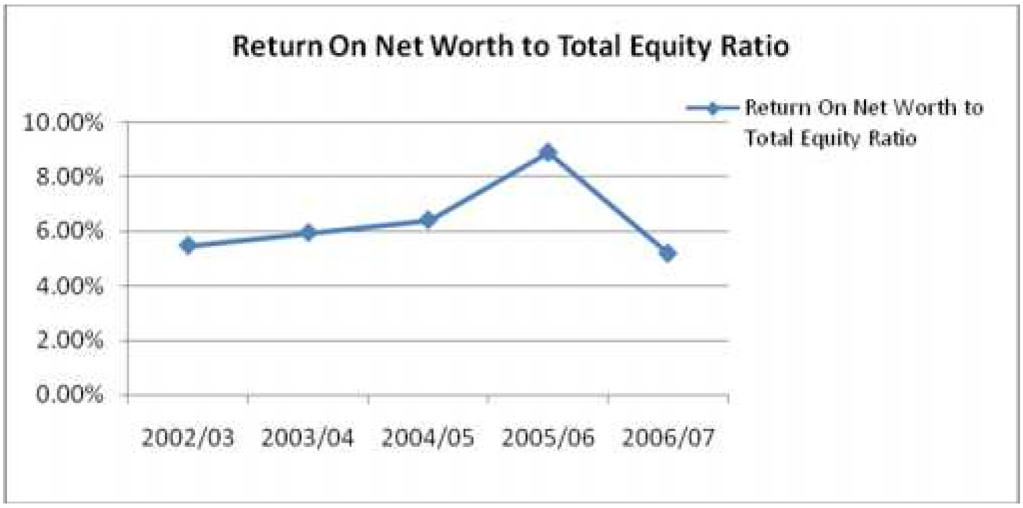
| Return On Net Worth to Total Equity Ratio (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Net Profit After Tax (Rs.) | 52.77 | 60.43 | 68.45 | 119.76 | 150.84 |
| Total Equity (Net Worth) (Rs.) | 964.95 | 1,017.38 | 1,068.23 | 1,344.56 | 2,912.83 |
| Ratio (%) | **5.47** | **5.94** | **6.41** | **8.91** | **5.18** |
| Mean Ratio (%) | 6.38 | | | | |

The above Table shows that the return on net worth total equity ratio of RMDC has ranged from 5.18% in (2006/07) to 8.91% in (2005/06). It is 5.47% in the year 2002/03 and then gradually increased to 5.94%, 6.41% and 8.91% in the following three years respectively. The return on an average is 6.38% which shows that RMDC seems to be fair enough in utilizing its net worth towards generating profit which ultimately increases the shareholders' wealth. The low rate of return is due to low net profit. The reason for low net profit is that RMDC has limited source of income. Though higher return on net worth to total equity ratio is preferable, it is reasonable for RMDC because it is not a fully profit oriented financial institution.

The trend of Return on Net Worth/Equity Ratio of RMDC has been presented in the following graph.

**F**

**Figure No. 5 – Return on Net Worth to Total Equity Ratio**




### 4.1.4.2 Return on Assets Ratio (ROA)

This ratio measures the management ability to utilize all the assets for profit generating activities. This ratio provides the foundation necessary for a company to deliver a good return on equity. Higher ROA ratio indicates higher efficiency in the utilization of total assets and vice-versa.

The ROA ratio of RMDC is presented in the following table.

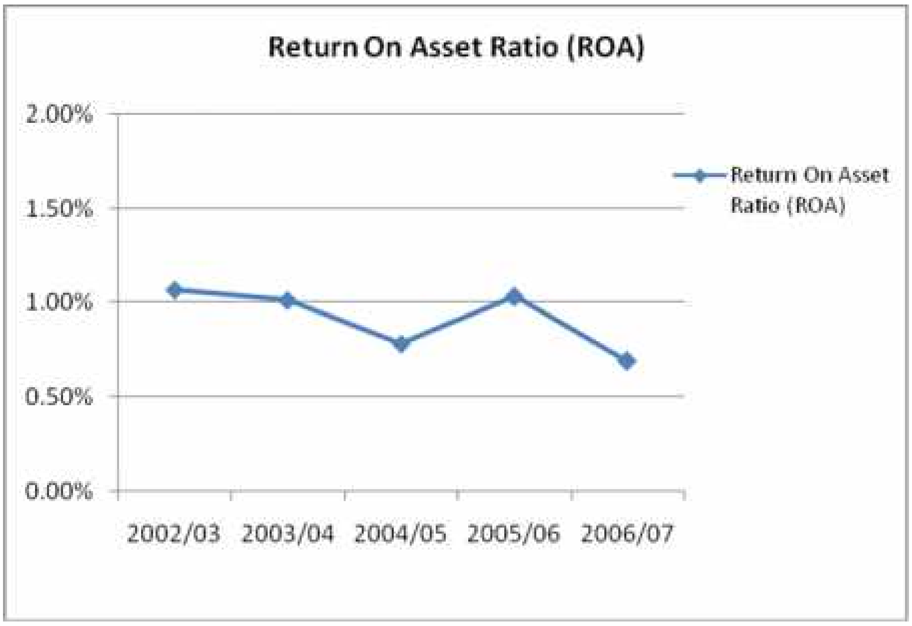
**Table No. 8 – Return on Asset Ratio**

| Return On Asset Ratio (ROA) (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Net Profit After Tax (Rs.) | 52.77 | 60.43 | 68.45 | 119.76 | 150.84 |
| Total Assets (Rs.) | 4,946.27 | 5,970.31 | 8,758.03 | 11,611.66 | 21,803.47 |
| Ratio (%) | 1.07 | 1.01 | 0.78 | 1.03 | 0.69 |
| Mean Ratio (%) | 0.91 | | | | |

The above Table reveals the ROA ratio of RMDC for the five years which ranges from 0.69% in (2006/07) to 1.07% (2002/03). It is in fluctuating trend with mean ROA of 0.91%. The ratio shows that RMDC has been utilizing overall resources in a fair way. However, lower ratio indicates that it does not seem to be utilizing its asset more efficiently. This may be due to its lower interest rate on loans and advances which covers good portion of the total asset.

The trend of return on total Assets Ratio has been presented below.

**Figure No. 6 – Return on Asset Ratio**




#### 4.1.4.3 Return on Investment (ROI)

This ratio measures the capability of the company to generate profit out of the total investment. In other word, it states how well the company has been able to earn the return on the total investment made. Higher the ratio, higher is the return and vice versa. Since the criteria for lending by RMDC is very strict, not all the borrowings has been disbursed as loans and advances. The remaining portion of borrowings is invested. The investment of RMDC includes investment in national saving bond, and certificate of deposits. The following Table shows the ratio of return on investment of RMDC:

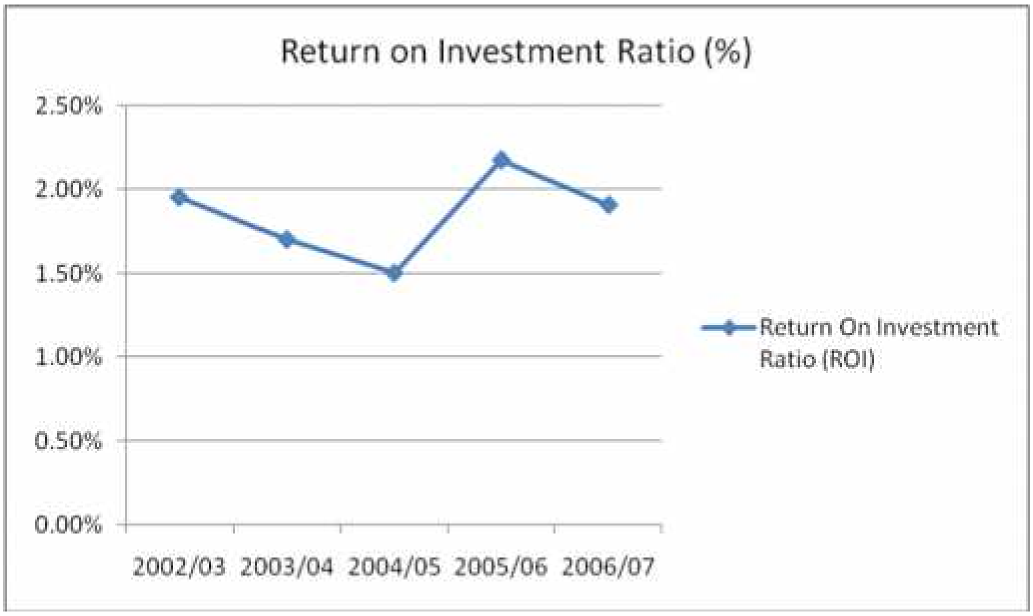
**Table No. 9 – Return on Investment Ratio**

| Return On Investment Ratio (ROI) (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Net Profit After Tax (Rs.) | 52.77 | 60.43 | 68.45 | 119.76 | 150.84 |
| Total Investment (Rs.) | 2,696.05 | 3,544.93 | 4,547.12 | 5,498.12 | 7,888.26 |
| Ratio (%) | 1.96 | 1.70 | 1.51 | 2.18 | 1.91 |
| Mean Ratio (%) | 1.85 | | | | |

The above Table shows the ROI ratio of RMDC that ranges from 1.51% in (2004/05) to 2.18% in (2005/06). In the fiscal year 2002/03, ROI is 1.96% and then it decreases to 1.70% and 1.51% respectively in the following two years. It has increased to 2.18% in year 2005/06 and then slightly decreased to 1.91%. The mean ROI of 1.85% shows that RMDC has not been utilizing the fund for investment efficiently. This is due to lower profit ability of RMDC. The reason behind this is it not a profit making organization and the income base is also narrow i.e. interest income from lending and investment, and service charge.

The trend of return on investment is presented graphically as follows:

**Figure No. 7 – Return on Investment**




**4.1.4.4 Total Interest Earned to Total Assets Ratio**

This ratio shows the interest generated by mobilizing the assets. Interest occupies significant place of income for the RMDC. It earns interest basically through two sources i.e interest on loans, and interest from investment. Higher the ratio indicates higher efficiency in the mobilization of resources and ability of interest earning and vice-versa. This ratio has been presented in following table.

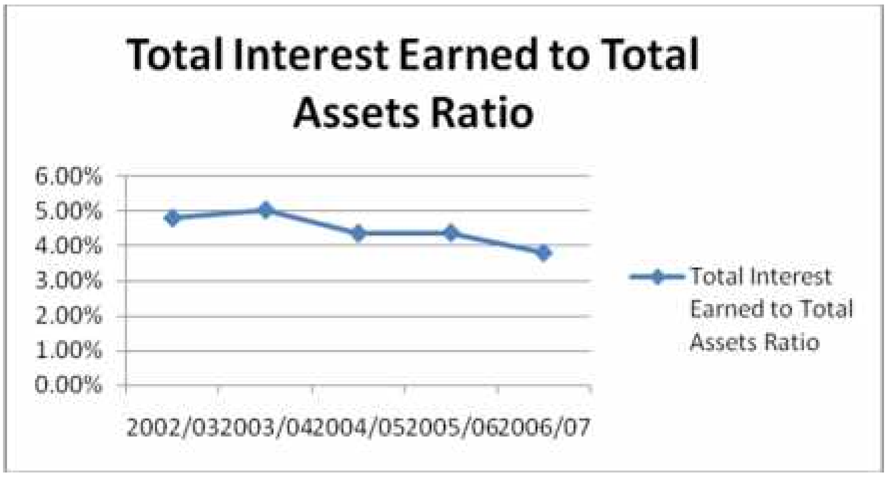
**Table No. 10 – Total Interest Earned to Total Assets Ratio**

| Total Interest Earned to Total Assets Ratio (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Total Interest Earned (Rs.) | 237.23 | 299.92 | 381.87 | 508.00 | 828.91 |
| Total Assets (Rs.) | 4,946.27 | 5,970.31 | 8,758.03 | 11,611.66 | 21,803.47 |
| Ratio (%) | 4.80 | 5.02 | 4.36 | 4.37 | 3.80 |
| Mean Ratio (%) | 4.47 | | | | |

The above Table shows that interest earned to total assets of RMDC is in decreasing trend. The ratio is highest in the year 2003/04 with 5.02% and then it starts to decrease then after in the following three years to 4.36%, 4.37% and 3.80% in the following three years. The reason for decline in this ratio is that there has been increase in total interest by around 63% in 2006/07 whereas; increase in total assets is 88%. The mean ratio of 4.47% shows that RMDC has been able to utilize its assets successfully to earn more interest.

The trend of interest earned to total assets ratio of RMDC has been presented below.

**Figure No. 8 – Total Interest Earned to Total Asset Ratio**




### 4.1.4.5 Earning Per Share (EPS)

Earning per share is one of the most widely quoted statistics in terms of company's performance of share value. It is the profit after tax divided by the number of common shares outstanding. This ratio measures how much earning does the common shareholder get for each share held. Higher the EPS, better for the shareholders. The status of EPS is presented in the following Table.

**Table No. 11 – Earning Per Share**

| Earning Per Share (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Net Profit (Rs.) | 52.77 | 60.43 | 68.45 | 119.76 | 150.84 |
| Total No. Of Shares ( No. In lakhs) | 8.00 | 8.00 | 8.00 | 10.00 | 25.00 |
| Ratio (Rs.) | 6.60 | 7.55 | 8.56 | 11.98 | 6.03 |
| Mean Ratio (Rs.) | 8.14 | | | | |

The above Table shows the EPS status of RMDC over the five years. In the first three years the ratio is in increasing trend i.e. from Rs. 6.60 to Rs. 8.56. However, this increase is due to the increase in the net profit, number of shares outstanding remaining constant i.e. 8 lakhs. In the year 2005/06, it has further increased to Rs. 11.98 though the number of shares has increased to 10 lakhs. But in the following year, there has been sharp decline in EPS to Rs. 6.03. This is due to increase in number of shares by 15 lakhs which counts to 150% increment whereas the net profit has increased by only about 25%.

RMDC has lower EPS which is due to low profit. The low profit on the other hand is itscause RMDC is not a fully profit-oriented FI. Also he income base is not broad. Subject to lower profit, if it goes public then there is a high chance that EPS will fall further. However, after going public, it will also have additional fund which it can invest to increase its income.

The trend of EPS of RMDC has been shown in the following diagram.

**Figure No. 9 – Earning Per Share**


### 4.1.4.6 Net Profit to Total Income Ratio

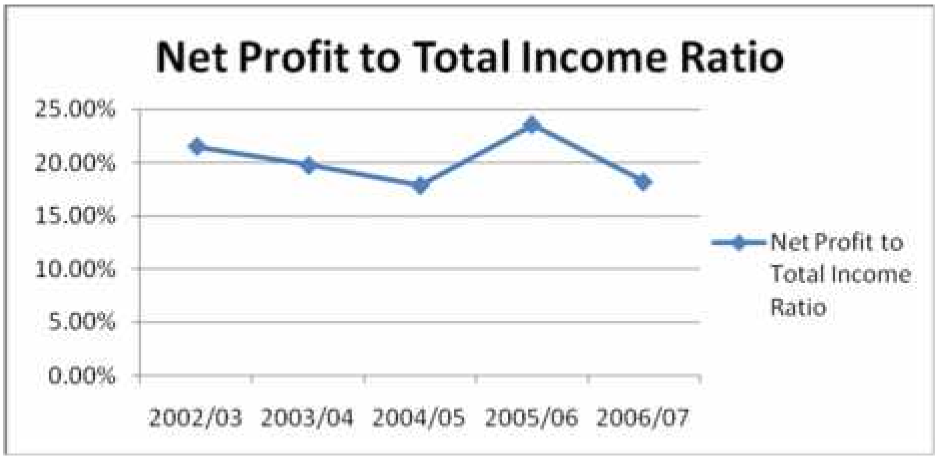
This ratio measures the amount of net income out of the total income. The total income of RMDC includes interest income and other operational income. Interest income includes interest from loans, and investment in different securities and deposits. Other operational income includes service charge and miscellaneous incomes. Likewise, net profit is derived from total income after deducting operational expenses, personnel expenses, loan loss provisions, interest expenses, employee bonus and income tax provision. Higher the ratio, better for the company. The following Table shows the data of net profit to total income ratio of RMDC for five years.

**Table No. 12 – Net Profit to Total Income Ratio**

| Net Profit To Total Income ratio (Rs. In Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Net Profit (Rs.) | 52.77 | 60.43 | 68.45 | 119.76 | 150.84 |
| Total Income (Rs.) | 244.95 | 305.96 | 383.03 | 508.06 | 829.03 |
| Ratio (%) | 21.54 | 19.75 | 17.87 | 23.57 | 18.19 |
| Mean Ratio (%) | 20.18 | | | | |

The above Table indicates that net profit to total income ratio of RMDC is 21.54% in the fiscal year 2002/03 which decreased to 19.75% and 17.87% respectively in the subsequent two years. And in the very next year i.e 2005/06, the net profit to total income ratio has increased to 23.57%. But again it declined to 18.19% in the next year. Thus, we can see that the ratio is fluctuating. The main reason for decline of this ratio in the year 2006/07 can be accounted to the increase in loan loss provision from Rs. 70.01 lakhs to Rs. 253.68 lakhs. This increase in provision in that year is due to the increase in loans to its partner organization. As a whole, the mean ratio of 20.18% shows that RMDC is fair enough in generating net profit out of total income. It is due to the company's ability to control its expenses in relation to increase in income. The trend of net profit to total income ratio is shown in the figure below.

**Figure No. 10 – Net Profit to Total Income Ratio**




**4.1.4.7 Net Profit to Borrowing Ratio**

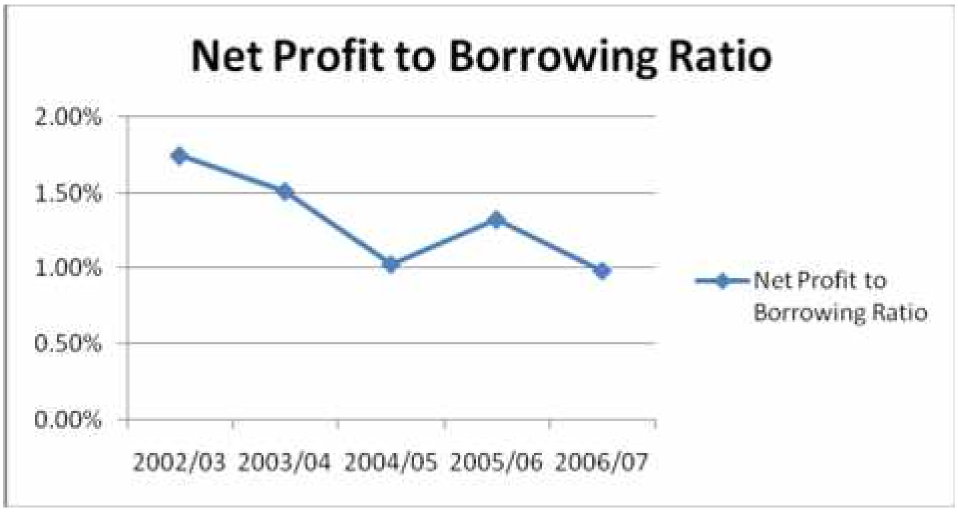
This ratio of measures the degree of net profit after tax earned by using total borrowings for various purpose and sectors. This ratio shows how efficiently the management is utilizing its borrowings in profit generating activities. This is an important ratio as the earning is made by the efficient and effective utilization of these borrowings. Higher ratio indicates better utilization of borrowings and vice versa.

**Table No. 13– Net Profit to Borrowing Ratio**

| Net Profit to Borrowing Ratio (Rs. in lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Net Profit (Rs.) | 52.77 | 60.43 | 68.45 | 119.76 | 150.84 |
| Total Borrowing (Rs.) | 3,019.02 | 3,995.76 | 6,670.19 | 9,036.13 | 15,339.51 |
| Ratio (%) | 1.75 | 1.51 | 1.03 | 1.33 | 0.98 |
| Mean Ratio (%) | 1.32 | | | | |

From the above Table it can be seen that return on borrowing ratio of RMDC ranges from the lowest 0.98% in (2006/07) to 1.75% in (2002/03). Overall, the ratio is in decreasing trend. In the fiscal year 2002/03, return of borrowing is 1.75% and from the next year it started to decline. It declines to 1.51% in 2003/04, further decreases to 1.03% in the following year and reaches to the lowest point of 0.98% at the end of 2006/07. About half a portion of total borrowing is invested in loans and advances to a number of partner organizations and remaining are utilized in other kind of investments. Thus, this ratio shows how much RMDC has been gaining from its total borrowings. Declining trend reveals that return on borrowings has been declining year by year and it needs to capitalize its huge amount of borrowing in high-return yielding sector. The trend of net profit to borrowing ratio is presented in the graph below.

**Figure No. 11 – Net Profit to Borrowing Ratio**




### 4.1.5 Other Ratios

There are various other ratios which are used widely relating to the financial aspects of the company. Although various ratios have been calculated and analyzed for the sake of completeness some other indicators have also been considered in this section. They are as follows:

#### 4.1.5.1 Interest Paid to Interest Income Ratio

This ratio reveals the proportionate relationship between interest paid to different liabilities and interest income made from different sources. Higher the ratio indicates that the firm has paid higher amount of interest on liabilities in relation to interest income and vice-versa. In this study, interest paid includes interest paid on borrowing. Similarly, interest income includes the interest from loan and advances, return from investment. This ratio over the study has been tabulated below:

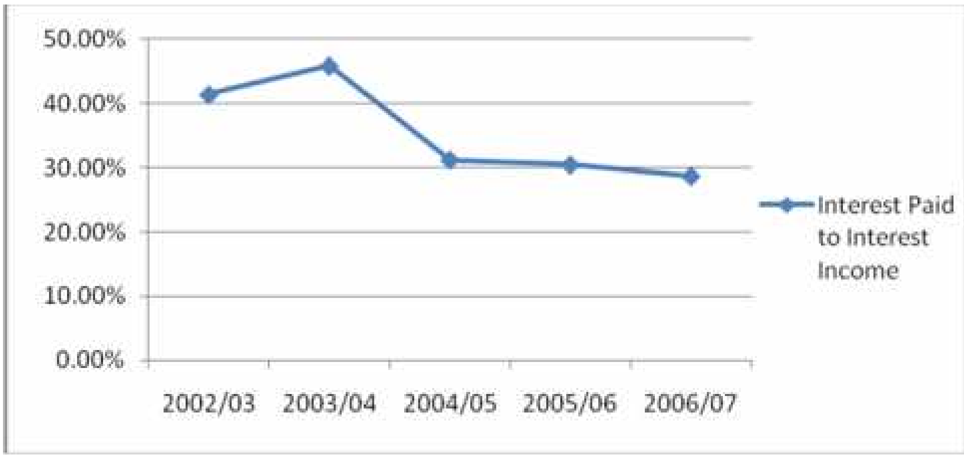
**Table No. 14 – Interest Paid to Interest Income**

| Interest Paid to Interest Income (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Interest Paid (Rs.) | 98.16 | 137.58 | 118.88 | 154.35 | 237.31 |
| Interest Income (Rs.) | 237.23 | 299.92 | 381.87 | 508.00 | 828.91 |
| Ratio (%) | 41.38 | 45.87 | 31.13 | 30.38 | 28.63 |
| Mean Ratio (%) | 35.47 | | | | |

The above Table reflects that the interest paid to interest income ratio of RMDC ranged between the lowest 28.63% in (2006/07) to the highest 45.87% in (2003/04). The ratio was maximum in the year 2003/04 and from then it started to decline. It declined to 31.13% in 2004/05, 30.38% in 2005/06 and further to 28.63% in 2006/07. The mean ratio of 35.47% shows that overall interest payment in relation to the interest income in these five years is low. This declining rate indicates that interest expense of RMDC is lesser than interest income. In other words, it has been gaining more interest by disbursing loans and advances to its partner organizations.

The trend of Interest Paid to Interest Income Ratio has been presented below

**Figure No. 12 – Interest Paid to Interest Income**




**4.1.5.2 Loan Loss Provision Ratio**

This ratio describes the proportion of provision for loss to the loan. It is very important for any financial institution to maintain quality of loan because a poorly administered loan portfolio usually has significant negative impact on the earning and capital of the company. Provision of loan loss leads to less profit and affects the capital fund.

The loan loss ratio indicates the adequacy of allowance for loan and trend in the collection of loan and the performance in loan portfolio. It is obtained by dividing the loan loss provision by the total loan. Higher amount this ratio indicates that the performance in term of recovery of loan is low and vice-versa

This ratio is presented in the following table.

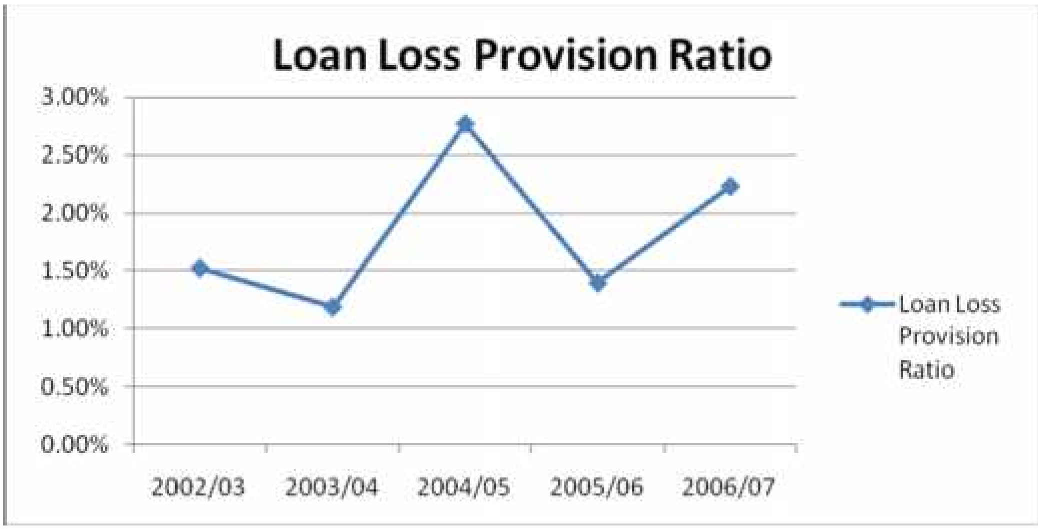
**Table No. 15 – Loan Loss Provision Ratio**

| Loan Loss Provision Ratio (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Loan Loss Provision (Rs.) | 18.45 | 15.86 | 90.29 | 70.01 | 253.68 |
| Total Loans & Advances (Rs.) | 1,209.06 | 1,334.67 | 3,258.35 | 5,008.54 | 11,350.44 |
| Ratio (%) | 1.53 | 1.19 | 2.77 | 1.40 | 2.23 |
| Mean Ratio (%) | 1.82 | | | | |

The loan loss provision of RMDC ranges from lowest in 1.40% in (2005/06) to 2.77% in (2004/05). Lower the loan loss provision ratio, better for the financial institution. This ratio was 1.53% in 2002/03 which then declines to 1.19% in the next year. Then again in the year 2004/05 it increased to the maximum of 2.77% and declined to 1.40% in next year. It reached to 2.23% in the year 2006/07. Thus, it is in very fluctuating trend. The mean ratio of 1.82% reveals that non-performing loan of RMDC is quite low. It has been able to maintain healthy loan loss ratio which shows that RMDC has been quite successful in recovering loans from its partner organizations timely. Another reason is the criteria for lending loan. The bilateral agencies which fund RMDC have given strict guidelines in lending loans. RMDC itself has strict criteria for lending loans to its partner organizations. So, all the loans are categorised under good loan.

The trend of Loan Loss Ratio has been presented below:

**Figure No. 13 – Loan Loss Provision Ratio**




### 4.1.5.3 Interest Income from Loans to Loans and Advances ratio

Interest income from loans to loans and advances ratio measures how much RMDC has been earning against the loans and advances disbursed to its partner organizations. Generally, interest on micro-credit is higher than on normal loan.

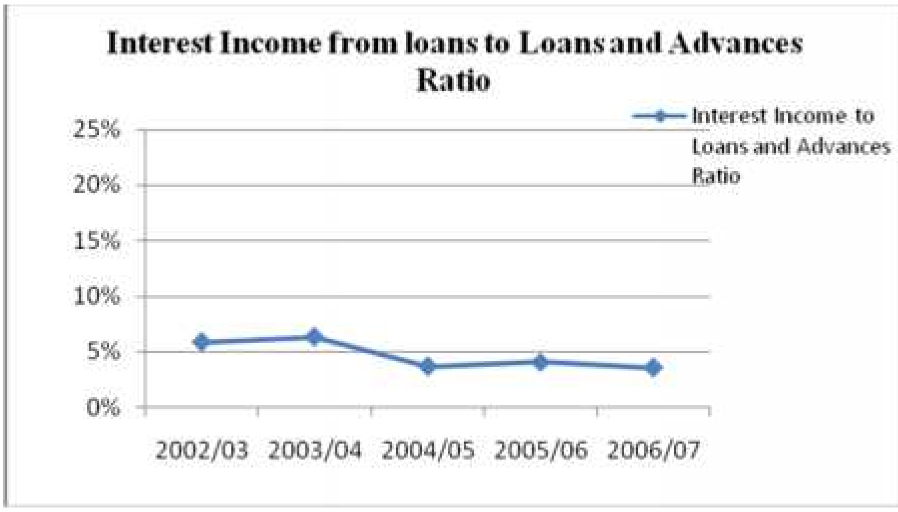
**Table No. 16 – Interest Income from Loans to Loans & Advances Ratio**

| Interest Income from loans to Loans and advances Ratio (Rs. In lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Interest Income from Loan (Rs.) | 71.16 | 84.33 | 118.66 | 203.16 | 400.56 |
| Loans & Advances (Rs.) | 1,209.06 | 1,334.67 | 3,258.35 | 5,008.54 | 11,350.44 |
| Ratio | 5.89 | 6.32 | 3.64 | 4.06 | 3.53 |
| Mean Ratio (%) | 4.68 | | | | |

The above Table shows the ratio of interest income to wholesale loans disbursed by RMDC to its partner organizations over the period of five years. The interest income is the income that RMDC earns from lending loans. It can be seen that in the year 2002/03, ratio of interest income from loans disbursed is 5.89% which increased to 6.32% in 2003/04. Then after, it started to decrease. The higher ratio in 2002/3 and 2003/4 is due to the high lending rates charged during the initial years. Similarly, the reason for decline in the ratio of interest income is due mainly to decrease in interest rate by RMDC in a bid to make the lending criteria more liberal so that its services could be expanded to more POs scattered around the country.

The trend of interest income from loans to loan disbursed by RMDC is shown graphically as follows:

**Figure No. 14 - Interest Income From Loans to Loans and Advances Ratio**




### 4.1.5.4 Interest Expenses to Total Borrowings Ratio

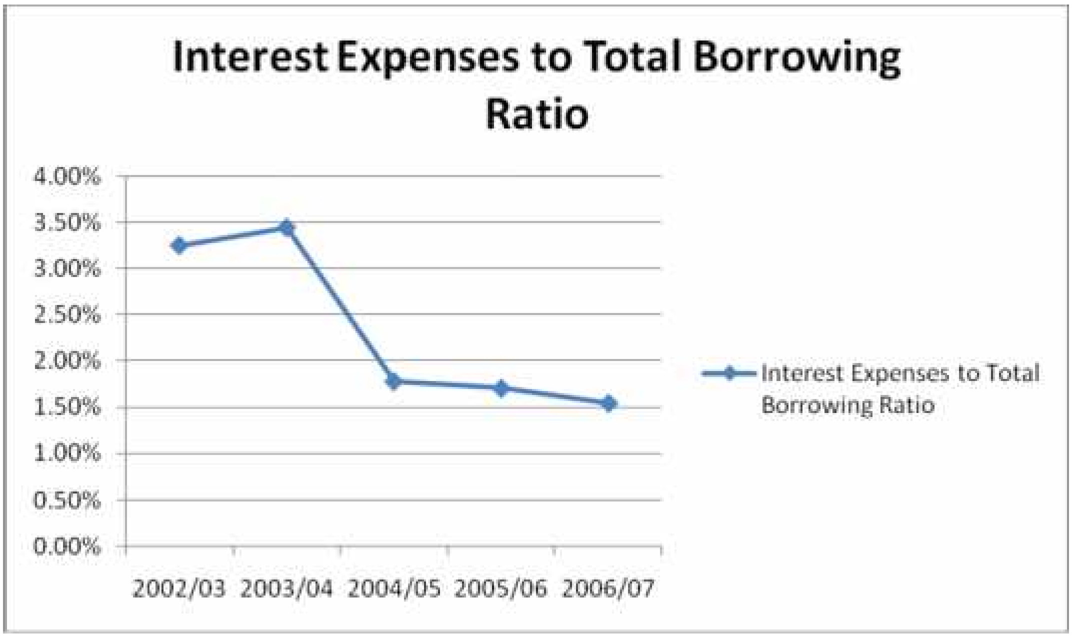
As RMDC is the wholesale microfinance lending institution which disburses loan to number of partner organizations (NGO, INGO, Credit and Cooperatives, etc), it needs to borrow sufficient amount of fund from outsiders like commercial banks, international donors etc. It has to pay certain rate of interest on those borrowings. Thus, this ratio measures how much interest on an average RMDC has been paying against the total borrowings. Lower the rate of interest, better and profitable for institution. The following Table shows the interest expenses to total borrowings ratio.

**Table No. 17 – Interest Expenses to Total Borrowing Ratio**

| Interest Expenses to Total Borrowing Ratio (Rs. in Lakhs) | | | | | |
|---|---|---|---|---|---|
| Details | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Interest Expenses (Rs.) | 98.16 | 137.58 | 118.88 | 154.35 | 237.31 |
| Total Borrowing (Rs.) | 3,019.02 | 3,995.76 | 6,670.19 | 9,036.13 | 15,339.51 |
| Ratio (%) | 3.25 | 3.44 | 1.78 | 1.71 | 1.55 |
| Mean Ratio (%) | 2.34 | | | | |

The above Table shows that interest expenses to total borrowing ratio of RMDC starts from 3.25% in the year 2002/03 which it slightly increases to 3.44% the next year and from then afterwards, it starts to decrease in the next three years. The ratio declines to 1.78% in 2004/05, and further declines to 1.71% and 1.55% respectively in the following two years. We can see that the rate is higher in these two years compared to other three years. It is because in the year 2003/04, total borrowing slightly increased to Rs. 3995.76 lakh from 3019.02 lakh. But in the next year, borrowings have sharply increased to Rs. 6670.19 lakh therefore; the rate of interest has been lowered in this year i.e. 1.78%. In the year 2006/07, total borrowing has reached to Rs. 15,339.51 lakh (increased by almost 70%), while the interest expense ratio is only 1.55%. Thus, it shows that higher amount RMDC borrows, lower the interest expenses it has to bear. Higher borrowing is due to the increment in partner organization of RMDC which has reached to 58 around the country. The trend of interest expenses to total borrowing is shown in the following figure.

**Figure No. 15 – Interest Expenses to Total Borrowing Ratio**




## 4.2 Appraisal of RMDC's Managerial Performance

RMDC's managerial performance has been evaluated on the basis of Micro-Finance Institution (MFI) staff training and Micro-Finance Institution (MFI) client training conducted by RMDC.

### 4.2.1 MFI and Partner Organization (PO) Staff Training

Training of PO's personnel has been identified as one of the vital activities of RMDC for enhancing institutional capacity of the former. This has supported the POs operate their functions professionally and successfully. RMDC also provides supports for providing training to the ultimate borrowers for strengthening their organizational capacity and upgrading their entrepreneurial skills. RMDC has separate department, i.e. Institutional and Social Development Department, to manage the training programs to make the programs cost-effective and result oriented.

Here, we will analyse the MFI Staff training program from fiscal year 2002/03 to fiscal year 2006/7.

**Table No. 18 - Annual MFI Staff Training Progress**

| S. No. | Fiscal Year | Participants Nos. | Annual Growth Rate (%) |
|---|---|---|---|
| 1 | 2002/03 | 1020 | - |
| 2 | 2003/04 | 1226 | 20.19 |
| 3 | 2004/05 | 1446 | 17.94 |
| 4 | 2005/06 | 1127 | -22.06 |
| 5 | 2006/07 | 2117 | 87.84 |
| | Total | 6936 | |

From the above table it can be seen that in each fiscal year, significant number of MFI staffs have participated in the training program. Annual growth rate of participants have also been calculated which shows that there has been increment in number of trainees each year except in the year 2005/06. In this year the number of trainees has been decreased to 1226 from 1020 but in the next fiscal year this rate has been highly improvised as the growth rate increases to 87%. In these 5 fiscal years the total number of MFI Staff trainees is 6936 which shows that RMDC has been highly supporting its PO for their capacity building. The major staff training programs of RMDC in each above mentioned fiscal year have been briefly described below:

In the fiscal year 2002/03, altogether 1020 staff of various MFIs and PO have participated in different training programs conducted and supported by RMDC.

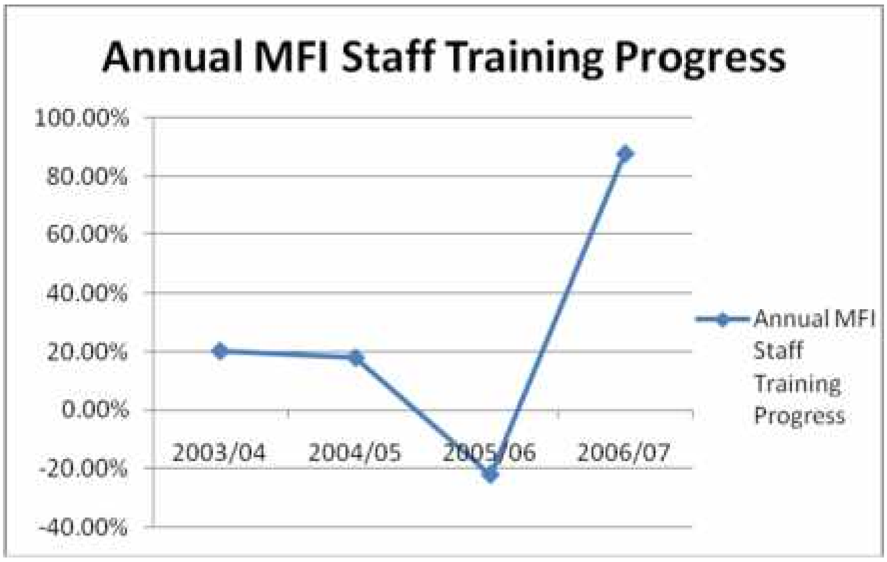
During the fiscal year 2003/04, 1226 staff of MFIs participated in different training programs supported by RMDC. It also organized an interaction program on microfinance for auditors of its partner organizations and another program with economic journalists. 20 Account Officers and Branch Managers of MFIs were trained on accounting and financial reporting. 13 branch managers were trained on financial analysis and on a computer software for branch viability planning, 25 senior officers including Chief Executives of MFIs participated in a workshop on center and branch rehabilitation, 58 board members of 14 FINGOs and cooperatives participated in Exposure Visit Programs to observe best practices of microfinance operations in successful organizations. 129 board members of different MFIs participated Interaction program on microfinance operation. 43 branch managers and officers of partner organizations trained on Delinquency Management and Interest Rate Setting. Chief Executives of 19 MFIs participated in a financial analysis and management.

Likewise, in the fiscal year 2004/05, 101 MFI training programs were conducted, in which altogether 1446 staff of MFIs participated. A total of 79 Accountants and Field Assistants of MFIs were trained on accounting and financial reporting. A total of 71 Board members of 19 NGOs and savings and credit cooperatives participated in exposure visit programs to observe best practices of microfinance operations in other successful organizations. A total of 10 MFIs were provided with on-site consultancy-cum-training service, in which altogether 42 staffs of those organizations were trained. 27 officers of partner organizations participated in training program on monitoring and supervision of MF program.

A total of 95 MFI staff training programs have been conducted in fiscal year 2005/06, in which altogether 1127 MFI staff participated. RMDC provided funds and technical assistances to the Sana Kisan Bikas Bank Ltd. (SKBBL). A total of 172 new recruits of 13 MFIs completed their six-month long induction training programs on micro finance operation with the financial supports and technical guidance of RMDC. Similarly, 98 Accountants and Field Assistants of MFIs were trained on accounting and financial reporting. A training of trainer course on "Integration of Health Education with Microfinance" was organized in collaboration with the Microcredit Summit Campaign, in which a total of 26 officials of MFIs participated. A special course "Financial Analysis and Delinquency Management" was organized for the Purwanchal Grameen Bikas Bank, in which 25 officers and managers of the bank participated. With technical collaboration of the Grameen Trust, Bangladesh, RMDC organized a training program on "Grameen Generalized System", in Kathamandu, in which 26 officials including chief executives of 4 Grameen Bikas Banks, the Centre for Self-help Development and the Neighbourhood Society Centre, Kathmandu participated.

Continuing its support for MFI staff training, RMDC conducted 168 MFI staff training programs in the fiscal year 2006/07 in which 2117 MFI staffs participated. A conference on microfinance for Rotarians was organized in Kathmandu, in which about 75 Rotarians and 25 MF professionals participated. A national level "Partners' Programs Review Workshop was organized, in which executive chiefs of partner organizations participated. A total of 347 trainee field assistants of 36 MFIs completed six-month long induction training program with the financial supports and technical guidance of RMDC. Likewise, 90 executive committee members of 20 institutions participated in exposure, visit programs to learn the best practices of microfinance adopted by successful microfinance organizations. RMDC also supported it's PO in organizing 5 training programs on "Microfinance Operation Management" in which 129 field assistants had participated. Similarly, a seminar on micro-enterprises financing was organized in Kathmandu, which was also participated by 22 executives of MFIs. The trend of Annual MFI staff training progress during the five years is shown in the following figure.

**Figure No. 16 – Annual MFI Staff Training Progress**




### 4.2.2 MFIs Clients Training

RMDC also offers financial and technical supports to its POs to organize need-based training programs for the clients in order to strengthen their credit groups and upgrade their income-generating and entrepreneurial skills. The following table shows the data of MFIs Clients Training from the fiscal year 2002/03 to 2006/07.

**Table No. 19 - Annual Progress of MFI Client Training Program**

| S.No. | Fiscal year | Participants Nos. | Annual Growth Rate (%) |
|---|---|---|---|
| 1 | 2002/03 | 41,962 | - |
| 2 | 2003/04 | 40,338 | -3.87 |
| 3 | 2004/05 | 44,506 | 10.33 |
| 4 | 2005/06 | 71,671 | 61.03 |
| 5 | 2006/07 | 83,087 | 15.92 |
| | Total | 281,540 | |

From the above Table, it can be seen that large number of MFI clients has been trained within the five years. The total number of trainees in 5 years is 281,540.

The annual growth rate is positive in each year except in the year 2003/04, which is -3.87%. But we can see the progress in the very next year in which the number of trainees has been increased by 10.33%. Likewise, in the next fiscal year the participants' numbers have increased massively by 61.03%. The major client training programs of each fiscal year has been briefly described in the following paragraphs.

In 2002/03, a total of 41,962 clients of POs were trained in various programs, workshops, exposures visits and interaction programs under the support of RMDC.

In 2003/04, a total of 40,338 MFI clients participated in different trainings. 194 clients of 11 partner MFIs participated in exposure visit programs to best practices. 10 POs organized workshops for their center chiefs, in which a total of 3000 center chiefs of those organizations had participated. Likewise, 8 POs organized refresher-training programs for their clients, in which a total of 36,037 clients including 7,797 clients' guardians had participated. 3 POs organized special interaction programs with members' guardians (male spouses of the female members), in which a total of 767 guardians had participated. 69 clients of 3 POs were trained on livestock raising and 123 clients of 2 POs were given training on making Vermi compost.

During 2004/05, a total of 44,506 MFIs clients participated in various programs. A total of 288 women members of 14 MFIS participated in exposure visit programs to best practices. 131 workshops of Center Chiefs were organized, in which a total of 4,180 center chiefs participated. 1,061 refresher-training programs was also organized for clients at their respective center which was participated by 29,124 women clients. Likewise, 1286 clients were trained on horticulture type enterprise, livestock, poultry farming, off-farm activities, junior electrical and mechanical works. POs organized 421 pre-group training programs, in which altogether a total of 8,390 eligible poor women participated. A total of 21 training programs on book keeping and accounting were organized, in which altogether 531 committee members of self-help groups participated.

A total of 71,671 MFIs clients participated in various programs in the fiscal year 2005/06. During this year, 455 clients of 45 MFIs participated in exposure visit programs. A total of 382 workshops of center chiefs were organized in which a total of 11,55- center chiefs participated. Similarly, a total of 1,108 clients or their family members participated in different income-generating skills development training programs. Nine training programs on vocational skills development were organized in which around 182 clients participated.

During the fiscal year 2006/07 altogether 83,087 MFIs clients participated in various training programs. A total of 202 clients of 16 MFIs participated in exposure visit programs to best practices. 356 workshops were organized. A total of 967 pre-group training programs for eligible members were organized, in which total 16,882 eligible women participated. A total of 2,634 clients or their family members participated in different income-generating skills development training programs. Likewise, 1,709 refresher training programs were organized for clients, in which a total of 50,050 clients participated. The trend of annual progress of MFI client training program is shown in the following figure.

**Figure No. 17 – Annual Progress of MFI Client Training Program**


### 4.2.3 Human resources (Manpower)

Manpower is also one of the main basis of measuring and evaluating managerial performance of RMDC. It shows how RMDC is able to utilize its human resources. The following Table shows the number of professional and support staff of RMDC from the year 2002/03 to 2006/07.

**Table No. 20 - Number of Staffs in Different Fiscal Year**

| Fiscal Year | Professional Staff* | Support Staff | Total Staff |
|---|---|---|---|
| 2002/03 | 7 | 4 | 11 |
| 2003/04 | 7 | 5 | 12 |
| 2004/05 | 9 | 5 | 14 |
| 2005/06 | 12 | 6 | 18 |
| 2006/07 | 12 | 6 | 18 |

**Includes the Chief Executive Officer*

The above table indicates that number of total staffs in RMDC after comprising professional and support staffs in the year 2002/03 was 11 which show few staff operating the institution. Then in the next year the number of staffs slightly increased to 12 and it further increased to 14 in the year 2004/05. In 2005/06, 4 staffs joined RMDC followed by 4 more staffs joined this institution the following year. Along with the increase in the area of operation, the number of staff has also increased. However the growth rate of staff can be considered as negligible. For a wholesale micro finance institution carrying out wide range of operation in micro financing, providing trainings to its POs and clients, it is indeed appreciable that few numbers of staffs are carrying out the operations efficiently. The low number of staffs shows the efficient and effective utilization of human resources by the management of RMDC thereby reducing operating costs. The staffs are well-trained, experienced, well-motivated to carry out various activities. This shows that RMDC has a very professional and skilled manpower.

### 4.2.4 Annual Loan Portfolio Growth of RMDC

The annual loan portfolio growth of RMDC from the year 2002/03 to 2006/07 is presented in the following Table:

**Table No. 21 - Annual Loan Portfolio Growth of RMDC**

(Rs. In lakhs)

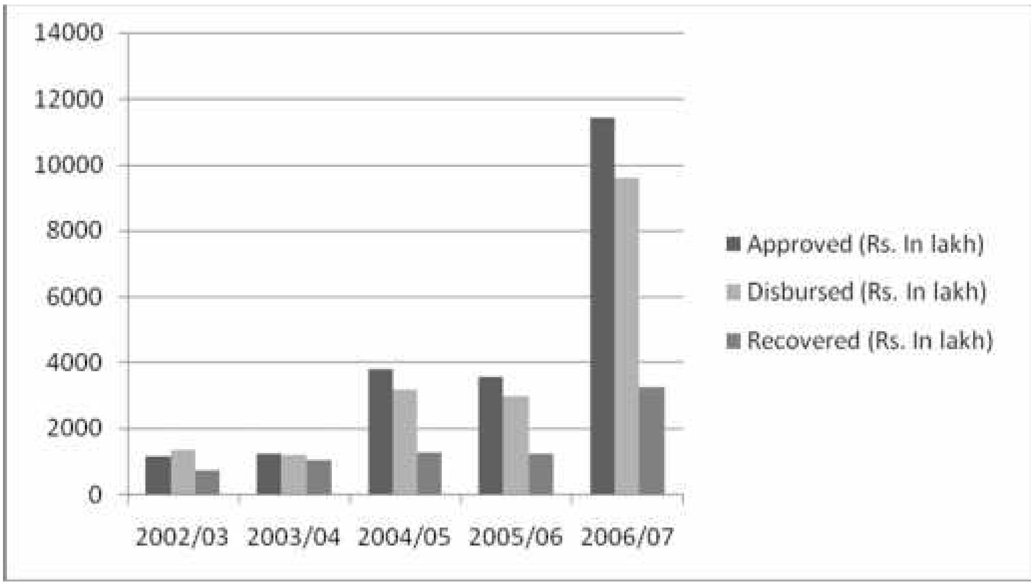
| Fiscal Year | Approved | Disbursed | Recovered | Outstanding |
|---|---|---|---|---|
| 2002/03 | 1165.20 | 1370.50 | 734.20 | 1209.10 |
| 2003/04 | 1232.00 | 1188.10 | 1062.50 | 1334.70 |
| 2004/05 | 3827.70 | 3206.50 | 1282.90 | 3258.40 |
| 2005/06 | 3578.30 | 2982.40 | 1232.20 | 5008.50 |
| 2006/07 | 11436.80 | 9610.70 | 3268.80 | 11350.40 |
| Total | 21,240.00 | 18,358.20 | 7,580.60 | |

The above shows the loan portfolio growth of RMDC over the five fiscal years from 2002/03 to 2006/07. The total amount approved for disbursing loan in the year 2002/03 is Rs. 1165.20 lakhs but it is seen that more than that amount has been disbursed by RMDC to its partner organizations, i.e. Rs. 1370.50 lakhs. In that year, Rs. 734.20 lakhs have been recovered which makes it around 54% of loan disbursed. Similarly, the outstanding loan is Rs. 1209.10 lakhs which includes the un-recovered loan from the previous years also. Likewise, in the year 2003/04, the total loan approved is Rs. 1232 lakhs out of which Rs. 1188.10 lakhs have been disbursed. Rs. 1062.50 lakhs have been recovered from the disbursed loan. The percentage of loan recovery that year is almost 90% which is an excellent loan recovery rate. And the outstanding loan for that year is Rs. 1334.70 lakhs. In the next year 2004/05, there has been significant increment in the amount of loan approved. The total approved loan is Rs. 3827.70 lakhs out of which Rs.3206.50 lakhs have been disbursed. The recovered amount is Rs. 1282.9 lakhs. That means, 40% of the loan has been recovered that year and the loan outstanding adds up to Rs. 3258.40 lakhs. Then in the year 2005/06, RMDC approves Rs. 3578.3 lakhs for the disbursement of loan and out of which it has disbursed around 83% i.e. Rs. 2982.40 lakhs to its partner organizations. The loan recovery rate is low in this year as well because only around 40% loans have been recovered and the outstanding loan is Rs. 5008.50 lakhs. In the fiscal year 2006/07, the amount approved for loan has increased extremely to Rs. 11,436.8 lakhs. It is an increment by almost 220%. The increase in loan is due to the increase in partner organizations and also RMDC made changes in its lending rates. Out of that amount, RMDC has disbursed Rs. 9610.70 lakhs which makes it 84% of loan approved. But in that year, only 34% loan has been recovered and the outstanding loan adds up to Rs. 11,350.40 lakhs.

In overall, it reveals that in those five fiscal years RMDC approved a total of Rs. 21,240 lakhs for the disbursement of loan to its partner organizations around the country. Out of the total approved loan RMDC has disbursed around 84% loan i.e. Rs. 9610.70 lakhs. And the total loan recovered over those 5 years is Rs. 7580.60 lakhs. And the loan outstanding at then end of year 2006/07 is Rs. 11,350.40 lakhs. Thus, it can be seen that loan portfolio of RMDC has been growing year by year.

The detailed particulars loan portfolio of RMDC is given in annexure. The bar diagram of loan portfolio is shown in the table below:

**Figure No. 18- Annual Loan Portfolio growth of RMDC**




## 4.3 Compliance with Legal and Regulatory Framework

The Bank and Financial Institution Act 2063 (BAFIA) requires that a bank or a financial institution licensed by NRB should comply with NRB directives apart from the legal framework. As such, a brief detail on the status of compliance of those frameworks by RMDC has been presented.

### 4.3.1 Paid-up capital requirement

The Section (40) of BAFIA has the provision of requirement of maintaining minimum capital as prescribed by NRB during a stipulated period of time. Accordingly, RMDC as a 'D' category financial institution operating at national level should maintain minimum paid-up capital of Rs. 10,00 lakh by 2070 B.S. In this context, paid-up capital of RMDC of last 5 years is as follows:

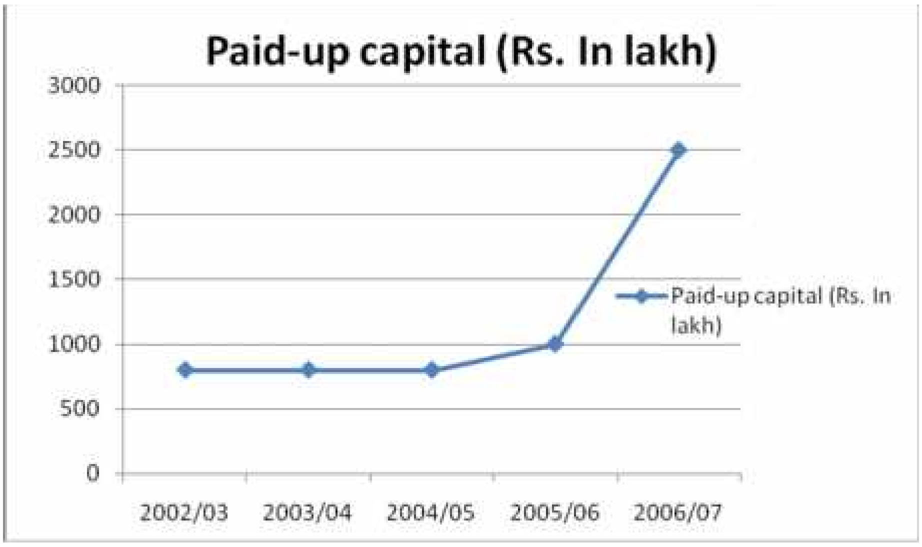
**Table No. 22 – Paid-up capital**

| Fiscal Year | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
|---|---|---|---|---|---|
| Paid-up capital (Rs. In lakhs) | 8,00 | 8,00 | 8,00 | 10,00 | 25,00 |

From the above table, it can be seen that the paid-up capital of RMDC was Rs. 8,00 lakh in the year 2002/03. It has maintained the same capital till 2004/05. In the year 2005/06, paid-up its capital was increased to 10,00 lakh which was further increased to Rs.25,00 lakh in 2006/07. Thus RMDC has been able to increase the capital in short span to time and has been able to maintain sufficient level of paid-up capital well before the given timeframe. It shows RMDC has strong paid-up capital base to expand its wholesale microfinance lending and support programs, strong enough to get the confidence of POs.

The trend of paid-up capital is shown in the figure below:

**Figure No. 19 – Paid-up Capital**



From the above figure also it can be seen that paid-up capital of RMDC is Rs. 8 crore for the first three years and then it has reached to the required level of Rs. 10 crore in the fiscal year 2005/06. Then, in the next year, paid-up capital has increased by 1.5 times.

### 4.3.2 Capital Adequacy Ratio

Adequate capital is necessary to absorb losses not covered by earnings. Capital adequacy provides protection to depositors and ensures public confidence in financial system. Capital adequacy ratios are considered to be most significant indicators for a financial institution. It helps to determine how much capital is required to be maintained by FIs for its financial strength so that it can run in financially sound base. What is an appropriate capital adequacy ratio for a financial institution depends on its transaction. Holding extremely high/low capital may e undesirable in terms of lower return from their investment or lower solvency position. In this context, NRB has directed financials institutions to maintain specific minimum core capital and capital fund. Similarly, NRB has prescribed the minimum paid-up capital for FIs.

This ratio measures the portion of firm's capital fund. In case of any financial institution this ratio is considered to be more important. Financial institution should maintain the capital fund according to their requirement. If financial institutions hold more capital than their minimum requirement, it can cause them to have higher holding cost and low return. At the same time holding too little amount of capital than required may result in the shortage of fund.

Here, core capital includes total of paid up capital, Reserve and surplus and undistributed profit, while capital fund is the total of core capital and supplementary capital.

NRB regulation requires that microfinance development banks should maintain the capital fund of minimum 8 percent of RWA and core capital of minimum 4 percent of RWA. Calculation of RWA is given in Annex XI. In this context, the Capital Adequacy Ratio: CAR (capital fund and core capital) over the period of five years is as follows:

**Table No.23 - Capital Adequacy Ratio**

| CAR (Core Capital and Capital Fund) (Rs inLakh) | | | | | |
|---|---|---|---|---|---|
| | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
| Paid up Capital (Rs.) | 800.00 | 800.00 | 800.00 | 1,000.00 | 2,500.00 |
| Reserves and Surplus (Rs.) | 165 | 217 | 268 | 344 | 413 |
| Core Capital (Rs.) | 965 | 1,017 | 1,068 | 1,344 | 2,913 |
| % of Core Capital to RWA | 72.23 | 65.99 | 14.07 | 13.14 | 14.77 |
| Capital Fund (Rs.) | 989 | 1057 | 1198 | 1545 | 3367 |
| % of Capital Fund to RWA (%) | 74.02 | 68.59 | 15.79 | 15.10 | 17.07 |
| Risk Weighted Assets (RWA) | 1336 | 1541 | 7587 | 10226 | 19718 |
| Mean % of core capital to RWA | 36.04 | | | | |
| Mean % of capital fund to RWA | 38.11 | | | | |

The above table shows the core capital and capital fund of RMDC for the five years. The required rate of core capital to be maintained as per NRB regulation is 4% but it can be seen that core capital % of RMDC is very high in the year 2002/03 and 2003/04. The ratio is 72.23% in 2002/03 and 65.59%. The reason for this high core capital ratio is due to low amount of risk weighted assets in those years. In those two fiscal years the amount of loan disbursement was very low due to few number of partner organizations. Later on, the number of partner organizations of RMDC increased and hence the amount of loan disbursement was also increased. According RWA also increased substantially. As a result, % of core capital to RWA has decreased sharply to 14.07% in the year 2004/05 and it has further decreased to 13.14% in the very next year and the ratio is 14.77% in the year 2006/07. Although the % of core capital has decreased in the recent years, it is well above the mandatory requirement.

Similarly, capital fund to RWA ratio is very high i.e. 74.02% and 68.59% in the year 2002/03 and 2003/04, whereas the required rate is only 8%. The reason behind this very high ratio is same as above. And in the very next year, this ratio has sharply declined to 15.79% and 15.10% respectively in the following two years due to increase in loan disbursement in the later years.

It can be seen that both the core capital and capital fund ratios are much higher than the standard stipulated by NRB. Thus, it denotes that capital adequacy of RMDC is very strong to carry out its lending operations.

### 4.3.3 Holding of Annual General Meeting (AGM)

The Section (76) of Company Act requires that every public limited company should hold AGM within 6 months of the expiry of fiscal year. RMDC has been conducting AGM within the stipulated timeframe during fiscal years 2002/03 to 2006/07.

### 4.3.4 Floating of Public Share

RMDC as a public limited company should issue at least 30% share of paid-up capital for public as per BAFIA, section (7). RMDC came into operation in 2001 but till now it has not issued public share. BAFIA section (46) also states that no dividend can be distributed in case of financial institution not going public. However, RMDC has been distributing dividend to its promoters from fiscal year as follows:

**Table No. 24 – Distribution of Dividend**

| Fiscal Year | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
|---|---|---|---|---|---|
| Dividend (Rs. in lakh) | - | 8 | 16 | 30 | 75 |

The above table clearly shows that RMDC has been distributing dividend to its promoters from fiscal year 2003-04 in accordance with its Articles of Association which states that RMDC will go in public if necessary. However, this clause is contrary to the provision in BAFIA.

### 4.3.5 General Reserve Fund

The General Reserve Fund is the statutory reserve. It is meant to strengthen the capital composition in commensurate with the earnings and to keep check on the distribution of profit to shareholders. The statutory reserves are not available for distribution by way of dividend and can be used or applied for the purposes specified in the NRB directives or with prior approval from NRB. The ratio shows capital growth and strength. There is no hard and fast standard of this ratio as such. It is measured by comparing with peer group and change from the previous period.

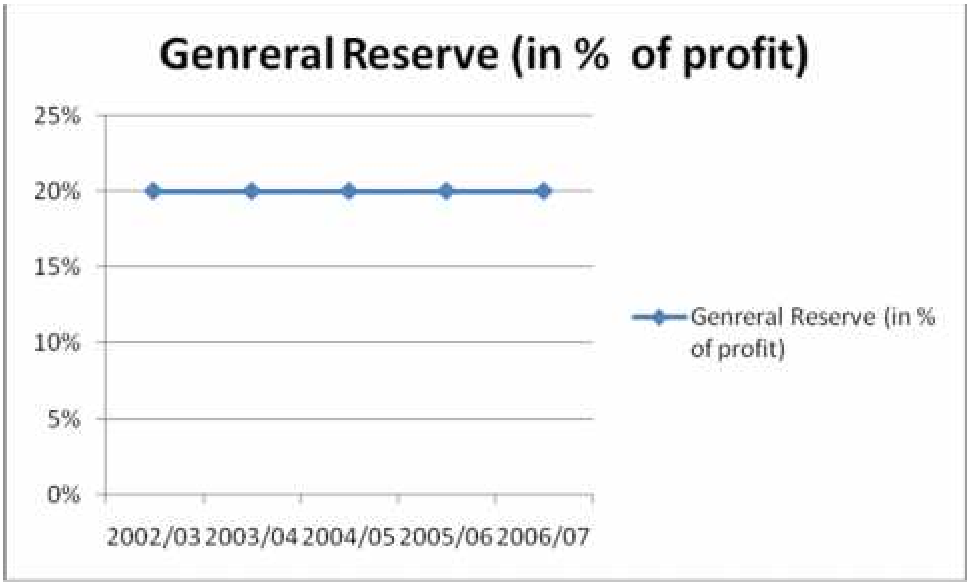
According to BAFIA Clause (44), financial institution are mandatorily required to earmark at least 20% out of its net profit in General Reserve Fund every year until it becomes double of paid-up capital. In this context, the annual contribution of general reserve over the period of five years in the case of RMDC is as follows:

**Table No. 25 – General Reserve Fund**

| Fiscal Year | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
|---|---|---|---|---|---|
| General Reserve Fund (Rs. in lakh) | 10.55 | 12.08 | 13.69 | 23.95 | 30.16 |
| Net Profit (Rs. in lakh) | 52.78 | 60.43 | 68.45 | 119.76 | 150.83 |
| Genreral Reserve (in % of profit) | 20 | 20 | 20 | 20 | 20 |

From the above table, it can be seen that RMDC has contributed 20 percent of its net profit to general reserve fund in each fiscal year. Thus, it has complied with the legal provision. This is shown graphically in the following figure.

**Figure No. 20 – General Reserve**



### 4.3.6 Cash Reserve Ratio (CRR)

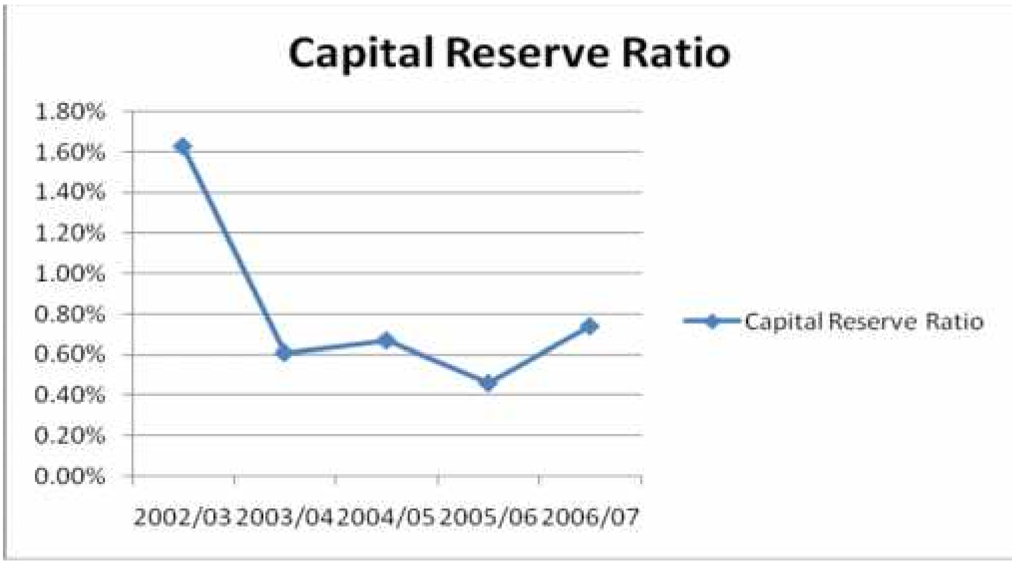
Cash reserve ratio is related to financial resource mobilization. It is the minimum balance to be maintained in NRB account. It should maintain 0.5% of total amount of financial resources in case of micro-finance institutions. like RMDC which has no public deposit, CRR should be maintained on the basis of total borrowings as financial resources. CRR is the percentage of NRB balance on total borrowings. CRR of RMDC of the last five fiscal years is shown in the table as follows:

**Table No. 26 – Cash Reserve Ratio**

| Fiscal Year | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
|---|---|---|---|---|---|
| Borrowings (Rs. in lakh) | 3019.02 | 3995.76 | 6670.19 | 9036.13 | 15339.51 |
| NRB Balance (Rs. in lakh) | 49.51 | 24.48 | 45.13 | 41.68 | 114.28 |
| CRR | 1.63 % | 0.61 % | 0.67 % | 0.46% | 0.74% |

From the above table, it can be seen that RMDC has maintained CRR of 1.63% in the fiscal year 2002/03 which is very much higher than the required level. In the very next year the CRR has been decreased substantially to 0.61% but still the required level of 0.50% has been maintained. Then in the year 2004/05 CRR is 0.67% in the next year CRR level has been decreased to 0.46% which is below the required level. Thus, it is found that RMDC has not maintained the 0.50% of CRR in this year but in the year 2006/07, it has increased its CRR to 0.74%. Thus it can be concluded that overall RMDC has been maintained the required level of CRR except in that 4$^{th}$ year.

**Figure No. 21 – Cash Reserve Ratio**



### 4.3.7 Liquidity Ratio

Liquidity ratio identifies level of liquidity and its risk factor. FIs with large balance sheet exposures or which rely heavily on large corporate deposits have relatively high level of liquidity risk. Liquid FIs is one that has the ability to meet large unexpected declines in its deposit base. A highly illiquid asset on the balance sheet is loans. Liquidity represents the ability of FIs to accommodate decrease in deposits and other liabilities as well as growth in assets. FIs have liquidity when it has the ability to obtain sufficient fund in a timely manner at a reasonable cost. FI is considered to have a liquidity problem if it needs to rely upon prohibitively high cost of funds or sale of assets, in order to meet unforeseen cash needs, such as deposit run-off. Sign of liquidity problem may cause loss of depositors' confidence in FIs, eventually leading to its probable closure.

A 'D' category financial institution is required to maintain 2.5% of deposit liabilities as liquidity. Liquidity includes; cash at vault, investment in government bond/NRB bond, deposits held in 'A' category institutions. As a wholesale micro-finance institution, RMDC does not collect deposit from public or partner organizations. And it is not mandatory to maintain 2.5%. However, RMDC has maintained sufficient liquidity in the form of cash at vault, government bonds, and deposits in banks.

**Table No.27 – Liquidity Position of RMDC**

| **Fiscal Year** | **2002/03** | **2003/04** | **2004/05** | **2005/06** | **2006/07** |
|---|---|---|---|---|---|
| **a ) Cash at Vault (Rs.)** | 9284.63 | 9109.50 | 7041.57 | 3012.14 | 9433.90 |
| **b) Investment on national saving certificate and bonds (Rs.)** | 42,500,000 | 42,500,000 | 42,500,000 | 42,500,000 | 12,500,000 |
| **c) Deposits in commercial banks (Rs.)** | 226,702,431 | 311,500,000 | 412,212,067 | 507,311,502 | 776,326,225 |
| **Total Liquid Assets (a+b+c)** | 269,211,716.63 | 354,009,110.5 | 454,719,109.57 | 549,814,514,14 | 788,835,659.9 |

From the above table, it can be seen that liquidity position of RMDC is maintained primarily by investment in national saving certificate/bonds, and deposits in commercial banks. As RMDC does not accept deposits from public, cash at vault is very less in each of the year i.e. Rs. 9284.63 in 2002/03 and this figure has decreased in the following three years and has reached to the lowest of Rs. 3012.14. Investment on national saving certificate & bonds is Rs. 42,500,000 in the year 2002/03 and it has remained constant in the next three years i.e. till year 2005/06. It has increased to Rs. 12,500,000 in the year 2006/07. Deposits in commercial banks have increased in every year. Deposits was around Rs. 2 crore in the fiscal year 2002/03 which then has increased to around Rs. 3 crore in the next year. Likewise, deposits have further increased to about crore, Rs. 5 core and Rs. 7.5 crore respectively in the next three years.

Thus the figures in the above table show the strong liquidity position of RMDC.

## 4.4 Impact of RMDC's Lending On Its Partner Organization

Performance of partner organizations has also been described briefly. The data for this purpose has been derived from the various reports of RMDC. In this context, operational

and financial efficiency of the partner organization is measured by certain relevant ratios and a study carried out by RMDC on Clients of RMDC's partner organization:

### 4.4.1 Impact of Microfinance at Client Level

RMDC, in August 2007, completed a study on the impact of microfinance services on the clients, who have participated in microfinance programs of RMDC's partner organizations for at least three years. The study report indicates that there has been positive impact of microfinance services on the livelihoods of the clients and their families. The major ones are follows:

- The dependence on money lenders and relatives has decreased by 69% and 65% respectively.
- There was increase in cash income by 250% among the beneficiary households.
- The average savings per beneficiary household increased by 286%.

- The beneficiary clients have added assets like radio, television, utensils, gold ornaments and furniture substantially.
- There is a gradual shift from houses of thatched roofing to tiled and corrugated and RCC among majority of the clients. The number of thatched roof houses has decreased by 65% in three years.
- The land holding size has increased by 61%
- Food self sufficiency for 12 months from own regular production and income source and income has improved from 31% to 85%.
- There are significant changes observed in the use of safe drinking water and sanitary toilets.
- Almost all of them are sending their children to schools.
- There have been big changes in social aspects. For example, feeling of untochability reduced, participation of women in community works increased, and respect to the women from their family members and society increased.

### 4.4.2 Staff Productivity Ratio

The following table shows the staff productivity ratio.

**Table No. 28 – Staff Productivity Ratio**

| Fiscal Year | No. of centers per field staff | No. of members per field staff | No. of borrowers per field staff | Outstanding loan per field staff (Rs. In million) | Ratio of field staff to total staff (%) |
|---|---|---|---|---|---|
| 2002/03 | - | - | - | - | - |
| 2003/04 | - | - | - | - | - |
| 2004/05 | 16 | 416 | 321 | 2.1 | 60.8 |
| 2005/06 | 16 | 438 | 342 | 2.4 | 62.5 |
| 2006/07 | 15 | 400 | 310 | 2.5 | 63 |

The above Table shows high productivity ratio on the part of the staff of RMDC partner organisations. From the available data, the number of centres per field staff as at 2006/07 seems to have decreased by 1 compared to previous two years. Similarly, the number of members per field staff and No. Of borrowers per field staff also decreased to 400 and 310 in 2006/07 as compared to previous two FYs. The number of members per field staff role to 438 in 2005/6 from 416 in 2004/5, which decreased to 400 in 2006/7. Same trend can be seen in the case of number of borrowers per field staff. It was 321 in 2004/5 which rose to 342 in 2005/6, then decreased 310 in 2006/7. This may be due to the security situation on that particular period of time. However, the outstanding loan per field staff is shows increasing trend. It was Rs 2.1 million in 2004/5 which rose to 2.4 million in 2005/6 and Rs 2.5 million in 2006/7. Similarly, the ratio of field staff to total staff recorded at increasing trend. It is 60.8 percent in 2004/5, 62.5 percent in 2005/6 and 63 percent in 2006/7. Overall the staff productivity ratio can be assessed as satisfactory.

### 4.4.3 Branch Productivity Ratios

The following table shows that branch productivity ratio.

**Table No. 29 – Branch Productivity Ratio**

| Fiscal year | No. of centers per branch | No. of members per branch | No. of borrowers per branch | Loan outstanding per branch (Rs. In million) |
|---|---|---|---|---|
| 2002/03 | - | - | - | - |
| 2003/04 | - | - | - | - |
| 2004/05 | 50 | 1349 | 1043 | 7.0 |
| 2005/06 | 57 | 1522 | 1189 | 8.46 |
| 2006/07 | 54 | 1434 | 1112 | 8.98 |

The above Table shows that the No. of centres per branch of the partner organisations of RMDC has risen to 54 in 2006/7 as compared to 50 in 2004/05. However, in 2005/6 , 57 centres per branch were operating. It means decline of centres by 7 in 2006/7. Similarly, the No. of members per branch, No. of borrowers per branch and the loan outstanding per branch are also in increasing trend.. Overall, the branch productivity ratio can be rated as very satisfactory.

### 4.4.4 Financial Efficiency Ratios

The following table shows the financial efficiency ratios.

**Table No. 30 - Financial Efficiency Ratio**

| Fiscal year | Operational Expenses (%) | Financial and operational expenses (%) |
|---|---|---|
| 2002/03 | - | - |
| 2003/04 | - | - |
| 2004/05 | 11.4 | 20.4 |
| 2005/06 | 10.7 | 19.7 |
| 2006/07 | 10 | 18 |

The above Table shows encouraging trend of financial efficiency of the RMDC partner organisations. For example, the operational expenses have decreased to 10 percent in 2006/7 as compared to previous two years which were ll.4 percent and 10.7 percent respectively in 2004/5 and 2005/6 respectively Similarly, the financial and operational expenses have also decreased to l8 percent compared to 20.4 percent in 2004/5 and 19.7 percent in 2005/6. Thus the POs have been found not only cost effective, but also they have been able to decrease such expenses over the years.

### 4.4.5 Portfolio Quality

The following table shows the data of portfolio quality.

**Table No. 31 – Portfolio Quality**

| Fiscal year | Current repayment rate (%) | Cumulative repayment rate (%) | Past due rate (%) |
|---|---|---|---|
| 2002/03 | - | - | - |
| 2003/04 | - | - | - |
| 2004/05 | 97.9 | 99.4 | 2.7 |
| 2005/06 | 97.9 | 99.4 | 2.7 |
| 2006/07 | 96.73 | 99.16 | 4.37 |

The Table exhibits the portfolio quality of partner organisations as very satisfactory. The cumulative repayment rate has been more than 99 percent in all the three years as per the available data. However, there is slight decline in current repayment rate which is 96.73 percent compared to 97.9 percent in previous two years.. So is the position of current repayment rate. As a result, past due rate of the portfolio has been maintained at 2.7 percent in 2004/5 and 2005/6, while it is 4.37 percent in 2006/7.

### 4.4.6 Profitability

The following table shows the profitability as follows.

**Table No. 32 - Profitability**

| Fiscal Year | Yield on portfolio (%) | Operational self-sufficiency (OSS) (%) |
|---|---|---|
| 2002/03 | - | - |
| 2003/04 | - | - |
| 2004/05 | 19.8 | 126.6 |
| 2005/06 | 21.8 | 127.8 |
| 2006/07 | 21 | 132 |

The Table shows the increasing trend of profitability of RMDC's partner organisations. For instance, the yield on portfolio has increased to 21 percent as compared to l9.8 percent and 21.8 percent in the previous FYs. Likewise, the OSS has increased to 132 percent in 2006/7, compared to 126.6 percent in 2004/5 and 127.8 percent in 2005/6.

### 4.4.7 Other Performance Ratios

The following table shows the ratios of borrower to member, loan outstanding per borrower and saving balance per member. These ratios also help ascertain the performance of the POs.

**Table No. 33 – Other Performance Ratios**

| Fiscal Year | Borrower to member (%) | Loan outstanding per borrower (Rs.) | Saving balance per member |
|---|---|---|---|
| 2002/03 | - | - | - |
| 2003/04 | - | - | - |
| 2004/05 | 77.3 | 6712 | 1815 |
| 2005/06 | 78.1 | 7116 | 1939 |
| 2006/07 | 78 | 8082 | 2100 |

The above Table clearly shows the increasing trend of ratios on borrower to member, loan outstanding per borrower and saving balance per member of RMDC partner organisations in the FYs under review. The borrower to member ratio has increased to 78 percent in 2006/7 compared to 77.3 percent in 2004/5. Similarly, the loan outstanding per borrower in 2004/5 was Rs 6712 which increased to 7116 in 2005/6 and 8082 in 2006/7. The saving balance per member has also increased substantially over the years. It was Rs l8l5 per member in 2004/5, which increased to l939 in 2005/6 and 2100 in 2006/7. Overall, it indicates that the POs are effortful to cater the growing need of the borrowers, thereby increasing the savings.

## 4.5 Findings of The Study

The findings with regard to the appraisal of performance of RMDC is based on the analysis of various related ratio analysis, managerial evaluation, loan portfolio and compliance of legal as well as regulatory framework and other indicators are summarised as follows:

**1. Liquid Assets**

From the calculation of cash and bank balance to borrowing ratio, it is found that RMDC has sound liquidity position. So, the financial institution is able to provide better serve its partner organizations. Moreover, RMDC has not been able to fully utilise its financial resources, i.e. liquid assets. As such they are invested in government bonds and deposits.

If we look at the trend of liquid assets, it is clear that they are in increasing trend every year, starting from Rs 26,92 lakh in 2002/3 to Rs 78,88 lakh in 2006/7.

**2. Activity/Turnover/Utilization Ratios**

Loans and advances to total borrowing was calculated under this heading. It is found that average ratio is 50.33% which indicates RMDC has invested only half of the total borrowings in the form of loan to its partner organization during the fiscal year 2002/03 to 2006/07. Rest of the total borrowing has been invested in the interest earning sector.

**3. Leverage/Capital Structure Ratio**

Under this ratio, debt to net worth ratio and total debt to total assets ratios have been calculated. The average total debt to net worth ratio of 6.04 times is very high and shows the risky position of the firm in general. However, as RMDC is a wholesale micro finance development bank and its creditors consist of government and bilateral agencies, it is free from such risks.

Similarly, total debt to total assets ratio is found to be 85% which is again very high and indicates risk of creditors' claim on assets. But as mentioned above RMDC's creditors are government and bilateral agencies, therefore, that high ratio will not affect RMDC and it is free from any such risks. Thus, high leverage/capital structure ratio is not a sign of threat for RMDC.

**4. Profitability Ratio**

Under profitability ratio, seven types of ratios have been calculated to find out the profitability position of RMDC. The average return on net worth to total equity is only 6.38% which cannot be considered as a good rate of return in general. But it is reasonable for RMDC because it is not a fully profit-oriented company. Rather, the financial institution was set up to equip the partner organisations, financially and technically.

ROA of RMDC is low in each of the years from 2002/03 to 2006/07. The mean ratio is 0.91% only which indicates that RMDC has not been utilizing its asset more efficiently and effectively. Similarly, ROI is also low with average of 1.85% which indicates RMDC has not been utilizing the fund available for investment efficiently. Thus, both the ROA and ROI are low and RMDC is not successful in utilizing its assets and investment for greater return.

Total interest earned to total asset ratio of RMDC is found to be in decreasing trend which shows that RMDC's interest earning is quite low but nevertheless it has been able to utilize its assets fairly.

Average EPS of RMDC over the five years is Rs. 8.14 which cannot be considered to be high. The reason behind low EPS is that proportionate increase in net profit is less than proportionate increase in total number of share. However, promoter shareholder should be satisfied with this EPS as RMDC is not fully-profit oriented firm.

Return on total income ratio of RMDC is found to be in fluctuating trend over the five years period of time. The average ratio is 20.18% which indicates the good rate of return out of total income for the wholesale institution like RMDC whose main motive is to serve the partner organization in disbursing loan and to enhancing capacity as well. Nevertheless, RMDC although not a fully profit-oriented institution, has been able to distribute dividend to its shareholders. As such, the profitability position of RMDC can be considered as satisfactory one.

**5. Other Ratios**

Four different ratios have been calculated under this heading.

From the calculation of interest paid to interest income ratio, it is found that RMDC's interest expense is less than interest income in each of the years from 2002/03 to 2006/07. This is very good from the point of view of RMDC as it is able to control its expense in relation to increase in income. This has positive impact on profitability.

Loan loss provision of RMDC is at the minimum from 2002/03 to 2006/07 with average of 1.82%. This indicates that RMDC has very good asset quality and it has been able to recover its loan from the partner organization in time.

Average interest income from loans to Loans and advances ratio is 4.68% which is generally low. It means the interest income that RMDC receives from disbursing loans and advances to its partner organization is not so attractive. It is because RMDC is a wholesale lending institution and its lending rates are not supposed to be high, since it aims at providing service to the poorest of the poor through its partner organization.

Interest expenses to total borrowings of RMDC have been declining year by year which is good for it because it is able to minimize its interest expenses. Total borrowing of RMDC has been increasing but interest expense has not been increasing in the same proportion which is beneficial for it. It shows that RMDC has been borrowing in reasonable rate of interest from commercial banks, international donors etc.

## 6. Appraisal of RMDC's Managerial Performance

In this heading, RMDC's managerial performance was evaluated on the basis of various indicators. They include steps towards capacity building of POs and aspects of its human resource management.

From the analysis of capacity building programs to participating microfinance institution staffs of its partner organization, it is found that from the year 2002/03 to 2006/07, a total of **6936 staffs** participated in various trainings programs conducted by RMDC. That is incredible number of trained staffs over these five years. Also it is found that the number of participants has been significantly increased by 87.84% in 2006/07.

Likewise, from the annual progress of MFI client training program analysis, it is found that during the period of five years, RMDC provided various training program for their clients in order to strengthen their credit groups and upgrade their income-generating and entrepreneurial skills. The number of participants who attended these training programs consists of **281,540** which is quite remarkable.

From the analysis of human resource management of RMDC, it is found that with few staffs also RMDC has been able to carry out its operation successfully. The number of staff in 2006/07 is only 18 including Chief Executive Officer. It shows that staffs are well-trained, experienced, well- motivated to carry out various activities and hence, there is efficient and effective utilization of human resource in RMDC.

From the study of annual loan portfolio growth of RMDC, it is found that loan portfolio of RMDC has been growing year by year and in recent years it has increased significantly. The increment in loan disbursement in recent years is because of increase in number of partner organizations and also RMDC has made some changes in its lending rates. The main objective of RMDC is to provide wholesale lending service to its partner organizations. Thus, from this analysis we found that RMDC has been performing to fulfil its objectives as it is seen that RMDC has been disbursing

Therefore, from these three types of analysis it is found that management of RMDC is strong and well-oriented towards its aim and objectives. The institution's human resource base is really commendable.

### 7. Impact on RMDC's Partner Organizations

The study reflects very positive impact of RMDC's lending to the partner organisations. As a chain effect, the clients of RMDC partners have been greatly benefitted. Their social and economic lives have been enhanced to a remarkable extent. Their dependence on local moneylenders and relatives has decreased by 69% and 65% respectively. They enjoy more cash income and saving as well. They have better lives by enjoying modern amenities like TV, radio, furniture and gold ornaments. As such they enjoy better facilities.

Similarly, the ratios on staff productivity, branch productivity, financial efficiency, portfolio, profitability and other ratios seem to be very encouraging. The POs are able to repay the wholesale loan on timely basis, resulting in good asset quality on the part of RMDC.

### 8. Compliance of prevailing legal and regulatory framework by RMDC

From the study of paid-up capital requirement, it is found that RMDC has been able to maintain the sufficient level of paid-up capital directed by NRB, well before the given timeframe. The required minimum paid-up capital is Rs. 10,00 lakh for a national level microfinance development by 2070 B.S. whereas it has already been able to increase its paid-up capital to Rs.25,00 lakh in 2006/07. Thus it has a very strong base of paid-up capital, well before going public. After floating public shares, the FI's paid-up capital will be strengthened even better.

Under capital adequacy ratio, the percentage of core capital to RWA and percentage of capital fund to RWA are calculated and it is found that RMDC has been able to maintain the required level of core capital and capital fund with sufficient cushion, as per the direction or NRB. It is well above the regulatory framework. The average percentage of core capital to RWA is 36.04% which is well above the required level of 4%. Likewise, the average percentage of capital fund to RWA maintained by RMDC has been found to be 38.11% which is also higher than the required level of 8%. Both the ratios are much higher than the standard stipulated by NRB. As such the capital adequacy of RMDC can be judged to be very strong and it is conveniently able to disburse more loans to its POs.

From the records maintained by RMDC, it is found that it has been conducting AGM during fiscal years 2002/03 to 2006/07 within the timeframe stipulated by BAFIA.

RMDC as a public limited company has not issued shares yet for general public although it came into operation on 2001. Additionally, it has been distributing dividend to its promoters contrary to the provision in BAFIA.

Financial institution are compulsorily required to earmark at least 20% out of its net profit in General Reserve Fund every year until it becomes double of paid-up capital. From, the study, it is found that RMDC has maintained this standard. From fiscal year 2002/03 to 2006/07, it has maintained 20% out of its net profit in general reserve fund.

Cash reserve ratio directive of NRB requires micro-finance developments like RMDC to maintain at least 0.5% of financial resources mobilized by it. From the study it is found that RMDC has maintained that level of 0.55 in year 2002/03, 2003/04, 2004/05 and 2006/07. However, it has failed to maintain CRR in the year 2005/06. The CRR in that year is only 0.46 % which is short of the required standard.

As a wholesale micro-finance institution, RMDC does not collect deposit from public or partner organizations. And it is not mandatory to maintain 2.5%. However, RMDC has maintained sufficient liquidity in the form of cash at vault, government bonds, and deposits in commercial banks.

# CHAPTER V
# SUMMARY, CONCLUSION AND RECOMMENDATIONS

## 5.1 Summary

Nepal is a developing country. Majority of its population is very poor. More than 30 percent of the country's total population lives below poverty line. The country needs to strengthen its economic structure to achieve rapid development. Therefore, the country’s economic development cannot take place unless the lives of such people are enhanced economically and socially. This calls for access to finance for these people. Lots of efforts in the form of plans, programs and policies had been made by the government sector as well as the private sector to address this issue for the last several years. Directed lending programs such as priority sector lending, educated unemployed lending program and the lead bank scheme are few of the examples. Currently the deprived sector lending by the commercial banks is in operation. However, majority of the population still live in poverty. There is lack of income-generating avenues particularly in the rural areas. To address these issues, there are a number of financial institutions in the Nepalese financial system. They comprise of commercial banks, development banks, finance companies, cooperatives and NGOs. Apart from this, the informal sector is still prevalent in many rural areas.

The development of any country largely depends on its economic growth. Capital formation is the prerequisite in setting the overall pace of the economic development. Well-organized financial system contributes a lot to the process of capital formation by converting scattered saving into meaningful capital investment in order to support the productive sector. The financial institutions, as indispensable element of the system, play dominant role in the process of economic development. In this context, the development banks contribute immensely toward mobilizing and allocating resources efficiently, developing capital markets for attracting long-term productive investments. They help promote industrialization thereby creating more opportunities for increased productivity. Development banks furnish necessary capital needed for trade, industry and other venture capital that in turns lead to the overall development of the economy and the country.

A micro-finance development bank (MFDB), unlike the general development bank has, however, different objective. It aims at uplifting the social and economic lives of the poor and deprived sector of the economy. Loan is targeted towards income-generating small projects. According to BAFIA, development banks are divided into two categories, viz. Category B and Category D. The former refers to the development bank, while the later indicates micro-finance development bank (MFDB). By type, MFDBs are further divided into two categories, viz. whole and retail development banks. The retail banks get loan from the wholesale one. The wholesale bank receives financial resources in the form of equity and borrowings. The retail development bank and other institutions receiving loan from the wholesale bank are called the partner organizations (Pos). Contrary to a development bank, a MFDB the size of loan is very small and it can transact (i.e. disbursement of loan and collection of savings) only with its members. Hence it is a fully member-based institution. Another peculiarity of such an institution is that it provides micro-credit without any collateral or with group guarantee.

The present study is related to the performance appraisal of RMDC. The financial statements of five fiscal years (from 2002/03 to 2006/07) have been taken for analysis to fulfill the objective of the study. The study has been carried out with a view to evaluate the performance of the RMDC, an apex micro-finance institution that on-lends wholesale loan to its member partner organizations (POs). The number of such POs has risen to 58 by 2006/07. The POs include micro-finance development banks, cooperatives and non-government organizations. As of mid-July 2007, the Centre has disbursed Rs 1,64,37 lakh as wholesale loan to these organizations. The outstanding loan with the partner organizations as at mid-July 2007 stands at Rs 1,13,50 lakh. The loan recovery rate of the Centre has been very encouraging (more than 95 percent) from the very beginning due mainly to the stringent criteria of ending and recovery policy. The POs, with the financial and technical support of RMDC, have disbursed microfinance services to over 5,00,000 poor families, which is nearly 60 percent of the total institutional microfinance outreach in Nepal.

RMDC has made remarkable contribution to the promotion and development of MFIs in Nepal. As of mid-July 2007, RMDC has provided training and institutional capacity building supports to 160 institutions consisting of banks, NGOs and cooperatives. Similarly, a total of 10,140 staff and 364,378 clients of the MFIs have participated various training programs carried out under the financial and technical support of RMDC. Such programs have very encouraging impact on the performance of the POs which generally attain operational self-sufficiency in 2-3 years. Similarly, they have maintained over 99 percent loan repayment rate.

Various facts and figures required for the study had been explored and discussed in the preceding Chapters. Analytical assessment of various aspects related to the financial performance of RMDC has been done by using relevant financial and non-financial tools. After completing the basic analysis required for the study, the final and most important task of the researcher is to enlist findings of the study which had already been done in Chapter IV. In this Chapter, recommendations for rectifying the weaknesses and improving RMDC's financial and operational aspect, based upon those findings have been made. This will provide necessary feedback to the decision makers of the RMDC so as to rectify shortcomings and bring improvement in terms of financial and managerial aspects.

## 5.2 Conclusion

From the findings based on various indicators of RMDC's performance as described in the preceding Chapter, the strength and weakness of the institution can be concluded. It has proved to be a wholesale institution having sound position in terms of financial and managerial aspects. The institution has been able to cater not only the need of finance to its Pos to a great extent, but also to enhance their capacity building through training. Overall, it has contributed towards access the microfinance services to a substantial number of people. RMDC has a very competent manpower, capable enough to run the institution with fewer staff.

The increasing trend of the important variables of the financial performance like net profit, loan and advances, net interest and earning per share reflect the overall improving performance of RMDC. Similarly, the increased capital adequacy ratio displays its sound financial position.

A financial institution's performance cannot be judged solely intern of the profit it has earned by maintaining adequate liquidity and safety, but it should also be evaluated on the ground of the contribution it has made to the community, to the government as well as national economy. It means the institution should come forward with the national priorities like more fund mobilization and service to maximum customers, developing skill and expertise in staffs, earning satisfactory profit and discharging their accountability toward the country and the economy. In this context, RMDC has proved itself very satisfactory.

On the side of weakness of RMDC, the stringent lending criteria can be cited as one. In fact, RMDC was compelled to adopt such policy due mainly to the terms and conditions set by its donors, i.e. the Asian Development Bank. Owing to this, very few institutions seeking finance are eligible to get the wholesale loan facility from RMDC. As a result, a large number of rural banks, cooperatives and non-government organizations are deprived from such a facility. On the part of RMDC, it is not a bad sign, since it has contributed towards making the asset quality very good at all times. The repayment has been very encouraging, since RMDC has to be very selective before embarking on any sort of lending to the POs. Nevertheless, RMDC has revised its criteria over the years which tend to be more liberal, resulting in increased number of PO.

Another area of weakness of RMDC is its non-compliance to legal framework. Even after the completion of nearly one decade of operation, it has not floated public shares. Additionally, it has violated the legal framework by distributing dividend to its shareholders despite the restriction which to FIs not floating public shares.

## 5.3 Recommendations to RMDC

On the basis of the strength and weakness based on the findings of analysis of RMDC, the following recommendations are prescribed. It is expected that they will be helpful to overcome the financial institution's weaknesses. There is sufficient scope for more improvement in thereby making it a financially and managerially sound wholesale institution that can cater the growing need of micro-finance in the years to come.

1. RMDC should be more serious to improve the efficiency in utilizing the borrowings in loan and advance rather than in investment and fixed deposit for generating the profit. Usually, loans and advances are the high yielding investment sector than any other sector. In the fiscal year 2006/07, around 70 percent borrowings were used in lending. RMDC should try to increase this ratio up to 90 percent

2. It is seen that large chunk of funds received as borrowings have been invested in fixed deposit with commercial banks. RMDC should not try to earn by way of investing in fixed deposit. Such borrowings should have been used in productive sector. If it can not properly utilize the fund, it should stop taking borrowings from commercial banks.

3. Floating of public share will definitely help raising capital. Once the public shares are allotted, there will be check and balance in decision making policies, with the appointment of public directors. Thus RMDC will get the status of public limited company in true sense. It also leads to compliance of legal framework. RMDC's higher leverage ratio can be lower by going in public issue.

4. The provision with regard to going public is contrary to BAFIA. It is not in line with the Bank and Financial Institutions Act, 2063 which mandatorily requires that all the BFIs licensed by NRB should earmark at least 30 percent of the equity to the public. It also states that distributing dividend is restricted until such companies float public shares. Therefore, the relevant clause should be duely amended by coordinating with NRB and the Company Registrar's Office.

5. In order to mobilize the borrowings in the productive sectors, RMDC should follow the government plans and polices and help in the overall development of the country.

6. Profit is essential for the survival and growth of any bank and financial institutions. Though RMDC is not fully profit-oriented institution, it should try to earn so that it can plough back the profit. For some years, it should pay attention in strengthening its reserve position by discontinuing the distribution of dividend.

7. In year 2005/06, it has a CRR shortfall i.e. 0.46%. It may be due to its insufficiency in fund management. In the other years it has been able to maintain the CRR level. However, RMDC should be cautious about maintain CRR all the times.

8. It is recommended to make its Internal Audit and Inspection Department stronger so that it could be properly tracked whether the bank is following the directives issued by NRB. Non-compliance to NRB directives may attract fines and penalties.

9. RMDC should give continuity to support its partner organizations. Apart form wholesale lending; various training programs, capacity building programs to its partner organizations should be continued in the coming years as well and try to benefit maximum number MFI staffs and MFI clients.

10. It is recommended RMDC to further increase its wholesale lending and number of its partner organizations by making its lending criteria more liberal. However, proper care should be taken for repayment.

## 5.4 Recommendations to Nepal Rastra Bank

It seems that NRB has been a bit harsh on the micro-finance development banks with the stringent directives in the existing deteriorating economic scenario. NRB should effectively monitor the impact and implementation of the directives. Besides, the directives should be reassessed and further amendments should be made if necessary. On the basis of the study, the NRB should pay attention to the following aspects.

1. The NRB issues directives to protect the interest of depositors and to uplift the banking sector of Nepal to international standards. However, such directives

should be issued after doing proper homework, consultation and interaction with experts. The impact of directives on the bank itself, investors, shareholders, depositors should be seriously studied. Besides, the regulations issued should be practical. Additionally the worldwide accepted regulation may not be applicable in the Nepalese context. In short, more liberal regulations on the part of the MFDBs are desirable.

2. The micro-finance development banks today have played a key role in making available the required finance to the needy. However, the setting up of MFDBs cannot be considered as encouraging. Out of 160 banks and financial institutions, there are only 12 MFDBs, out of which two are wholesale lending institutions. In this context, the NRB should encourage establishment of more micro-finance institutions to cater the growing need particularly in rural sector. Nevertheless, the efforts made by the central so far can be assessed as satisfactory.

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