

**INSTITUTIONALIZATION AND FINANCIAL
SUSTAINABILITY OF
SMALL FARMERS' COOPERATIVES IN THE HILLS OF
NEPAL**

A Dissertation

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The Faculty of Humanities and Social Sciences of
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for the Degree of **DOCTOR OF PHILOSOPHY (PhD) in ECONOMICS**

By

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LETTER OF RECOMMENDATION

We certify that, this dissertation entitled '**INSTITUTIONALIZATION AND FINANCIAL SUSTAINABILITY OF SMALL FARMERS' COOPERATIVES IN THE HILLS OF NEPAL**' was prepared by Mr. Kirti Devkota, under our guidance. We hereby recommend this dissertation for final approval by the Research Committee of the faculty of Humanities and Social Sciences, Tribhuvan University, Kathmandu, in fulfillment of the requirements for the **DEGREE OF DOCTOR OF PHILOSOPHY (PhD) in ECONOMICS**.

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APPROVAL LETTER

This dissertation entitled **“INSTITUTIONALIZATION AND FINANCIAL SUSTAINABILITY OF SMALL FARMERS’ COOPERATIVES IN THE HILLS OF NEPAL”** was submitted by Mr. Kirti Devkota for final evaluation to the Research Committee of the Faculty of Humanities and Social Sciences, Tribhuvan University, in fulfillment of the requirements for the **DEGREE OF DOCTOR OF PHILOSOPHY IN ECONOMICS**. I hereby certify that the Research Committee of this faculty has found the dissertation satisfactory in scope and quality, and has accepted it for the degree.

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ABSTRACT

Agriculture Development Bank Limited, with the technical assistance of GTZ, initiated Small Farmers' Cooperatives Limited since 1993. Prior to this, the ADBL had, since 1975, been actively promoting the Small Farmers' Development Program but it was marred by the higher overhead cost despite its contribution in uplifting the rural economy. The program was supported by multilateral donor agencies such as IFAD, FAO, UNDP and GTZ.

The Small Farmers' Cooperative Limited functions with the guiding philosophy of group principle, self-help development and institutionalization of networks at the grassroots level to reduce the poverty. SFCL has three tier structures - village level groups, inter-groups and the main committee. The village level groups are formed by involving 5 to 10 members from same geographical location and similar economic status having less than 40 katha of land for terai regions whereas 30 ropani of land for hills areas or whose income is less than NRs. 2500 per year per member. Inter-groups are formed by the representation of several village level groups, finally main committee elected from the general assembly. Besides, formulation of main committee at apex level, some other sub-committees such as loan, account and supervision, education and extension are formed to perform specialized function such as looking after loan, account and supervision, education and extension and the overall operation.

Within a very short span of time since its inception, the SFCL has gained the reputation of being a very powerful and effective tool for poverty reduction in the South Asian region and in recognition of this contribution, the CGAP/World Bank, in 2003, awarded the program with the best award carrying a purse of US \$ 50,000.

Some of the most remarkable contributions of these institutions are: saving collection, credit investment and socio-economic improvement. The SFCLs are guided by democratic norms and shares are issued to the members who are empowered with one member one vote for the general assembly purpose. Designing of the saving deposit schemes, credit investment schemes and other activities are planned in a democratic manner with the participation of the largest number of members possible. The institutions function for socio-economic development with the strong policy of being apolitical and

unbiased with no discrimination of any kind on religion and gender basis. The massive success of the SFCL in assisting economic development resulted in fast replication of the program in the adjoining villages since 1999. Through this program, the women members of SFCLs very effectively and efficiently implemented various socio-economic activities. Initiation of the Small Farmers' Development Bank in July 2002 under the Company Act led to further strengthening of SFCLs, which could now provide wholesale credit and enhances capacity of SFCLs.

The male and female SFCL groups showed an increase at an average rate of 10.4 percent and 14.9 percent whereas enrollment of male and female members in the groups increased by 9.8 percent and 14.4 percent respectively. The trend of women participation in the SFCLs has shown quiet positive picture.

Nevertheless, from the primary survey of this research investigated that saving collection from the group members and credit investment on income generating activities had not shown an encouraging increment. Analysis shows that average saving deposit per month per member stood at NRs. 36.88 in the Uttarganga SFCL of Surkhet district, NRs. 36.76 in Fedikhola SFCL of Syangja district, NRs. 21.70 in Shreeantu SFCL of Illam district and NRs. 8.21 in Kalena SFCL of Doti district. Women dominated the Uttarganga and Ferdikhola SFCLs and saving deposit was found to be satisfactory in these institutions.

An average monthly saving per member from five SFCLs stood NRs. 21.57. Likewise, average total amount of saving per member from these five institutions was found to be at NRs. 1966.50. Average interest rate given for savings stood at 6.78 percent ranging from 5 to 8 percent per annum.

Status of saving deposits was found to be at a better position in Mid-western and Western Development regions whereas there was a grim picture of the situation in the Far-western Development Region.

Major chunk of loan investment was made to the SFCL members for undertaking livestock rearing, marketing, cash crop production and for off-farm activities. This investment generated profits, which could be used for further investment or for maintaining the operation cost of the institutions.

Although the SFCLs were found to be playing a great role in improving the overall livelihood of poor people mostly in the rural vicinity, loan investment and collection was not found to be very encouraging suggesting that much needed to be done in this front to fulfill the basic objective of the SFCL to improve the standard of the vastly poor populace.

Of the total 555 sample respondents only 65 percent borrowed loans from the SFCLs while the rest 35 percent members did not have proper access to loan facilities. Average loan investment stood NRs. 42559.7 in marketing, NRs. 32142.85 in off farm activities, NRs. 26884.61 in livestock and NRs. 25660.89 in agriculture projects.

Large amount in borrowing stood at 73 percent in agriculture whereas lowest found at 1.9 percent in social activities

In Kumpur SFCL located in the Central Development Region 27.1 percent of the members were found to have taken loan from the institution, making this the institution issuing loan to the largest percentage of members, the figure stood at 21.1 percent in the Kalena SFCL in Doti of Far-Western Development Region, Uttarganga SFCL in Surkhet of Mid-western Development Region had issued loans to 20.2 percent members, Shreeantu SFCL in Illam of Eastern Development Region issued loan to 16.3 percent members while the figure stood at 15.2 percent for Fedikhola SFCL in Syangja of Western Development Region.

In the loan collection front, it revealed that the average loan collection per project was NRs. 29981.51 in marketing, NRs. 21700 in off-farm activities, NRs 20500 in livestock and NRs 15020.63 in agriculture activities. Delinquency stood at 97.17 percent in marketing, 81.52 percent in livestock and 42.89 percent in agriculture. Uttarganga, Surkhet SFCL had delinquent loan of five per-cent against the 63 percent figure in Kalena, Doti SFCL. The situation in other sample SFCLs were also not very encouraging. The standard norm of operating self-sufficiency ratio is greater than 1.50 However, Kumpur, Shreeantu, Kalena, Uttarganga and Fedikhola SFCLs maintained the self-sufficiency ratio of 1.89, 1.80, 1.17, 0.87 and 0.51 respectively.

Furthermore, for assessment of SFCL financial sustainability, this research carried-out the major statistical analysis on correlation coefficient, multiple regressions, zero order correlation matrix, fit the regression model and chi-square test. Among these

analysis, correlation coefficient between the net profit after provision and provision due to arrears shows strong negative correlation with $r = -0.982$. The result shows that provision amount significantly reduces the net profit of the project and strongly recommend for prompt collection of the loan amount. Multiple regression analysis of dependent variable taking as net profit after provision and a set of independent variables like total income from the project, staff salary, interest rate, interest cost, cost on meeting allowance, miscellaneous cost, total saving per year, repayment amount and outstanding loan shows that the net profit of the project is 71 percent influenced by these set of independent variables. In addition other analysis as carried out to see the functional relationship between the selected variables viz., duration of loan, interest rate, annual saving and income from project. In this analysis the coefficient of determination stood (R-Square) = 0.558, which indicates that 56 percent of the variation in the dependent variable is explained by regression plane.

In addition, zero order correlation matrix of credit activities between the selected variables was carried-out for the analysis purpose. The variables are tested for the presence of any interdependency between them. However, zero order correlation matrix predicts that loan amount is significantly correlated with variables repayment amount, outstanding amount and delinquent amount (with $p\text{-value} < 0.05$). Likewise, repayment amount is significantly correlated with variable loan amount only (with $p\text{-value} < 0.05$). While outstanding amount is significantly correlated with variables loan amount, and delinquent amount (with $p\text{-value} < 0.05$) and finally delinquent amount is significantly correlated with variables loan amount, and outstanding amount (with $p\text{-value} < 0.05$). Analysis of variance on net profit after provisioning of SFCL that shows significant difference in the mean net profit after provisioning among the five SFCLs. Correlation between profit from the project and repayment amount was analyzed, however this shows strong positive correlation. Likewise, correlation between investment and repayment amount was analyzed for the statistical analysis, while it shows significant positive correlation.

Apart from these, satisfaction level was assessed on social, community activities, organizational structure and operational process of SFCLs in order to assess the institutional sustainability of the institution.

While in assessment of social activities, this research shows that satisfaction level of the performance from these activities, among the 555 respondents reflected a distinct stress for educational activities, because overall weightage mean for literacy programs run by the SFCLs stood at 0.87 reflecting the fact that literacy program is found highly popular program of SFCLs. Following the literacy program, members of SFCLs focused for vaccination of children with a score of 0.83, health and sanitation activities has shown a score of 0.79, construction of community drinking water system has a score of 0.77, community afforestation score stood at 0.72, convenient toilet construction is at 0.48 and the least importance was given to sprayer distribution with a score of 0.46.

Likewise in the assessment of organizational structure and SFCLs operation, satisfaction level on performance of inter-group with a weightage mean score of 0.55, main committee scored 0.44, and village level operation scored 0.23. This analysis indicates that the main functioning units of the SFCLs including the village level bodies and the main committees have not been able to perform their task as requirement and this has caused much dissatisfaction among the members. On the other, weightage mean on decision making of main committee members stood at 0.51 meaning that the performance is far below the expected level. There has been a low level satisfaction related with the member participation with a score of only 0.35 and this is at a dwindling trend. Failure to hold regular meetings, lack of motivation by the main committee members or the staff, lack of regular interaction and the non-compliance of saving rule and lack of strongly committed facilitators and motivators at the lowest level affected the participation aspect of the members. The members of SFCLs at all levels did not seemingly have good knowledge of the vision about the formation of SFCLs that the institutions are to be managed by themselves and that the loans invested by the organization would earn more income for collective activities. Lack of such a vision discouraged people from participating in the regular activities in the institutions. The members refrained from repaying loans because they never realized that the SFCL was their organization and this affected the performance of the institution resulting in reduction of saving and profit and thereby moving towards bankruptcy.

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ABBREVIATIONS AND ACRONYMS

ACTI	:	Agricultural Credit Training Institute
ACTRI	:	Agricultural Credit Training and Research Institute
ADB	:	Asian Development Bank
ADBL	:	Agricultural Development Bank Limited
ADBNI	:	Agricultural Development Bank Nepal
Adm. Exp.:	:	Administrative Expenditure
ALC	:	Adult Literacy Classes
Amt	:	Amount
Aoc	:	Annual Operating Cost
APP	:	Agriculture Perspective Plan
ASA	:	Association for Social Advancement
ATM	:	Automatic Tailor Machine
Av	:	Average
BDFCL	:	Bhutan Development Finance Corporation Limited
BEP	:	Break-Even Point
BoD	:	Board of Directors
BS	:	Nepali year
BWTP	:	Banking with the Poor
CAMELS	:	Capital, Assets, Management, Earning, Liquidity and Sensitivity to Market Ratio
CARE	:	Cooperative For Assistance & Relief Everywhere
CBS	:	Center Bureau of Statistics
CBO	:	Community Based Organization
CDR	:	Central Development Region
CECI	:	Canadian Center For International Studies and Cooperation
CEE	:	Central & Eastern Europe
CEO	:	Chief Executive Officer
CEPRED	:	Centre For Environmental & Agricultural Policy Research Extension and Development

CF	:	Community Forestry
CFG	:	Community Forestry Group
CGAP	:	Consultative Group to Assist the Poor
CGISP	:	Community Ground Water Irrigation Sector Project
CICTAB	:	Center for International Cooperation and Training in Agricultural Banking
CJ	:	Cooperative Journal
CSD	:	Center for Self-help Development
CSI	:	Cottage and Small Industries
CTI	:	Central Training Institute
CUBESEA:		Credit Union Bench Marketing in South East Asia
CMF	:	Center For Micro Finance
CV	:	Coefficient of Variance
DDC	:	District Development Committee
EDR	:	Eastern Development Region
DECSI	:	Debit Credit and Saving Institution
EEC	:	European Economic Community
DGM	:	Deputy General Manager
FAO	:	Food and Agricultural Organization
FA	:	Fixed Assets
FDC	:	Foundation For Development Cooperation
FI	:	Financial Institutions
FIDC	:	Foundation For Development Cooperation
FINGO	:	Financial Intermediary NGOs
FI-NGOS	:	Financial Intermediary Non Governmental Organization
FSS	:	Financial Self Sustainability
FWDR	:	Far-western Development Region
FY	:	Fiscal Year
GA	:	General Assembly
GB	:	German Bank
GDP	:	Gross Domestic Product
GM	:	General Manager

GNP	:	Gross National Product
GO	:	Group Organizer
GTZ	:	German Agency for Technical Co-operation
HH	:	Household
IBP	:	Intensive Banking Program
IC	:	Indian Currency
ICA	:	International Cooperative Association
ICIMOD	:	International Center for Integrated Mountain Development
IDA	:	International Development Agency
IDP	:	International Development Program
IFAD	:	International Fund for Agricultural Development
IFC	:	International Financing Co-operation
IG	:	Inter Group
IGA	:	Income Generating Activity
ILO	:	International Labor Organization
IMF	:	International Monetary Fund
INGO	:	International Non-governmental Organizations
Int	:	Interest
IRR	:	Internal Rate of Return
IT	:	Information Technology
JDTC	:	Jute Development and Trading Corporation
KF	:	Cooperative Federal
LDC	:	Least Developed Countries
Max	:	Maximum
MC	:	Main Committee
MCPW	:	Micro-Credit Project For Women
MDG	:	Millennium Development Goal
MFI	:	Microfinance Institutions
MG	:	Mother Groups
MIS	:	Management Information System
Min	:	Minimum

MoF	:	Ministry of Finance
MT	:	Metric ton
MWDR	:	Mid-western Development Region
n	:	Sample Size
NABARD:		National Bank For Agriculture and Rural Development
NARC	:	Nepal Agricultural Research Council
NBA	:	Non Banking Assets
NBL	:	Nepal Bank Limited
NCB	:	National Cooperative Bank
NCDB	:	National Cooperative Development Board
NEFSCUN:		National Federation of Saving and Credit Cooperative Unions Limited
NGO	:	Non-Governmental Organizations
NGO-FD	:	Non-Governmental Organizations Federation Doti
NGO-FS	:	Non-Governmental Organizations Federation Surkhet
NIS	:	New Independent States
NLSS	:	National Living Standard Survey
Nos	:	Numbers
NPA	:	Non Performing Assets
NPC	:	National Planning Commission
NRB	:	Nepal Rastra Bank
NRs	:	Nepalese Rupees
RBB	:	Rastriya Banijya Bank
RD	:	Rural Development Banks
RMP	:	Rural Micro-finance Projects
ROSCAS	:	Rotating Saving & Credit Association
OECD	:	Organization for Economic Co-operation and Development
OPIC	:	Overseas Private Investment Corporation
OSS	:	Operational Self Sufficiency
OXFAM	:	Oxford Committee For Finance Relief
PAF	:	Poverty Alleviation Fund
PAPWT	:	Poverty Alleviation Project in Western Tarai

PCRW	:	Production Credit for Rural Women
PEARLS	:	Protection, Effective Financial Structure, Assets Quality, Rate of Return and Cost, Liquidity, Sign of Growth
PRA	:	Participatory Rural Appraisal
Popn	:	Population
Prov	:	Provisioning
RMDC	:	Rural Microfinance Development Center
RO	:	Regional Office
RSRF	:	Rural Self-Reliance Fund
RTC	:	Regional Training Center
RUFIN	:	Rural Finance Nepal
SAARC	:	South Asian Association for Regional Cooperation
SADF	:	South Asian Development Fund
SACCOS	:	Saving and Credit Cooperative Society
SAFD	:	The Saudi Fund for Development
SAPAP	:	South Asia Poverty Alleviation Program
SCC	:	Saving And Credit Cooperative
SCOs	:	Saving and Credit Organizations
SF	:	Small Farmers
SFDC	:	Small Farmer's Development Centre
SFG	:	Small Farmers' Group
SFCL	:	Small Farmers' Cooperative Limited
SFDB	:	Small Farmers' Development Bank
SFDP	:	Small Farmers' Development Program
SKBBL	:	San Kisan Bikas Bank Limited
S&M	:	Supervision and Monitoring
SM	:	Social Mobilizer
SMAS	:	Social Mobilization Agencies
SNA	:	Statistical Information on Nepalese Agriculture
SO	:	Supervision Office
SPOs	:	Sub-Project Offices

SPSS	:	Statistical Package for Social Science
Std.dev	:	Standard Deviation
STI	:	Second Tier Institution
TA	:	Technical Assistance
TLDP	:	Third Livestock Development Project
UNDP	:	United Nations Development Program
UNICEF	:	United Nations Children's Fund
USA	:	United States of America
USAID	:	United States Agency for International Development
US \$:	United States Currency
VB	:	Village Banking
VDC	:	Village Development Committee
WB	:	The World Bank
WDR	:	Western Development Region
WECUMI	:	Women Empowerment Credit Union Microfinance Innovation
WGO	:	Women Group Organizer
WHO	:	World Health Organization
WTPAP	:	Western Tarai Poverty Alleviation Project
WTS	:	Drinking Water System