SFCL Model :

Problems and Prospects

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ACRONYMS

ADBL	-	Agricultural Development Bank Ltd
FAO	-	Food and Agricultural Organization
MC	-	Managing Committee
SKBBL	-	Sana Kisan Bikas Bank Ltd.
SF	-	Small Farmers
SFCL	-	Small Farmers Cooperative Ltd.
SFDP	-	Small Farmer Development Project
SPO	-	Sub Project Office
VDC	-	Village Development Committee
WB	-	World Bank

ABSTRACT

While the Small Farmer Development Project (SFDP), implemented by the Agriculture Development Bank of Nepal beginning 1975 was the foremost poverty alleviation initiative in the country under which small farmer groups were formed and credit channeled through them to promote self-help economic and social development activities at the grassroots. However, due to high overhead costs and poor recovery rates over the years threatening its possible collapse, they were turned into farmer managed Small Farmer Cooperatives or SFCLs which now number 228 in the country. Most of them are affiliated with the Sana Kisan Bikas Bank, established in 2001 with SFCLs themselves as among the shareholders for catering to them and other micro finance organisations. Lately, by increasing their share component, the SFCLs are poised to take over the management of the bank with potentially far-reaching implications for the entire SFCL programme.

The SFCLs are 3-tiered organisations with small farmer groups at the grassroots promoting very useful functions for small farmer development. Their other performances include high levels of local savings mobilisation, expanded emphasis on women's participation, exclusive focus on income generating activities, weaning poor farmers away from sense of despondency and turning them into active entrepreneurs, and inducting the landless villagers too with supervised credit. Bulk borrowing from the ADBL and retailing them to the members has been a very important attribute of the SFCL programme and enables the farmers to invest more in their income generating activities setting the stage for early exit from poverty. The SFCLs have significantly contributed to income improvement of their members and community development and governance improvement in their areas. The SFLC problems include its failure to attract sufficient attention and priority from the policy makers, and its limited ability to replicate them on a wider scale. Equally worrying is the problem of low recovery rates on ADBN loans, even as the lending from the coops' own source enjoy more than 90 per cent repayment.

While the SKBB and SFCLs are faced with the prospect of contraction of the vitally important credit source from ADBL, the bank is poised for the possibility of a new, SFCL-controlled management. This could, however, be a very valuable opportunity to inspire and institutionally require the SFCLs to raise their recovery rates to acceptable levels. This could not only ensure the continuation of ADBN bulk lending facility but also qualify the existing SFCLs to possibly borrow from regular commercial banks too. This will also set the stage for the much-needed countrywide replication of the SFCLs in this overwhelming agrarian country of small and poor farmers.

SFCL Model: Problems and Prospects

1. Introduction

The Small Farmer Cooperative programme, formally known as Small Farmer Cooperative Limited (SFCL), was initiated in the country beginning 1988. The SFCL programme has its origin in the Small Farmer Development Project (SFDP) implemented by the then Agricultural Development Bank of Nepal (ADBN) - now Agriculture Development Bank Limited, (ADBL) - which, in co-operation with the FAO, piloted the initiative in two villages in 1975. The success of the piloting was followed by a rapid replication in the country. To implement the SFDP the ADBN extended its bureaucracy to the villages by setting up what was known as Sub-Project Office (SPO), generally one in each Village Development Committee (VDC), which promoted Small Farmer (SF) groups of 5 to 7 mutually trusting small farmers. Based on a self-reported threshold income of 2500 rupees per capita, most farmers in the villages were eligible for membership. All members made redeemable monthly contribution to the group savings and undertook other co-operative activities for their common good. Although the original philosophy of the initiative was to make credit accessible even to the landless by making collateral-free lending based on joint liability of the group members, the collateral system was introduced in 1978 due to high defaulter rate, thus, precluding from membership the small proportion of landless farmers. With the availability of foreign aid the programme went through rapid expansion. By 1990, there were 445 SPOs covering a total of 622 or 15 percent of the 4000 VDCs and catered to 200,000 small farm households in 73 of the country's 75 districts in the country.

However, the ambitious expansion of the project and increased emphasis on meeting lending targets affected its quality. Along with high overhead costs due to excessive recruitment of manpower, default on repayment of principal and interest mounted resulting in precipitous decline in recovery rates. By late Eighties the SFDP was clearly becoming a liability and faced with the prospect of imminent collapse. Since it was the only significant poverty alleviation initiative in the country at the time, in 1988, the then ADBN, mobilising the technical assistance of the German Technical Co-operation (GTZ), implemented an institutional transformation initiative leading to the conversion of the SPOs into farmer-managed cooperatives. In 1993, the first four SFCL cooperatives were registered in Dhading district. At present, there are a total of 228 SFCLs in 40 districts even as the SPO-managed SFDP has been completely phased out in the country.

In 2001 the ADBL in partnership with the Government a few other commercial banks and the SFCLs themselves helped establish a separate *Sana Kisan Bikas Bank* (SKBBL) or Small Farmer Development Bank to cater to the credit and development needs of the SFCLs and other micro finance institutions. Of the total 228 SFCLs in the country, 219 of them have so far been affiliated with the bank accounting for a total of 1,33,195 members. The bank provides them support through its eight regional offices in the country.

Presently, the SKBBL is majority-owned by the ADBL representing Rs.7 crore in the total paid up capital of 11.98 crore rupees, thus allowing the latter to control the management of the bank. While the SFCLs own shares worth only Rs. 2.28 crores, the SKBBL charter stipulates that the bank will eventually be owned by the SFCLs themselves and, to that end, the ADBL and other promoters should off-load their shares in favour of the SFCLs as and when they are ready to buy them. In pursuit of that goal, lately, the SFCLs mobilised additional resources from among themselves and formally offered to increase their share by three crore rupees more. This increment in share capital has been a universally shared among the SFCLs. While the poorer SFCLs contributed only a few thousand rupees, most of them gave in the range of one hundred thousand rupees, with Anandaban SFCL of Rupandehi being the biggest contributor with 1.5 million rupees.

Now following this new bid by the SFCLs and the impending off-loading of shares by ADBL to that extent, the prospect is that for the first time in the history of micro finance in the country, the stakeholders themselves would now be running their bank. For all practical purposes, this impending take over by the SFLCs of SKBBL management could unleash far-reaching changes in the entire gamut of SFCL management all the way down to the grassroots that could also dramatically transform the very character of the micro finance scenario in Nepal. This will be dealt with in greater detail further down.

While a few of the SFCL districts have had district-level federations for some time, more recently, a SFCL national federation too has come into existence to provide "non-financial services" to member SFCLs such as training, consultancy, supervision and audit supports. Since the SKBBL focuses more on financial services, these voluntary federations are expected to perform functions complementary to the former and cater to their members' various developmental needs.

2. The socio-economic context of SFCL programme

While 86 per cent of population are rural and 78.5 per cent of workforce are engaged in agriculture in Nepal, due to the country's mountainous terrain only 18 per cent of land is arable. In 1998, 70 percent of the agricultural holdings were estimated to be below 1 ha. and 40 percent below 0.5 ha. (NSAC, 1998). Due to unabated population growth over the decades, the per capita land availability has been decreasing steadily. In 1954, the land availability was estimated to be 0.6 ha per capita which declined to 0.24 ha in 1990 (WB, 1990), and to only 0.15 ha in 1998 (NSAC, 1998). According to World Bank source, poverty in Nepal is directly related to the amount of land owned. While the incidence of poverty among people owning less than 0.2 ha of land is 39 percent, the corresponding figure for those with more than 0.2 ha is just 24 percent (New Era, 2006:61). Despite the large proportion of the workforce engaged in agriculture, the sector contributes only 39 percent to the country's GDP (2001).

Another aspect of rural poverty in Nepal is that despite agriculture being over-crowded, the possibilities for the shift of surplus workforce to non-agriculture sector has remained chronically limited. According to ILO-SAAT only 10 percent of the increased work force each year find work in the non-agricultural sector (NSAC, 1998:100). Although the manufacturing sector is generally the biggest employer of labour, only about 20 percent of jobs are unskilled. Besides the sector has been traditionally small in Nepal, employing less than 5 percent of total labour force of the country. In 1990, it was observed that the manufacturing sector was adding jobs only at the rate of 9,000 per year, even as the growth in labour force was in the order of 250,000 per annum (WB, 1990:63). Since most of the rural labour force has to remain "trapped" in the overcrowded agriculture the rate of rural under-employment is high at 47per cent. Therefore, going on seasonal and longer-term out-migration, mainly to India, has traditionally been the safety valve to the otherwise potentially combustible situation in rural Nepal. .

In recent years, there has been a further spurt in the out-migration of people for employment mainly to overseas countries. It is estimated that more than one million Nepalese are currently working abroad and remitting more than one billion US dollar annually. This has significantly contributed to the reduction in poverty in the country - from 41.8 per cent in 1995/96 to 30.8 per cent in 2003/04 - with the proportion of households receiving remittance increasing from 23 percent to about 32 percent during the period. Despite this progress, however, poverty remains stubbornly rural in Nepal with the rural poverty being 34.6 per cent, down from 43.3 per cent whereas the urban poverty went down from 21.6 per cent to 9.6 per cent during the period (New Era, 2006:62-76: 2004)

Besides, poverty in Nepal is deeply intertwined with the traditionally deriving exclusionary nature of its social structure. Orthodox Hinduism being the basis of the Nepali polity for centuries, the two high caste groups of *Brahman* and *Chhetri* have been the most powerful politically and enjoyed priority land grants from the state in the past. In the fourfold vertically defined caste classification characteristic of orthodox Hinduism, the artisan castes, defined as the "serving castes" traditionally, come at the bottom, suffer from the stigma of being "untouchable" and were discouraged from owning any land. They render labour and caste-specific occupational services to higher caste households in the traditionally perpetuating patron-client relationship under which they receive seasonal payments and other occasional largesse for their subsistence from the former. Due to these historical reasons the occupational caste groups, now generically referred to as *Dalit*s (the oppressed), remain the poorest and the most deprived in the country.

The ethnic landscape of Nepal also includes a large population of casteless, and mutually distinct Tibeto-Burman groups, now generically referred to as *Janajati* (ethnic people), which have been indigenous to specific geographical regions of the country, number over sixty and represent some forty per cent of the country's population. Due to the all-pervasive nature of Hindu caste system, these casteless groups too, over the centuries, have been drawn into the vortex of the caste hierarchy and assigned a status just above that of the *Dalit*s. Of the *Janajati* groups, only the *Newar*s, indigenous to the fertile Kathmandu valley, share the affluence and power of the two Hindu high caste groups of *Brahman* and *Chhetri*.. In 1998, the three elite groups accounting for some 20 percent of the population had the highest Human Development Indices (HDI) in the country, *Brahman* 0.441, *Chhetri* 0.348 and *Newar* 0.457, all of which were higher than the national HDI of 0.325 (NSAC, 1998). Thus, poverty is much more pronounced among the *Dalit* and *Janajati* groups. This situation is also true of the *Tarai* region where the *Dalit*s are relatively more numerous, and are even more disadvantaged and stigmatised than in the hills. Given such exclusionary nature of the social system traditionally, land has been highly unevenly distributed in the country. In 1990, it was estimated that 5 percent of the people at the top owned 40 percent of land and the bottom 60 percent had only 20 percent of it (WB, 1990). Only half of the total households were food secure in 1997

Women as a class too have been the victims of the exclusionary forces of Hinduism which relegates them to inferior status across all caste, class and ethnic categories. Serving men has been defined as their highest calling in life, and their deprivation continues more or less unabated through various political dispensations. While women's illiteracy is rampant, in the households they bear the major brunt of both domestic and farm work and put in many more hours of work than men. In most cases, they do not own assets, receive less food to eat and less attention during illness even as their mobility is severely circumscribed. Household decisions involving money and external contacts remain the exclusive prerogative of men. Much of these result from discriminatory marriage and inheritance laws which themselves have been the manifestations of the lower status that orthodox Hinduism imposed on them.

While successive national development plans have, in various forms, continued to lay emphasis on alleviating poverty in the country, no significant progress has yet been made, particularly in the rural areas. The Tenth Plan (2002-2007), for instance, acknowledged that that annual economic growth rate "hovered around 4 percent for the last three decades as against the annual population growth rate of 2.5 percent during the same period", leading to "very minimal per capita income increments". While this precluded any percolation of benefits to the poor and was unable to prevent the perpetuation of poverty in the country, the Plan further recognised that what growth took place has been in the non-agricultural sector in the urban areas that “side-stepped the rural areas where most people live”.

All these lead to the compelling conclusions that rural development, particularly rural poverty alleviation, constitutes a precondition for the overall and balanced development of the country. And given the structurally defined nature of poverty and deprivation in the rural communities special instruments are needed to enable the poor and deprived in the rural communities to access resources and benefits of development for themselves. This is where micro finance in general and SFCLs in particular have a special role to play.

3. The Small Farmers’ Cooperatives Limited (SFCL) Programme

One of the distinctive features of the SFCL approach is that these cooperatives are three-tiered organisations, each of the tiers performing mutually complementary functions. At the bottom of the ladder comes the Small Farmer (SF) groups which are generally composed of 5 to 8 members and perform vital function for the empowerment and poverty alleviation of their members. These groups are federated into Inter Group (IG) at the ward level, which are further federated as Main Committee (MC) at the level of the Village Development Committee (VDC). Since a VDC consists of nine wards, the SFCLs too are composed of nine IGs generally, although large SFCLs have more IGs, the maximum number being 15. The SF groups meet at least once every month, collect monthly savings from members, assess credit needs of members for income generating activities based on their individual capacities, recommend the same for endorsement to the IG which in turn submits the same for approval to the MC. The SF group also monitors the credit use by members, encourage the timely repayment of principal and interest, and regularly reviews their social and economic development performances. The group savings are deposited with MC, which pays an interest on them. There is a probation period of six months for new members to be eligible for loan.

The IGs function as the bridge between the SF groups and the MC and are assisted by a volunteer Facilitator called *Sahayogi Karyakarta,* who mainly liaise with SF groups and their members, and promotes the formation of new groups. The IG is composed of the representatives of the SF groups under it, normally their chairpersons. The main function of the IGs is to ensure timely loan recovery from the SF groups based on which further loans are recommended to the MC. The IGs also undertake saving activity for development purposes. Each SF members in the groups under the IG also save at the rate of one rupee per month, and this fund is used mainly for community development activities in its area. When other small farmers want to join the coop, most often do so by forming a new group of their own with endorsement of the IG and approval of the MC.

The MC is the Board of Directors of the cooperative and is composed of the representatives of the IGs, normally their chairpersons, formally designated by them. So the SFCL requires that an IG member prove his worth at that level before he can aspire to get elected to the MC. This provision is designed to prevent possible politicisation of the SFCL leadership and protect the professional nature of their management. An MC manages, with the aid of its employees, credit and repayment of loans and a range of other development activities. The MC is aided by a separate 3-member Accounts Committee directly elected by the General Assembly to keep track of the coop's accounts. To obtain a loan, a borrower presents his land ownership certificate to the MC as collateral. The coop requests the government Land Revenue Office to "block" the land for the coop, so that its ownership cannot be transferred to others until the coop writes it again to "unblock" it after the dues are cleared.

All SFCLs hire and pay for their own staff which number at least two, one Manager and one Woman Worker. However, many SFCLs presently maintains a fairly large contingent of its staff to attend to the needs of their expanding development activities. For instance, the Dumrawana SFCL in Bara district, which runs a range of services for the people – milk collection, packaging and marketing, agricultural inputs marketing, farmer livestock insurance, agricultural extension, and a school – has a total of 52 staff on its payroll, of whom 38 are permanent. The SFCLs receive no grant or subsidy from the government or from any donor for the purpose.

4. The SFCL's small farmer development performance

The SFCL initiative constitutes one of the most promising poverty alleviation and general development effort for the rural populace in Nepal. By and large, the programme gravitates around four principle functions namely saving, credit, income generation and community development. Its structure is more or less custom-tailored to enable the poor farmers to derive multi-faceted benefits for their own development in an incremental and sustainable manner as can be seen from the following paragraphs.

4.1. Savings mobilisation

Mobilising rural savings constitutes one of the main attributes of the SFCL initiative. The SFCL members are required to make voluntary savings in their respective groups most of which (60 per cent) is deposited with the MC which pays a regular interest on it. While these monthly individual redeemable contribution to group savings constitutes a basic qualification for SF group membership, the rate of saving is decided by individual groups themselves and generally ranges between 5 to 20 rupees a month, some even higher. These savings are utilised for extending credit for their income generating activities based on their own groups' decision and implicit supervision. As of Kartik 2064 (November 2007) the total group savings of the 219 SFCLs affiliated to the SKBBL has amounted to Rs.227 million, which comes to around Rs. 1,700 per member

The programme has also innovated a range of other saving portfolios to maximise SFCLs' resource base. The SFCL's shares that each member must buy are generally priced at Rs.100 per unit, although there are more ambitious SFCLs like Naktajheej in Dhanusha, which has raised its share price to Rs. 500 with the aim to generate more capital more quickly. As a result while the 7-year old Prithvinagar SFCL with 1557 members had a total share capital collection of some 700,000 rupees, the 2-year old Naktajheej with 509 members had already made it to 500,000 rupees in 2002.

Another instrument of saving is Loan Security Fund, which requires the borrowers to deposit a minimum of redeemable 2 percent of the loan amount extended to them by the coop. The fund is intended to augment individual saving as well as a liquid fund for the client to make timely interest payment on the loans and make himself eligible for a rebate. Since this saving is made immediately upon the receipt of a fresh loan, the borrowing members are often found to be willing to deposit a larger proportion. In Naktajheej again, for instance, they have gone for 10 percent of each lending to be deposited in the loan security fund. In a 2002 study of four selected SFCLs (Sri Antu and Samalbung in Ilam, Prithvinagar in Jhapa and Naktajheej in Dhanusha) with a total membership of 2846, their loan security fund had a cumulative deposit of Rs.3.7 million which averaged out at Rs. 1,319 per member (Shrestha, BK, 2004).

Another major source of saving for the SFCLs is the self-managed Livestock Insurance Scheme. The Scheme evolved out of the ADBL's credit programme over the years in order to protect the small farmer borrowers of livestock loans who often went bust due to the death of the animal. Under the scheme, the coop charges a non-refundable annual premium of five percent of the market value of the insured livestock from the policyholder in which the government too contributes an equal sum for the insurance. A separate Livestock Insurance Committee under the SFCL looks after the programme. In case of the death of the animal during the period of insurance, the policyholder is paid a compensation of 80 percent of the insured value. The insurance scheme has been very popular with the SF members because their premium deposits remain in their own coops and are used for credit to members.

In their enlightened self-interest the SFCLs with such insurance programme have also set up a veterinary support service with a view to reduce the mortality of insured livestock and thus, reduce losses for themselves. A SFLC veterinarian regularly inoculates and treats the insured animals with considerable effectiveness. In 2002, the four SFCLs together mentioned above had a total earning of Rs. 5,142,000 from the insurance business, which averages out at Rs. 1807 per member (Shrestha, BK, 2004).

A few fortunate SFCLs also run a special Limited Banking facility with prior approval of the central bank which had several years ago piloted the concept of "decentralised banking" in the rural areas and had issued license to a number of local micro finance organisations which has since been discontinued. Under this scheme, the SFCLs run limited banking services under which they allow their members to open savings and fixed deposit accounts and pay interest on them at 8 percent per annum which is higher than the rates generally paid by the commercial banks. Besides, such coop-related incomes are exempt from income tax which make saving with the SFCLs more attractive, thus making it an important source of local saving mobilisation too. In 2002, the two SFCLs, Prithvinagar in Jhapa and Sri Antu in Ilam had together mobilised Rs. 2,556,000 in saving deposits and Rs. 439,000 in fixed deposits. The coops themselves lent at much higher rates and enjoyed a comfortable interest spread of around 8 to 9 percent. While Maoist rebels robbed money from such finance centres with impunity at the time, the Sri Antu coop had maintained that if the security situation were to improve, this limited banking facility alone could mobilise local savings up to 4 million rupees per year (Shrestha, BK, 2004).

4.2. Women's participation

Another distinctiveness of the SFCL approach is the increased space it provides for women to engage in their own socio-economic development as well as that of the community. While the existing rules require at least 10 percent of members to be women, the actual proportion of women members has been much higher. Of the total of 133,195 members in 219 SFCLs affiliated with the Small Farmer Development Bank, 51 per cent are women. The rise in women's participation has been achieved after the SFCLs came into being. It was generally recognised by the SFCL members that women not only constituted disadvantaged section of society, they also made disciplined borrowers and responsible homemakers, thus deserving preference. In specific terms, it was emphasised that unlike men, women are available in the village all the time, attend group meetings regularly, hardly ever engage in politics and are true to their word. They are also more interested in social activities and devote fully to their income generating activities. In this regard, the experience of Naktajheej SFCL is particularly instructive. When the Naktajheej SFCL was transferred to local management in 2000, women membership consisted of only 20 percent. But after it became self-managed cooperative and embarked on the expansion of its membership, all the 38 incremental groups it formed were composed exclusively of women, raising their proportion to 45 percent in less than two years. Where literacy is low, the SFCLs have created a new compulsion for women to be literate because they have to keep track of their finances. (Shrestha, B. K, 2004).

4.3. Exclusive emphasis on income generating activities

The distinctiveness of SFCL approach as a potent instrument of poverty alleviation lies in the fact that the small farmer loans are directly tied to the income generating activities of the borrowers. The members can borrow only for the stated income generating activities, which are endorsed by their own SF groups and are implemented under the watchful eyes of the fellow members. Credits are extended for three different terms - short-term i.e. for a period of one and half years; medium-term for up to seven years, and long-term for more than seven years, thus making the borrowers eligible for projects with long gestation periods. The lending for seasonal agricultural crops are generally short-term, horticultural activities medium term, and projects such as irrigation schemes long-term. The activities the borrowing farmers undertake with their loans include: livestock keeping, vegetable growing, orchard nursery, sugarcane cultivation, cereal crop production, iron smith workshop, rice mill, trading and so on, depending on the terrain, market potential and the occupational background and history of the small farmers themselves. Women's activities generally include small livestock, retail shops, and vegetable cultivation.

Occasionally, the SFCLs also provide credit for "group projects" which are normally activities requiring large investment for which the SF members pool their resources together including credit. For instance, in 2001 in Sukhajor village of Naktajheejh SFCL, four members of an SF group including one who had studied agriculture in high school pooled together their land measuring a total of 0.3 ha and ran a horticultural nursery. By obtaining a group loan of 20,000 rupees. In a span of mere two years they made a net profit of 250,000 rupees. They marketed their produce in the local market centres and neighbouring villages, with buyers often coming from India too. They believed that they could have done even better had they received necessary technical support from relevant agencies.

4.4. Role of SF groups in motivating poor farmers

The SF groups at the grassroots play a vital role in promoting IG activities and helping them towards alleviating their own poverty among their members. In most human situations some people are more pioneering, proactive and innovative than others. Thus, the poor farmers, otherwise resigned to their state of poverty, meet their "role models" in their own groups, learning from them the tricks of trade as they too decide to embark on income generating activities of their own. This is a major transformation in the personality of the small farmers. Over the months and years, they learn to wean themselves away from the sense of being helpless due to their poverty and slowly establish themselves as active entrepreneurs too like others in the group. This is by far one of the major contributions of SFCL approach towards poverty elimination in the country.

4.5. Addressing the problem of asset-less farmers

The landless farmers pose special problem for the SFCLs, because loans from the ADBL and the coop are extended only against collateral, which is invariably the land. Therefore the landless, who need such support the most in the village communities are the ones excluded from these coops. However, the coop members do feel morally obliged to do something about their less fortunate neighbours. Therefore, many SFCLs have adopted a policy of supervised credit, that is, lending the coop's own money, a few thousand rupees a time, without collateral to a few selected landless households for income generating activities. It is believed that after about three years of such supervised lending, the landless borrowers are normally able to buy some land of their own which enables them to become full-fledged asset-holding members in their coop. So, while the SFCLs themselves are the self-help organisations of the poor, most of them, as part of their stated policy, run such special credit outlet to bring their ultra poor neighbours too within their fold. This approach offers a possibility to effectively deal with hardcore poverty in the communities on a countrywide scale without having to create new institutional mechanisms of uncertain effectiveness and sustainability as has been the case many a times in the country.

4.6. Bulk borrowing from the ADBL

Another innovative aspect of the SFCL programme is the bulk borrowing facility it enjoyed from the ADBL, now channeled through the SKBBL, which remains a major source of resource for income generating activities of the SFCL members. The system comes down as a historically legacy from the past when the ADBL lent the farmers through its SPOs. The SFCLs present their annual credit plan to the ADBL regional branches and upon its approval, they draw the funds which are then retailed among the members for slightly higher interest rates for their income generating propositions for the year. This credit facility coupled with the increasingly large savings of their own enables the SFCLs to make relatively large loans to their members, enabling them to make increased investment in their income generating undertakings and ensuring the prospects of early reprieve from poverty. As of October 2007, the total outstanding credit among the 219 SFLCs affiliated with the SKBBL from this source amounted to Rs.1.55 billion which averaged out at Rs.11,600 rupees per member. This investment is significantly matched by the volume of investment from own source of the coops themselves. As of the same time last year, the outstanding credit from coops' own source amounted to Rs. 686 million, which came to Rs. 5,200 per member. Thus, it is apparent that the SFCL members were investing several thousand rupees in a given year in their income generating activities with the prospect of even larger investments in the years ahead.

While ADBL's rate of interest has been steadily coming down, now standing at 7 per cent, the SFCLs retail it among their members at around 11 or 12 per cent, thus appropriating for themselves a comfortable interest spread. While recovery from this source of credit has generally been problematical (to be discussed below) it nonetheless remains an important source of SFCL investment. At the same time, it is also a significant pointer to the possibility of accessing commercial bank resources for rural poverty eradication in general without recourse to foreign grants or loans. Some SFCLs, in their zeal to bolster their capital base rapidly, charge much higher rates of interest on their own as well as the ADBL funds. For example, the highly frugal SFCL, Naktajheej charged an interest rate of 20 percent, even as it employed only two paid staff in 2002 to economise on overhead costs with the board members volunteering when additional help was needed.

4.7. Income improvements of SF members

Given the overwhelming state of poverty in Nepal and the very slow pace in its improvement particularly in rural Nepal, the overall experience of the SFCL members in this respect verges on being extraordinary. Most SFCL members maintain that they are now able to stand on their own feet due to SFDP and SFCL. There is a palpable sense of self-confidence among SFCL members, both men and women. While they very much appreciate the cheap and easy loans for their income generating activities, something that almost all members undertake, they also know that they have to make their investments work. There is a shared sense of destiny among fellow members in the SFCL who were otherwise mutually competing neighbours in the past. Most members who have been members of the SF groups for some years are success stories invariably. For instance, the Dumrawana SFCL in Bara district claimed in 2002 that of the 689 small farmer members in the coop, some 100 of them became millionaires "within the last ten years", Such claims of success has been widespread all across the country. However, for want of resources the SKBBL has not been able to undertake an objective study based on a nation-wide sample in this respect.

4.8. Community development

The SFCLs also significantly contribute to general development of their communities such as in drinking water, sanitation, child care centres, construction of tracks and trails, forest conservation and so on. In Naktajheej in Dhanusha, they have categorised various development activities under three broad headings namely, *Collective*, *Social* and *Community Activities*. The "collective activities" include savings, irrigation, afforestation, forest nursery, establishing service centres in the village, fisheries promotion, livestock insurance, and primary school. To accelerate fruit cultivation in the village, it once bought one full truckload of various fruit saplings and sold them to individual members. Similarly, its "social activities" consisted of latrine construction and installation of drinking water tube wells, and its "community activities" comprised of health care including DPT, veterinary services, cultural activities, women's development, and family planning activities. While many of these activities derive from the SFDP days, Naktajheej boasts of a fairly long list of development achievements in all those areas. Sri Antu still cherish its past association with UNICEF which used the local SFDP as partner for various child development activities in the area.

Similarly, the Prithvinagar SFCL of Jhapa runs a full-fledged 10 plus 2 school in its area. The coop has created a special "unit" in its organisational structure for Education, Health and Community Development activities, which is responsible for women's literacy, women empowerment, kitchen garden promotion, health camps, afforestation, environment protection, and child development. In 2001 and 2002, the unit conducted legal education and women empowerment training for 492 of its women members with the aid of two INGOs, organised free health clinics and undertook activities for child development in cooperation with the local schools and the District Administration Office. In order to promote vegetable cultivation, it distributed two quintals of vegetable seeds to its members. It also formed some 20 women's groups to fight social evils like polygamy, to extend support to helpless women, and above all, to curb drinking and gambling in the community. They once organised a rally of 4000 women against drinking in the village. Almost all SFCLs undertake such social and community development activities in their communities.

Economic improvement, access to services, and enhanced sense of confidence have been the major gains for the small farmers from the SFCL/SFDP programme. Most SF members are now able to send their boy and girl children to school. Their living conditions have improved and can now afford better food, clothing and shoes. Most SFCLs have a provision of interest-free loan in the event of death in the family. The awareness about the need for family planning is widespread among the SF members, and most go for temporary devices, mainly pills and depo provera for women. The preferred number of children is two, although preference for son remains.

4.9. Governance Improvement

Governance improvement has also a special SFCL turf. Within their organsiations themselves, which are built on small SF groups at the base, their decision-making is highly decentralised and participatory. All members are continuously involved in decision-making at various levels regarding the allocation of credit, use of credit, recovery of loans and other community development activities. Such widespread participation of members in the decision-making of the organisation ensures the continuing transparency of management and accountability of leaders to the members. It is these good governance conditions that have ensured the effectiveness and sustainability of SFCL approach. By and large, the members feel that loan disbursements are quick and no bribes need to be paid to the officials. The coop employees, who come from amongst the locals themselves, are answerable to the SFCL itself, and are willing to work overtime and at odd hours according to the convenience of its members. There have been many instances of migration by members belonging to other saving and credit groups to the local SFCLs.

Equally significant is the SFCL contribution to improved governance conditions in their communities too, particularly by their influence in the functioning and decisions of the local elected bodies, namely the VDCs. Generally, the members of these local bodies are elected on the basis of affiliations to various political parties and are motivated accordingly in their decisions. However, in the SFCL villages themselves, the dynamics is different. Given the fact that the coops represent a large proportion of local voters, the relationship between the VDC and the SFCL has been characterised by mutual deference and consultations at regular intervals. A new practice has evolved over the years inviting the SFCL presidents to the meeting of the Village Councils, and the VDC presidents to the annual general assembly of the SFCLs. When theelected VDC members where still there until 2002, there was considerable overlap of membership between the two institutions. For instance, in the erstwhile Naktajheej VDC, seven of its eleven members were SFCL members, and of the 47 members in the Village Council, 37 belonged to the SFLC. In Sri Antu, of 11 members in the VDC, 9 including the VDC President and Vice President were SFCL members, and in the Village Council, only about three percent were non-SFCL members. Given the dominance of SFCL members in the composition of the VDCs, there existed a structural compulsion for their needs and priorities to be reflected in programmes of the local bodies. In Sri Antu, for instance, in 2002/03, of the 18 projects approved for implementation by the VDC, 10 were those proposed by the SFCL president, and they included nine road extensions needed by the SFCL members for access to markets.

Many male and female SF members acknowledge that their best gain yet from their participation in SF programme has been their new found ability to speak in public. The SF members recall that in the past, the rich and powerful did not even tolerate their presence around them, let alone their venturing an opinion. Now, this has totally changed.

5. SFCL problems

Despite the many successes to its credit, the SFCL programme also suffers from many problems, some of them being quite severe. First of all, as significant as the approach has been for poverty alleviation of small farmers in this predominantly small holder agricultural country, it has not yet been able to receive the priority that it deserves in the country's national development plans. For one thing, this has severely compromised the chances for its wider replication in the country. This lacunae has made it difficult for the programme in accessing technical supports mainly for its income generating activities from the government agencies which, in the rural areas, are often the only institutions available for them.

However, recovery rate on loans has by far been a worse and chronic problem for the SFCLs. While the recovery rate (cumulative) of the SKBBL, which only lends to the SFCLs was 95 per cent in 2006/07, that of the individual SFCLs was not good. Of the 219 SFCLs affiliated with SKBBL, some 87 of them have problems, recollecting repayment from member farmers. Furthermore, in 16 percent of total MC members themselves have been wilful defaulters, thus resulting in a situation in which they are morally unable to ask other to repay.

There is another seemingly paradoxical dimension to this problem. While the repayment rate of loans from their own sources is almost always more than 90 percent, it is only the ADBL loan, which is defaulted. In the case of own source lending, there is a greater sense of accountability on the part of the borrowers accompanied by continuing peer pressure for timely repayment. This is even truer of own source lending within SF groups. Group pressure for timely repayment is unrelenting, and when default occurs, most groups jack up the interest rate often as high as 60 percent per annum at par with the market rate.

However, there are also many instances such as in the case of Naktajheej where due to totally committed leadership, the recovery rates for both the ADBL and own source loans have been 100 percent. Therefore, two factors seem to be at work for proper credit management in the coops. First, because of the sense of ownership, the recollection rate on their own-source lending remains almost always 100 per cent, whereas the ADBL money is treated as something negotiable. Secondly, leadership does make a difference as in Naktajheej, except that not all SFCLs can boast of such leadership. While the coops have the rule to clamp an additional 2 percent interest once the loan defaults, this has not been sufficient to discourage the would-be defaulters. Since the market rate of interest is much higher, it is profitable for the borrowers to delay repayment on the loans as long as possible.

Borrower defaulting is apparently encouraged also by the ADBL's own longstanding practice of writing off parts of interest and principal on bad loans. This is done to encourage repayment of whatever can be salvaged out of such bad loans. As a result, many borrowers wilfully default on repayment in the hope that such rebates and reductions would come along. According to ADBL policy, such benefits is available only to the ADB,L's direct clients and are denied to the SFCLs which are autonomous bodies. However, the SFCL members - most of them having been the SFDP clients and therefore ADBL's direct clients in the past - continue to harbour the lingering hope that sooner or later the bank would definitely give in. This has kept the SFCL borrowers defaulting at will (Shrestha, B. K, 2004).

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During the last few years, the problem of non-repayment interest and principal has been further aggravated by Maoist insurgency. In a number of districts, the rebels have been threatening the SFCL members not to repay the coop's loans. The SFCLs in some districts such as in Dhading and Illam have remained virtually paralysed, with the recovery rates dipping to historical lows.

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Because of these repayment shortfalls, the SFCLs are going to find themselves in a severe predicament. Following the reform measures implemented by the ADBL in recent times, it has tightened the screws on the SFCL defaulters. The bank now approves bulk loans only equal to the amount repaid. Thus, should the SFCL defaulting continue, it is going to mean that the amount of credit available for the income generating activities of the small farmer members is going to shrink rapidly. Obviously the SFCL programme is going through a major crisis.

The SFCL programme also suffers from what can be terms as "second generation problems, which paradoxically derives from its own successes. In the established SFCLs, there is an elitist tendency in the making. Due to their need for larger loans, an increasingly large number of successful borrowers no longer want to go through the SF groups and Inter Groups. Instead they would prefer to transact directly with the MC or even ADBL. For instance, in Sri Antu SFCL in Ilam, following the successful adoption of tea growing by small farmers, there has been a major spurt in the demand for credit. The coop's manager once observed that "people whose credit need was limited to just 5000 rupees only a few years ago, now seek a loan of more than 100,000 rupees." Since all SFCL members need to go through the SF groups and IGs for their loan requests, the successful farmers now feel suffocated because these entities generally do not endorse their large loan requests. An inverse relationship now seems to be in the making. The more prosperous the members, the less the sense of belonging to their groups, even as the groups remain useful for their less fortunate members. The SFCLs are now emerging as institutions in conflict with themselves (Shrestha, B. K, 2004).

As a result, there are now calls for the SFCL credit ceiling to be raised from the present 60,000 rupees to 200,000, so large loans can be accessed. Another opinion has it that the SFCLs should now be divided into various categories on the basis of their performance to make high performing ones eligible for larger loans. In 2002 some 60 SFCL members in Sri Antu SFCL also transacted directly with the ADBL for larger loans, although the coop;s membership policy did not allow it. Some members chose a less conspicuous route to expanded credit by just persuading their fellow members in their SF group to let them use their share of SKBBL credit too. It is obvious that the SFCLs' success in raising the income and enterprise levels of its members is now generating an internal combustion of its own kind.

SFCLs being registered under cooperative Act. basically need to be regulated by the cooperative department. However, the department seems to be little interested in directing and supervising the activities of SFCLs.These SFCLs being outside the scope of any regulatory framework are not obliged to comply with any prudential or non prudential regulations. This ultimately results in poor governance, poor financial performance and anarchism in the microfinance industry.

In order to expand outreach (both in terms of breadth and depth) a few mature and capable SFCLs, since last year have started business business expansion in their neighbouring VDCs. But because of lack of social and physical infrastructure like education, electricity and communication, they are not having business friendly environment in the local level. For want of incentives they are reluctant to expand their microfinance business in the remote and far-flung areas which is a major setback in expanding the frontiers of microfinance.

6. Prognosis.

It is at such a juncture that the SKBBL management is headed for a major transition, from ADBL's control to that of the SFCLs themselves. The foremost and most important problems that the new SFCL-controlled management will have to come to grips with would be the poor recovery rates. Here, the new management will have a special advantage. It can now send the message to all the SFCLs that they now own most of the SKBBL and that there is non-negotiable need for bringing the recovery rate to the same level as that of own-source lending. If the recovery rate does not improve, it is going to seriously affect not only the credibility of the new management, but also the chances of the SFCL members for making an early exit from poverty. On the other hand, should the recovery rate improve, the SKBBL would be riding on an altogether new tangent under which it should qualify for bulk loans from other commercial banks as well. This will enable the SKBBL to provide larger income generating loans to the members accelerated exist from poverty even as it embarks on the much needed replication of the programme in the country.

As things stand, the SFCL programme, for all its worth, has basically been in retreat. While its predecessor, the SFDP, covered 622 VDCs in 1990, at present the SFLCs exist just in 228 VDCs in 2008. While for a bureaucratically minded management of the SKBBL, such diminution of programme does not matter much. But once the primary stakeholders themselves are in the driving seat, they would not be able to afford such indifference. All possible efforts will have to be made so that the SFCL members are able to invest increasingly large sums of capital in their income generating endeavours. .

The government and donors would continue to have a major role to play too, mainly in supporting the SKBBL to backstop it towards its effort to improve its own management as well as that of the SFCLs. Once the recovery rate rises to acceptable levels by dint of its policies and good governance initiatives, the first national need it must address is to bring about countrywide replication of the programme. After all, Nepal, a country of 26 million people, has the highest proportion of people in agriculture in the world (78 per cent) and a large proportion of them are small and poor farmers. The SFCL experience shows that micro finance in general and the SFCL approach in particular are particularly equipped to deal with the specific nature of the deprivations that women and the poor suffer in the Nepali society. The SFCL initiative basically provides them with space wherein they would transform themselves into stakeholders willing to assert against the traditional forces of persecution and dispossession in order to protect their stakes on their way out of poverty. .

7. Recommendations

With or without the SFCL take over of the SKBBL management, there are a number of conditions that need to be fulfilled for the more satisfactory implementation of the SFCL programme in the country. The following would be some of the essential improvements that would need to be made in the programme:

7.1. Improving recovery rate

There is an urgent need for the improvement of recovery rate, particularly in the loan financed from the ADBN sources. In order to achieve this, the SFCL management should be sensitised about the direct relationship that exists between improved recovery rate and the continuance of the bulk financing from the SKBBL and also for possibly accessing other commercial bank financing. Therefore, since SFCLs are small farmer owned institutions, they must improve the recovery rate in the interest of the small farmer members themselves.

7.2. Replication and simplified methodology

As it stands, the programme has been able to reach only a small fraction of the small farmer population in the country. Therefore, there is an urgent need for its replication in he new areas. Besides, the present method of replication takes something like three years for a new SFCL to be set up. Therefore, less time consuming methodology has to be developed for the purpose. Besides, in order to make the replication more cost effective, a demand driven method could be adopted. Under such method, a village aspiring to have a SFCL set up in its community should bear the better part of responsibility in promoting the cooperative. This will transfer much of the cost to the beneficiary community itself and make it more cost effective for the SKBBL to replicate the programme more widely across the country.

7.3. Addressing second generation problems

SFCLs across the country have many success stories in terms of people having graduated out of poverty in rather large numbers even as there are many continuing to struggle in the margins of poverty. There are calls from successful small farmers for the loan ceilings to be raised or to allow them to directly deal with the MC or the ADBL branches to access large loans. These issues can be seen as "second generation" problems. But unfortunately, for want of resources, necessary studies are not being undertaken. Since poverty reduction has been the central theme of all our national plans, the National Planning Commission should mobilise necessary resources and mount a nationwide study of the poverty reduction achievements not only of the SFCLs but of all micro finance initiatives in the country. Such a study would provide useful insights as to the future course of action for micro finance sector in general in this predominantly small farmer country.

7.4. Donor consortium

While the SFCL programme has had the benefit of GTZ support right from its very genesis back in 1988, unfortunately, many problems remain for want of resources. Since the micro finance community has the attention and priority of many donors, it is necessary that all donors join hands to form a micro finance consortium in Nepal. Such a move would steadily contribute to promote better co-ordination among the various micro finance initiatives in the country even as the scarce donor resources could be used for strategic interventions in the micro finance sector as a whole for the benefit of poor farmers in Nepal.

7.5. Financing of micro credit

In view of the realized need of micro credit to improve the quality of life of the rural poor, grass roots level sustainable MFIs have to emerge, grow and flourish especially in the rural and remote areas. In order to create conducive environment for microfinance industry, the government as well as the central bank has to play a leading role. A micro credit fund to meet the credit needs of rural MFIs needs to be created .The government and / or the central bank have to take initiative in this regard.

7.6. Legal and regulatory framework

A separate regulatory body needs to be created for micro credit which can develop into a dynamic financial sector with appropriate policy support. Central bank of the country can play an important role.

7.7. Exemption of Corporate income tax:

The government's policy to charge corporate tax to the microfinance development banks at par with the commercial banks cannot be considered equitable and inducive to microfinance institutions serving to the rural poor. Government therefore has to think of exempting the corporate tax to the MFIs and directing them to utilize such saved amount for further expansion of microfinance services.

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