DEPROSC Nepal
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Client Retention and Overlapping

This paper analyses the client retention strategies adopted by Microfinance institutions and situation of overlapping and its potential risk to the both parties: clients and MFIs. Overlapping has two fundamental perspectives. For MFIs, it is a fast track to attain sustainability but it is risky option as it might default loan. For clients it is an option not only to choose institutions and products by their own[1] but also to obtain services from more than one institution, cross finance projects and enjoy the fungibility but remains the risk of falling into debt trap.

MFIs are also put under pressure to be more efficient as well as created chances to overlap or duplicate the clients. MFIs consider it as an opportunity to finance a trained and disciplined client and overlap overestimating the need and potentiality of clients in the process of sharing targeted market niche which results over-indebtedness of clients thereby degrading the portfolio of all MFIs in the market (CGAP, 2001) as happened in Latin American countries.

1. Background

Microfinance in the form of different informal institutions prevailed since time immemorial embedded with other traditional, cultural and social institutions such as Dhukuti originated from Thakali community and Bheja from Magar community. Savings are mobilized as credit under Dhikuti whereas under Bheja, it is used for community projects and ceremony (Baral, 2005). Pewa – a patent asset of daughters and women in Nepalese community – is also a popular form of micro savings and credit. Later these different forms evolved as user groups, mother groups and professional credit unions (ibid).

Formal sector financing began with the establishment of credit cooperatives from the government level in 1950s particularly to supply the production support to the farmers. Further, Cooperative Bank established in 1963 was envisioned to supply adequate credit for the agriculture sector. Development financing through ADB was further focus when it introduced a separate programme in 1975: Small Farmers Development Programme (SFDP) characterized with group collateral. SFDP, a state sponsored and subsidized developmental credit programme, has covered almost whole country geographically. Since 1990s, such groups developed under SFDP were converted into Small Farmers Cooperatives Limited (SFCL) to hand over to the community along with shift in equity is a clear turn from subsidized credit to the concept of sustainable microfinance.

1990s remained one of the most influencing decades in the history for microfinance in Nepal as well. Number of donors, bi-lateral agencies, and international non-governmental organizations (INGOs) supported and subsidized for the promotion of microfinance through operation deficit, seed funds, capacity building and systems development. Considering the enactment of Cooperative Act 1992, thousands solidarity groups were emerged out of which many legalized as Savings and Credit Cooperatives (SCCs). A very few of them also obtained the limited banking licence from NRB.

Further during 90s, NRB established Regional Rural Development Banks (RRDBs) with the partly support from government starting from 1992 to replicate the Grameen Bank of Bangladesh (Sinha, 2000).

[1] This applies only to those areas where more than one MFI are working for same clients.

Following the move, twelve microfinance development banks are also established from the private sector after the enactment of Development Bank Act 1996.

Besides, during the decade, government, donors, central bank supported programs and many more projects based saving credit activities were and are being practiced. Overwhelmingly, many socio-economic projects and programmes also emphasized savings and credit as one major component for poverty reduction.

In addition to the promotion and facilitation of solidarity groups; savings and credit cooperatives; and intermediary non-governmental organizations to carry out microfinance, many NGOs themselves started implementing microfinance activities once the Financial Intermediary Act 1999 allowed them for retailing. Certain number of SCCs and NGOs also scaled up with subsidized wholesale fund of Rural Self Reliance Fund (RSRF) created in 1991. But, NRB at the moment is in the process of transforming RSRF into a National Microfinance Development Fund. Later in 2000, Rural Microfinance Development Centre (RMDC), in support of Asian Development Bank was established with the aim of providing wholesale fund at competitive rate. Recent development is the policy formulation which is yet to be approved.

During the whole evolution of microfinance, access to credit services was itself crucial so drop out of clients and overlapping was basically never considered as important factor in microfinance, but upon the gradual increment of MFIs and their concentration on relatively accessible area created the situation of competition among the MFIs to share the same potential market which created the situation of overlapping and at the same time it provided options to clients to choose products and MFIs. Therefore, it is important now to have an overview in the concentration of MFIs, their operational mechanisms, overlapped situation, demand and supply side prospective and its benefits and potential dangers to both the parties: MFIs and clients.

2. Objectives of the Paper

The paper has the objectives of (i) tracing out the geographical coverage of MFIs and their intensity of services, (ii) finding client retention situation in the MFIs in Nepal, (iii) analysing the situation of overlapping of microfinance services among clients and its consequences and potential risk to both the parties.

3. Concepts and Analytical Framework

Client Retention or drop out

Concept of client retention itself is viewed from two perspectives. In credit driven countries like East Africa, some MFIs consider that clients those who do not have outstanding loan is considered as dropped out member whereas some other MFIs consider members having savings deposit as retained members (CGAP, 2000). For this paper, members who have continued savings is considered as retained members therefore the formula used for calculation is = (End clients / (Beginning clients + New clients)). Client's retention in a single MFI for quite a long time is not expected in general. There are many factors that lead to drop out from one MFI: product design and availability; rest during economic down turn; socio-economic issues - peer risk, infeasible loan size, increasing demand etc. In access to the alternative financial services is one of such forces that compel them to have continued business relations. Factors such as product testing by clients and weeding out by MFIs also lead to clients drop out. Dropping out from one institution can not be considered as drop out from the microfinance industry per se (ibid).

Operational self sufficiency and financial self sufficiency

Operational self sufficiency indicates 'generating enough operating revenue to cover operating expenses, financing costs, and the provision for loan losses' (Ledgerwood, 1998). If an MFI does not reach operational self-sufficiency, eventually its equity (loan fund capital) will be reduced by losses (unless additional grants can be raised to cover operating shortfalls). This means that there will be a smaller amount of funds to loan to borrowers, (which could lead to closing the MFI once the funds run out). To increase its self-sufficiency, the MFI must either increase its yield (return on assets) or decrease its expenses (financing costs, provision for loan losses, or operating costs) (ibid).

Financial self-sufficiency indicates whether or not enough revenue has been earned to cover both direct costs, including financing costs, provisions for loan losses, and operating expenses, and indirect costs, including adjusted cost of capital. The adjusted cost of capital is considered to be the cost of maintaining the value of the equity relative to inflation (or the market rate of equity) and the cost of accessing commercial rate liabilities rather than concessional loans. Theoretically, this puts all MFIs on a somewhat level playing field regardless of their funding structures (ibid). Only those MFIs can be sustained who can meet their operational and financial self sufficiency (Rijal, 2007).

Overlapping

'The most prominent implication of MF competition discussed within the MF industry even in Bangladesh is also the "overlapping"—a term whose definition itself has undergone changes over the years. The term was first used very broadly to denote similar service-providing NGOs working within a geographical area. In recent times, the term is used to indicate multiple microfinance membership at the level of the household' (Martin, undated).

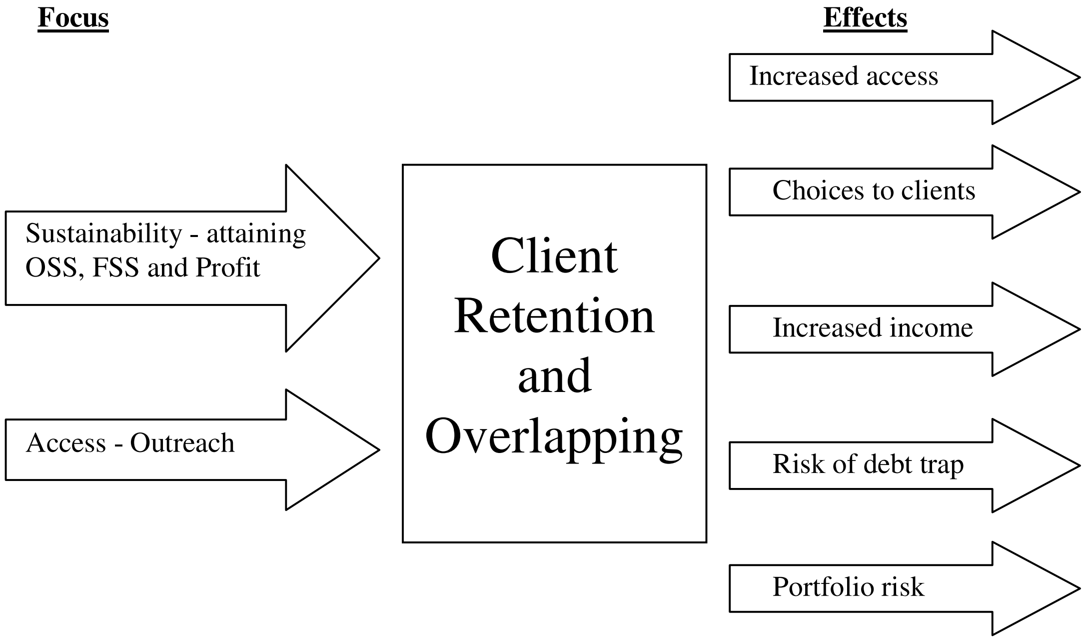
Access

'*[A]ccess* becomes perhaps the most critical resource of all if people are to build sustainable, poverty alleviation rural livelihoods' (Bebbington, 1999). 'Access is defined by the rules and social norms that determined the differential ability of people in rural areas to own, control, otherwise "claim", or make use of resources' (Ellis, 2000).

Analysis of the paper is based on the framework presented in Figure 1. The focus – effects nexus framework designed within the concepts mentioned above that help in analysing the issues raised in the question.

As explained earlier, microfinance is promoted as a strategy for poverty reduction. The scenario begins from the promotion of microfinance. This allows evolve various rules, norms and changes the microfinance market affecting the ability of the people to access it. Microfinance promotion helps MFIs to increase their outreach, business turnover and competitiveness. These could contribute for enhanced access to general people which means people might have better access to microfinance—savings, loan, insurance and transfer facilities. But, the paradox emerges from the same context. In one hand, MFIs are compelled to make microfinance sustainable meeting their OSS and FSS that also allows microfinance clients have options while on the other, people at large are trapped in debt in case of poor fungibility skills and project failure. Thus, the question of client retention in one MFI and overlap is analysed reviewing the end effects on clients increase income and risk of portfolio quality. In the whole process, role of GoN and NRB becomes crucial since they provide the ground for promoting microfinance to attain the objective of poverty reduction.

Figure 1: Analytical Framework: Focus – Effects Nexus



4. DATA PRESENTAION AND ANALYSIS

4.1 ACCESS TO MICROFINANCE

Outreach

At present, various types of institutions are providing microfinance services mainly the savings and credit, however some are also rendering transfer services but in association with other banks and financial institutions. Similarly, insurance services are also catered in an informal way. Livestock insurance is mainly linked with Deposit Insurance and Credit Guarantee Corporation and outreach on microfinance services has significantly increased over the years.

Including overlaps among banks and financial institutions, some 1,760,699 members are covered by all sorts of formal and semi-formal financial institutions which is around 40% higher than the outreach of 3 years back - July 2006. However, some of the following institutions are not catering microfinance services (Thapa, 2010). See table below for detail.

Table 1: Microfinance Outreach by type of Institution

Name of Banks and Financial Institutions	Members as of July, 2006	Members as of July, 2009
Microfinance Development Banks (MFDB)	401,401	547,435
Financial Intermediary Non-governmental Organizations (FINGO)	290,357	381,392
Sana Kisan Bikash Bank (SKBBL)	139,368	145,419
Savings and Credit Cooperatives (SCCs)	435,000	686,453
Total	**1,266,126**	**1,760,699**

Data Source: Compiled by Upreti,2008 and Thapa,2010

Despite all efforts, only '[a]bout 38 percent of Nepalese households have an outstanding loan exclusively from the informal sector, 16 percent from both the informal and formal sector, and 15 percent from only the formal sector' (Ferrari, 2007). Moreover, 'access to financial services remains limited for many people in many parts of Nepal and in recent years has been declining' (ibid). This implies a clear flaw in the real microfinance outreach which is a result of overlapping in the microfinance membership / clients. In order to analyse such overlap further analysis is done on the geographical concentration of the MFIs.

Geographical concentration of MFIs and overlaps

There are altogether 17 MFDBs, 45 FINGOs and 5161 SCCs in Nepal. All MFDBs have extended their services in 57 districts where as 45 FINGOs have rendered their services in 38 districts and similarly, there are only 3 districts left without any SCCs.

Ironically, among the 75 districts of Nepal, only a few districts have higher concentration of MFIs. Jhapa is the one where 10 MFIs are working (the highest number of MFIs in a single district) followed by Morang - 9 MFIs, and Tanahun and Sunsari - 8 MFIs. Udayapur, Bara and Makawanpur districts are the one having 7 MFIs working. The table below shows number of district with the existence of MFIs[2].

Table 2: Number of Districts by number of MFIs working

Type of MFI	Number of MFIs working in districts											Total Districts
	None	One	Two	Three	Four	Five	Six	Seven	Eight	Nine	Ten	
MFDBs	18	14	11	10	9	8	4	1	0	0	0	75
FINGOs	46	11	13	5	0	0	0	0	0	0	0	75
Both	16	13	6	7	12	8	6	3	2	1	1	75

Data source: Telephonic survey, January 2010

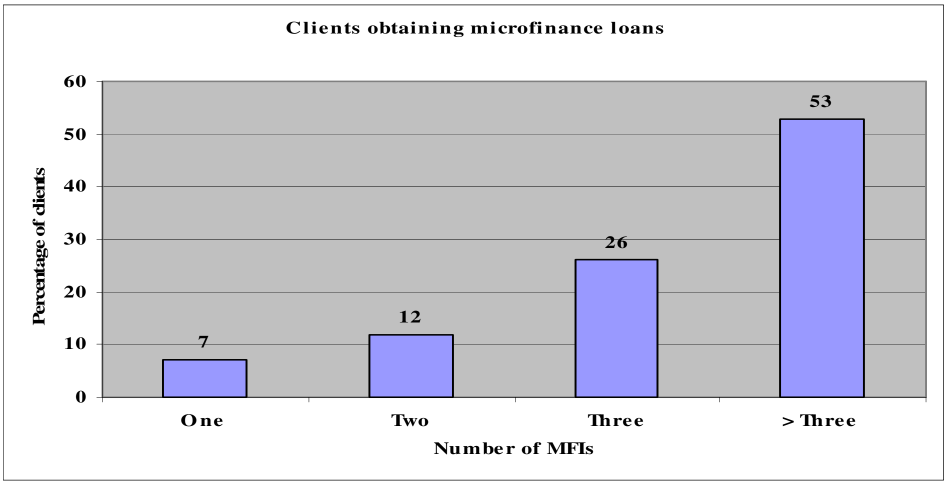
Accessibility, literacy status of people, petty trade and business potentiality are some of the factors that have attracted MFIs to particular areas, which in turn allow MFIs to provide loan in better size, thereto attain the operational and financial sustainability at the earliest.

This paper has not been able to trace out the coverage and overlaps within the district at national level for which further study is necessary. However, it has attempted to trace out the overlaps on a sample basis. Sample survey of 264 clients of different 8 MFIs at 3 districts –Jhapa, Morang and Makawanpur- shows that only 7% clients are obtaining services from a single MFI. Whereas, 12% clients are obtaining loan

[2] FINGOs that have more than 10000 members and all MFDBs are considered.

from two MFIs followed by 26% from three and more than half (53%) clients are obtaining services from more than 3 MFIs at a time. In that sense, we can say the overlap is 93% which is significantly high compared to some of the Indian estimates where 25% of borrowers in urban and peri-urban areas have borrowed from more than 5 MFIs and average borrower in those areas have three MFI loans (Srinivasan, 2009). See the graph below.

Figure 2: Percentage of clients with overlapped loan



Data source: Field survey, January, 2010

Since MFIs have dual mission of enhancing access to microfinance of the poor and to sustain themselves. In this process, MFIs targeted to the relatively accessible and business potential areas – which is true from a business prospective - created this situation of overlap. Moreover, MFIs are adopting every possible effort to increase their portfolio by providing loans to additional clients. MFIs set periodic targets to branch, unit offices and individual credit officers (COs) which is one of causes to have such overlap since achievements of these targets are the indicators for individual incentives, performance evaluation and overall career development opportunities of microfinance staff. In other word it is lowered lending discipline and borrower selection standard (Srinivasan, 2009).

From the client's perspective - revealed during the field survey - having membership to more than one MFI gives them opportunity to mobilize higher loan amount so that they can meet the requirement of their enterprises and grow bigger. They can invest on land and building and household amenities. They find such membership as forced savings mechanism as well however, some members mentioned such multiple loans ease to repay loan instalment of previous loan of other MFIs. Moreover, they find it cheaper compared to the interest rate of local money lenders. Surprisingly, some of the members mentioned they reinvest the money to other locals on higher rate of interest as local money lenders do.

Similarly, clients have persuaded some disadvantages of such multiple loans as well. Problem on time management - they have to present on the centre meeting of all MFIs - difficulties in finding savings amount to deposit in each MFIs' account and difficulty to manage instalments of multiple loans.

Further to analyse, why microfinance clients prefer to take loan from more than one organization? Policy induced loan ceiling of Rs. 60,000 for collateral free group loan is one of the main reasons for multiple membership or overlap. Once they need higher amount, they must go to the other MFI. Therefore, ceiling setting seems problematic. Policy might have justified it as ensuring MFIs go to the poorest clients. But Rs. 60,000 as upper ceiling does not ensure that MFIs go to the poorest because poor people might not demand or could absorb Rs. 60,000 while MFIs all the time reserves the option to go up to Rs. 60,000 legitimizing service to poor and increase their portfolio, means poorest can easily be excluded therefore access to microfinance to poor has not increased despite significant increment in outreach (Rijal, 2007).

MFIs concentrate on particular class of people who are potential for them. A case study of Anarmani VDC of Jhapa clearly shows that among the households of 5174 (Dahal, 2002), none of the MFI has covered more than 20% households. The intensity of coverage is very poor. The average coverage is 8.9% in a context of huge overlap which in a sense proves, all the MFIs are serving the same clients. So loan ceiling to assure services for poorest is not a pragmatic policy rather there should be some motivational incentives to MFIs to reach to the poorest clients and to avoid such overlap.

Table 3: Number of members covered by MFIs: A Case of Anarmani VDC of Jhapa

S.N.	Name of MFI	Total Member	Total Client	% of HHs covered
1	Forward	468	392	9.05
2	Sahara Nepal	690	690	13.34
3	Jeevan Bikash Samaj	587	536	11.35
4	P Grameen BB	432	365	8.35
5	Swablamban BB	519	471	10.03
6	Chhimek BB	233	233	4.50
7	Nerude BB	221	186	4.27
8	Karnali	676	609	13.07
9	Summit BB	229	209	4.43
10	Deprosc Nepal	987	905	19.08
11	Nirdhan UB	22	21	0.43
	Total	5064	4617	
	Average	460	419	8.9

Data source: Field survey, January 2010

4.2 Member Retention and drop out

Members drop out is an expensive proposition (Wright, 1997) since they have to invest quite a significant time and efforts to bring them into the programme orbit including initial training, reorganization test, and familiarization with their products and methodology. Moreover, drop out adversely affects the attainment of OSS and FSS of the MFIs. Number of clients served and outstanding portfolio directly lead towards attaining OSS and FSS which are hindered by such drop outs. Average outstanding loan decreases with the changes in the member. As an old client's average loan holding will always be higher than that of a new client because all MFIs gradually increase loan size with the increment of their loan cycle. Similarly, the internal resource generation (member savings) is also affected since higher volume depositing member goes out and new member starts from zero. However, it can also be argued, drop out does not only occur just against MFIs interest but the force expulsion equally prevail.

As of July 2009, cumulative members drop out ratio in some of the MFIs seems quite a large; it is as high as 41.83 percent in Central Region GBB and lowest in Swablamban BB (10.04%) among the MFIs surveyed. However, if we see the period which ranges from 7 to 16 years, the annual drop out might not be quite high. It is below 3% except in Central Region GBB whereas annual client drop out in East Africa ranges between 25% to 60% (Wright, 1997). Moreover, bulk of these drop outs represents particular cases during the conflict. See Table below. Nevertheless, segregated data on force drop out - screening by MFI - and voluntary drop out is not available. Whatever, such a drop out is not a good tendency unless and until they are graduated to other products or institutions. However, the plausibility of obtaining services from other MFIs can not be denied.

Table 4: Cumulative Members and Drop out by MFIs

Organization	Drop out as of July 2009	Total Members as of July 2009	Drop out percentage	Number of Years
Chhimek	27240	93047	22.65	8
Farwestern Grameen	6310	18105	25.84	16
Purbanchal Grameen	39615	93950	29.66	16
Nirdhan	38483	115174	25.04	10
Swabalamban	9729	87127	10.04	7
Central Region	26076	36267	41.83	13
Total	**147453**	**443670**	**24.94**	

Data source: Telephonic survey, January, 2010

Drop out of the members/clients basically has revolved around four major reasons which are (i) forced by situation, (ii) forced by MFIs itself - supply side, (iii) natural process (iv) option choose by the clients-demand side.

Nepal has undergone a severe arm conflict for more than a decade which has affected all the areas of socio-economic life. Microfinance could not remained in exception which forced many MFIs mainly NRB promoted Rural Development Banks phased out or suspend their branches which caused forced drop out of the clients/members in microfinance.

Causes forced by MFIs itself to drop out include defaulter screening, merging of branches, concentration of programme to create efficiency, screaming of members based on discipline, and credit officers focusing on semi-urban areas.

Similarly, permanent migration, marriage, seasonal labour migration, natural death, failure of enterprise is some of the causes that naturally created situation of drop out of the members/clients.

Information revealed from some of the MFIs over the last three years shows that client retention ratio ranges from 91% to 98% during the fiscal year 2064/065 and 2065/066 which is quite good. Client retention is improved compared to the past - data does not perfectly correspond to the institution and period - and this is as a result of various strategies adopted by MFIs in the context of competition which has discussed below.

Table 5: Client Retention Rate by MFIs

Organization	**2064/065**	**2065/066**
Chhimek	0.97	0.91
Swabalamban	0.93	0.98
Deprosc dev. bank	0.91	0.93
Nerude dev. bank	0.94	0.90
Sahara Cooperative	0.97	0.94
Total of sample	0.95	0.93

Data source: Telephonic survey, January, 2010

Availability of new MFI with new and innovative products, higher loan size, flexibility of loan products and interest rates variation across the MFIs are some the reasons that lead to change – in minimum case- and add the membership of additional MFIs. Survey of 264 member shows that only 5.6% has dropped out because of centre itself dissolved and 62% members have added membership with other MFI maintaining the one over the last five years. Therefore, tendency is not to drop out from one to have other but have other for different benefit package without leaving one. Therefore, the overlap has increased.

4.3 Adopted client retention and outreach strategies in MFIs

During the initial years, MFIs were not much concerned about such drop out since there were plenty of in-accessed potential microfinance members, once number of MFIs grew bigger targeting the same market niche, MFIs need to retain their clients and hold the market niche for longer term. Thus, MFIs adopted many strategies of outreach and portfolio increment to attain OSS and FSS which can be categorized into three major groups. These include (i) diversification and differentiation of products and services, (ii) Changes in methodology and loan ceiling, (iii) Other support services and personal approaches.

Product Diversification - Choices

Product diversification across the MFIs is one of the major positive outcomes of the strategies adopted by MFIs for client retention or holding the market niche in the context of competition in a particular geographical area. Diversification is aimed at addressing the varied needs of clients thereby creating ample opportunities to clients in choosing appropriate product. Some of the innovative ones are seasonal loan product, housing loan products project loans, informal insurance products - compensation for disaster and death - maternity support products, longer term savings products such as life savings / pension savings etc. Pension saving product seems specifically targeted for the longer term member retention.

Methodology changes

MFIs in Nepal have undergone major changes in programme methodology of microfinance service delivery. Among which shift of weekly centre meetings to fortnightly or monthly, withdraw of loan guarantee fund deduction from loan, revision on interest rates - higher to savings and lower to loan -

counter collection system, collateral loan, longer term and short term loans – more than one loan at a time – next loan with the mid time repayment of earlier loan, higher loan size even from the first loan cycle, one tier centre system, longer loan term, interaction between centre chiefs, exposure visits and improve monitoring and supervision. Such changes in microfinance widely allowed clients to find appropriate methodology and improved portfolio quantity of MFIs. Time management problem of clients was also addressed through such changes which allowed clients to participate in more than one MFI.

Other support services and personal approaches

In addition to above mentioned strategies, MFIs adopted other measures to retain and increase their clients. Which include personal motivation, skill development training, organization of health camps, souvenir presentation etc. Even some MFIs unofficially targeted existing microfinance centres promoted and served by other MFIs and provided loan with higher ceiling to attract them. However, even today there are some MFIs which look for field level coordination to avoid overlapping.

4.4 Increased Income

Access to number of MFIs and opportunity of multiple loan and fungibility has incredibly enhanced the chances of raising income and graduate from the poverty in general. During the survey number of clients were met those having benefited from the multiple loans. As an illustration, a case of Ms. Mohakha Sahani is presented below who has multiple memberships to MFIs and outstanding loan of Rs. 230000 obtained from 7 different MFIs. She has been successful in doing so therefore, these are not the cases to worry about which neither risk the portfolio of MFIs nor push down clients into the dept trap.

A case of Ms. Mohakha Sahani, Bhadrapur, Jhapa

Mohakha Sahani (Pawan Sahani), her husband, 2 children, brother-in-law, including her four family members has been staying in Bhadrapur. In the beginning they had only 1.5 kathha land, and one small house. The family had no collateral for credit. Then the families took loan from Gramin Bikash Bank, ten years ago, and established a fire-wood business on others land. The credit taken from Gramin Bikash Bank was not sufficient for the family, hence; they took loan against high interest rate from a local money lender and continued their business. She also knew that DEPROSC-Nepal provides credit and continued the business by being associated six years ago with the group and getting loan. The family switched the fire-wood business to a furniture shop, as the furniture business required more investment, the family started borrowing from Sahara Nepal as well. Then 4 others MFIs namely: Jeevan Bikash, Nerude, Karnali, and Swabalamban also came and the family took loan from all those MFIs. Then a Sawmill was also bought which is required for the furniture shop. From the business they have been able to manufacture table, chair, sofa, cupboard, bed and according to the demand and choice of the customers.

Now, to operate the business a piece of land has been purchased and a shed constructed on it. She says that, “it is not difficult to send their children to a boarding school as income has significantly increased”, where as they used to go in a government school before.

Ms. Sahani has been maintaining her membership and loan with all 7 MFIs. At the moment she has been holding total loan of Rs. 2300000 (Two hundred thirty thousands only) and repaying instalments of all MFIs without making default.

MFIs	No. of years maintained membership	Amount
P Grameen BB	10	40,000
DEPROSC-Nepal	6	50,000
Sahara	4	40,000
Jeevan Bikash	3	30,000
Nerude BB	2	40,000
Karnali BB	1	10,000
Swabalamban BB	1	20,000
Total		**230,000**

Source: Field survey, January 2010.

4.5 Falling into debt trap

Upon failure to handle the opportunity of fungibility or a failure of projects or other domestic issue that led to fail in handling the resources creates a situation of both: put MFI portfolio into risk and the client into a debt trap - particularly when the clients has weak fall back position. A case of Ms. Shanta Rajbanshi is presented here as an example. There might have so many other reasons for her falling into debt trap but the access to number of MFIs and providing loan without assessing the potentiality of client is one of the major causes that supported her falling down into debt trap without leaving the chances of breaking it out.

A case of Ms. Shanta Rajbansi, Birtamod, Jhapa

Shanta Rajbansi (Bhandari) born in Galagaliya, India got married with Surya Bahadur. Bhandari of Morang. They started living temporally in Birtamod, Jhapa to find livelihood means. She obtained membership in DEPROSC-Nepal and received Rs 10,000 as first loan to start vegetable business. She had to finance her 6 children and husband. She managed to repay the loan and interest out of the earnings made from vegetable business and labor wage of her husband. She was encouraged and took second loan of Rs. 20,000 for Rikshaw which her husband used for earning. Her husband started spending certain amount on drinking alcohol for relaxation. That drinking habit usually created conflict in the family. Then they were unable to pay instalments of Rs 20,000 loan hence other members of the groups paid up to 3 instalments for her. She became irregular in the centre meeting and MFI collected the remaining instalments from the group. She found other ways of getting loan to repay the fellow members of the group. But, she also could not repay instalment of Rs. 30,000 loan taken from Sahara and the MFI collected instalments from the centre again. Later, it was realized, she continued taking loan from Chemek, Jeewan Bikash and Karnali which all are defaulted. She partly used the money to pay back the instalments of previous loan and used rest money for household consumption. Now no MFI provides loan and she is completely in a debt trap. Moreover, now she is disqualified for additional financial services. Later, she even sold her Rikshaw to manage her household expenditure.

Among 6 children, the elder one (12 years) started working as a household laborer. He was even sacked no more than a year since mother frequently visited and asked for advance. None of her junior child goes to school. There is no one to save her now. May be some other MFI…………..

4.6 Portfolio at risk

This paper has already discussed the perspective of client obtaining loans from more than one MFI to enjoy the fungibility and to meet the higher loan demand. MFIs are also aware of the fact that there is huge competition and overlap among them. All competitions are not fair. MFIs deny unfair competition from their end and also put concerns as it deteriorates the portfolio quality but this is being widely practiced knowingly or unknowingly. Some of the examples are (i) provide higher loan as others are also offering the same. Credit officers are familiar that they would not receive their instalment if other competitors do not provide the loan to their clients. This has been triangulated with the version of client as they accept that they repay the instalment of one loan with the money borrowed from other MFI. Similarly, (ii) serving the microfinance centre of one MFI - same clients - with new loan product. MFIs may overestimate the need and potentiality of a client. These sorts of cases are observed in a situation when a Credit Officer or a Branch itself is assigned with targeted outstanding portfolio or number of member/client in the process of attaining financial viability as early as possible. MFIs considered it as an opportunity to finance a trained and disciplined client with relatively higher absorption capacity and better assurance of repayment.

In general, multiple membership facility benefits clients. But sometime it may result a devastating situation in the economy of a client – that immediately reflects into the portfolio quality of MFIs as well - particularly because of over fungibility in the non-productive sector or project failure, however overlapping would not always be responsible for this since a client always have the option to go to informal money market to overlap.

5. Findings, Conclusion and Recommendations

5.1 Findings

Geographical Coverage and intensity

Outreach of microfinance services (savings, credit, insurance and transfer) has increased by around 40% over the last three years reaching to 1760699 members, however, access to financial services remains limited for many people in many parts of Nepal. Only a few districts have higher concentration of MFIs.

The intensity of coverage is very poor. None of the MFI has covered more than 20% households. The average coverage is 8.9% in a context of huge overlap which in a sense proves, most of the MFIs are serving the same clients.

Client Retention and drop out

As of July 2009, cumulative members drop out in some of the MFIs is as high as 41.83 percent, however annual average drop out is not more than 3% except in Central Region GBB. Information revealed from some of the MFIs over the last three years shows that client retention ratio ranges from 91% to 98% during the fiscal year 2064/065 and 2065/066. Such drop outs is because of four major reasons which are (i) forced by situation, (ii) forced by MFIs itself - supply side, (iii) natural process (iv) option choose by the clients-demand side.

MFIs need to retain their clients and hold the market niche for longer term. Thus, MFIs adopted many strategies of outreach and portfolio increment to attain OSS and FSS which can be categorized into three major groups. These include (i) diversification and differentiation of products and services, (ii) Changes in methodology and loan ceiling, (iii) Other support services and personal approaches.

Diversification is aimed at addressing the varied needs of clients thereby creating ample opportunities to clients in choosing appropriate product. Some of the innovative ones are seasonal loan product, housing loan products project loans, informal insurance products - compensation for disaster and death - maternity support products, longer term savings products such as life savings / pension savings etc. Pension saving product seems specifically targeted for the longer term member holding.

MFIs in Nepal have also undergone major changes in programme methodology of microfinance service delivery. Among which shift of weekly centre meetings to fortnightly or monthly, withdraw of loan guarantee fund deduction from loan, revision on interest rates - higher to savings and lower to loan - counter collection system, collateral loan, longer term and short term loans – more than one loan at a time – next loan with the mid time repayment of earlier loan, higher loan size even from the first loan cycle, one tier centre system, longer loan term, interaction between centre chiefs, exposure visits and improve monitoring and supervision.

Other support services and personal approaches include personal motivation, skill development training, organization of health camps, souvenir presentation etc. Even some MFIs unofficially targeted existing microfinance centres promoted and served by other MFIs and provided loan with higher ceiling to attract them.

Overlapping

Sample survey of 264 clients of different 8 MFIs at 3 districts –Jhapa, Morang and Makawanpur- shows that only 7% clients are obtaining services from a single MFI and overlap is 93% among the clients.

Availability of new MFI with innovative and differentiated products-savings and insurance-higher loan size, need of additional loan amount, flexibility on loan products and interest rates variation across the MFIs are some the reasons motivating clients to overlap. This allows them grow business; invest on land and building and household amenities. Tendency is not to drop out from one to have other but have other for different benefit package without leaving one. Therefore, the overlap has increased. Survey of 264 member shows that 62% members has overlapped with other MFI maintaining the previous one over the last five years.

Similarly, clients have persuaded some disadvantages of such multiple loans as well. Problem on time management - they have to present on the centre meeting of all MFIs - difficulties in finding savings amount to deposit in each MFIs' account and difficulty to manage instalments of multiple loans.

Accessibility, literacy status of people, petty trade and business potentiality[3] higher loan absorption capacity of clients, established trend of borrowing and repayment among the clients, less efforts required to increase the membership are some of the factors that have attracted MFIs to particular areas, which in turn allow MFIs to provide loan in better size, thereto attain the operational and financial sustainability at the earliest.

Policy induced loan ceiling of Rs. 60,000 for collateral free group loan is one of the main reasons for multiple membership or overlap. Once they need higher amount, they must go to the other MFI.

Access to number of MFIs and opportunity of multiple loan and fungibility has incredibly enhanced the chances of raising income and graduate from the poverty in general. Ms. Sahani has been maintaining her membership and loan with all 7 MFIs. At the moment she has been holding total loan of Rs. 2300000 (Two hundred thirty thousands only) and repaying instalments of all MFIs without making default.

In general, multiple membership facility benefits clients. Upon failure to handle the opportunity of fungibility or failure of project or other domestic issue that led to fail in handling the resources creates a situation of both: put MFI portfolio into risk and the client into a debt trap - particularly when the clients

[3] business potentiality include urban and semi urban area where market, road and other infrastructures are available

has weak fall back position. Access to multiple loans seems to be the major reason for Ms. Shanta Rajbanshi to fall into debt trap.

MFIs are also aware of the fact that there is huge competition and overlap among them. All competitions are not fair. MFIs deny unfair competition from their end and also put concerns as it deteriorates the portfolio quality but this is being widely practiced knowingly or unknowingly.

5.2 Conclusions

Expansion of microfinance in the country and increased outreach is quite apparent in the recent years. At the same time, larger number of people is still remained in accessed to microfinance services. And, major MFIs have concentrated their business in a particular geographical area targeting a class of people that is accessible and potential for larger portfolio so that they can sustain themselves and cross finance the loss area branch if any. Average intensity of coverage is only 8.9, hence, overlapping in particular area is as high as 93 per cent which is not a good indication for the microfinance industry as whole.

Approve more than one MFI to work in particular geographical area has created sorts of competition among them. This has broken the situation of monopoly thereby allowing microfinance clients to choose institutions and products. MFIs have adequately improved their products and services so as to satisfy the clients' needs and to hold market niche. Beside, MFIs are also put under pressure to be more efficient. But at the same time, this situation has allowed microfinance clients to obtain services from more than one MFIs as well as allowed MFIs to provide services to already served members/clients thus has created situation of overlapping which fundamentally has two perspectives: MFI's perspective – fast track of sustainability but risky option as it increases risk of default; client's perspective - an option to cross finance projects and enjoy the fungibility but has a risk of falling into debt trap in case of over fungibility, unproductive investment-consumption- project failure and has weak fall back position.

Similarly, the regulation includes loan size ceiling which could have mainly two reasons. First: the loan size cap might ensure that loan does not go to rich people which may imply the capacity of 'poor' to mobilize the resources which in other word is of rating risk bearing capacity of client. Second: ceiling restricts MFIs from providing big loans to relatively better off people. This has significant contribution to create overlapping.

Area of operation as well as branch expansion is covered under the regulation and supervision mechanism, but it is silent on overlapping. Moreover, it excludes the credit information to be maintained among MFIs which is fully ignored by MFIs. This will have direct impact on the client as well as the portfolio risk of MFIs.

5.3 Recommendations

MFIs should enhance their coverage intensity which allows increased outstanding portfolio with minimum incremental cost therefore helps to increase the outreach sustaining the programme. NRB or proposed STI can regulate it through approval and withdrawal process. MFIs with X level of intensity within Y number of years will have their approval in Z area be cancelled.

MFIs in the process of holding market niche can expand their programme but should at least maintain a mechanism of credit information, or a information desk at regional or X level to make sure the client with overlapped services are not at risk viz-a-viz the portfolio of MFI. Cost of loan portfolio default will be much higher than the cost of maintaining credit information. Moreover, if MFIs still ignore such overlaps, they might have to face the situation as happened in Bolivia in 1999 (CGAP: 2001).

NRB should come up of with a regulation mechanism of addressing poorest clients with innovative incentive mechanisms to MFIs. Regulation alone without incentive directly threats the sustainability of MFIs which will not fulfill any objectives. For example RMDC or any other fund which is subsidized by government to increase the access to microfinance can be used with their varied interest rate on wholesale loan based upon loan retailed by MFIs. For example number of loan with less than X amount of loan in Y area will have access to Z type of wholesale loan, if government / NRB really want MFIs reached to the poor.

Collateral free group loan ceiling of Rs. 60,000 needs to be reviewed and breakdown into different ceilings. What is the use of this regulation when a client like Ms. Mohakha Sahani requires Rs. 230,000 and has been mobilizing from 7 different MFIs. There should be some mechanism of higher loan amount to the experienced / capable clients other than enterprises loan[4]. This will make the situation transparent among MFIs. In principle, one can say such clients will move to formal sector financial system but access to such formal sector financial system is not easy to take place thus clients would prefer to remain with MFIs.

[4] Enterprises loan of Rs. 150000 requires collateral which is the biggest constraints on access to financial services.

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