How to Establish Linkages of Community Organizations and SACCOS with Micro Finance Institutions, Protecting Rights of Clients over Assets

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Abstract

Poverty incidences and its reduction at disaggregated level in terms of social groups have remained highly disproportionate in Nepal. Poverty Alleviation Fund (PAF) has adopted a demand-led, community-based approach to poverty alleviation where the targeted communities are provided full decision-making authority to prepare, implement and manage their sub-projects. PAF targets the poor households through Participatory Social Assessment and community well-being ranking method. PAF has, so far, covered 334,000 poor household members of 25 poorest districts, where 11,500 community organizations/groups (COs) are operative. Of the total households, 65.8% are hardcore poor, 25.5% are medium poor, 8.5% are poor and 0.2% are marginal Non–poor category. Of these, gender wise 71% are female, ethnicity wise 30% Dalits, 29% Janajati and rest are from other ethnic groups. Further to the above, among the COs, 206 are federated to carry out the sub-projects in joint venture. Likewise, 100 COs have established networks of their own and over 50 multi purpose as well as savings and credit cooperatives are registered and functional. Several COs are heading towards amalgamating into cooperatives.

PAF supported COs are trained and practicing systematic loan processing, loan sanction, loan disbursement, loan repayment, loan utilization, loan monitoring system and collection of revolving fund. Eventually, these strong grass-root level organizations of poor could be presumed as good client for Micro-finance Institutions. Those COs are managing Revolving Fund of about NRs. 4000 M. and carrying out income-generating activities in 25 poorer districts of the country. PAF is also providing support to COs for their institutional development, so that these community institutions of poor are enabled to manage and run their business sustainably. COs' aforementioned revolving fund amount and their regular savings amount is maintained as their equity , which will be a strong collateral to get access with MFIs and banks to cater their further financial needs. PAF funded COs have subsidized funds so that they could balance the actual interest rate in order to maintain unrest in the rural area. When it is so, COs will be most appropriate clients for the microfinance providers, from lending perspective.

1. Background

1. 1 Poverty Scenario of Nepal

Though there has been a significant progress in the reduction of income poverty in the last decade, poverty incidence is still very high in Nepal. The Nepal Living Standards Survey (NLSS), 2003/04 showed that although poverty had declined dramatically by 11 percentage points between 1995/96 and 2003/04, approximately 31 percent Nepalese were below national poverty line in 2003/04. Poverty was more prevalent and severe in rural areas because the decline was slower (from 43 to 34 per cent) in rural areas than that of urban areas (from 22 per cent to 10 per cent). This indicates that the incidence of poverty in the rural areas was almost four times higher than in the urban areas in 2003/04. There is also evidence that the underprivileged social groups are the most impoverished.

Poverty incidences and its reduction at disaggregated level in terms of social groups have remained highly disproportionate in Nepal. It is more prevalent in some social groups and also in remote geographical regions. The NLSS data and also a recent study done by the World Bank and DFID show that some social and religious groups and geographic regions remained at high intensity of poverty. For instance, despite the national headcount poverty rate of 31 percent, still 45 per cent of the Dalits and 44 per cent of the hill indigenous nationalities were still absolutely poor. Moreover, while poverty in Terai higher caste was less than 12 percent and that of Newar community only 14 percent, the same for Hill Dalits was about 48 percent.

1.2 Rationale of Poverty Alleviation Fund (PAF)

In 1992, soon after the restoration of multiparty democracy in the country, the Task Force on Poverty set up under the National Planning Commission (NPC) had strongly suggested to set up autonomous poverty and other sectoral funds, and polycentric institutional arrangement for quicker diminution of poverty. The rationale behind proposing the autonomous funds was the much required flexibility in – i) fund flows, ii) support mechanism, and iii) incentive structure. Similarly, the proposition of polycentric institutional structure was for fostering competition among service deliverers towards efficiency. It is to be noted that there were no dearth of good policies, programs and commitments for poverty alleviation within the government sphere.

What was lacking was the flexibility in operation caused by rigid and cumbersome processes and incentive structures. This is the reason why the NGOs enjoying the freedom of flexibility had much more efficient outcomes compared to resource-rich government. Again, the question arises as to why autonomous funds would be needed when the task of poverty alleviation could be done more efficiently and effectively by the NGOs? The answer is simple. NGOs operate on – i) scattered basis; ii) have difficulty in achieving scale due to resource constraint; iii) are highly donor dependent and iv) have no guarantee of continuity of support at least until a reasonable cycle of support is provided to the poor until they come out of poverty.

In the above sense, the autonomous funds can have the advantage on both grounds – flexibility and continuity (permanence). While sectoral funds started to evolve little earlier, the establishment of poverty fund was delayed considerably. It eventually came about in 2003 through Poverty Alleviation Fund Ordinance and later in 2006 permanently rooted through Poverty Alleviation Fund Act. It is a national programme aiming to improve the livelihood of the poor and excluded communities. Along with the support for capacity development and income generation initiatives, PAF is supporting small-scale community infrastructure like rural water supply, small irrigation, health center, school building, micro hydro, rural road and bridge, among others. These small-scale infrastructure are providing the community different types of services and contributing to improve their livelihood and socio-economic standard. The main elements of social inclusion under PAF are: (i) Addressing spatial exclusion by focusing on most deprived districts while providing services in other poverty-stricken areas as well, (ii) Reaching the poor – the targeted beneficiaries – with the services while maintaining social harmony, and (iii) Focusing exclusively on marginalized communities taking adequate care to ensure community cohesiveness and solidarity.

1.3 PAF Working Approach and Modality

PAF has adopted a demand-led, community-based approach to poverty alleviation where the targeted communities are endowed with full decision-making authority to prepare, implement and manage their sub-projects. PAF's targeted beneficiaries include the extreme poor, women, *dalits* and indigenous nationalities (*janajati*) and at least 80% of Community Organization (CO) members are from among the targeted beneficiaries. The PAF also requires at least 50% CO members to be women and that the key position holders in the COs including Chairperson, Secretary and Treasurer are from among those groups.

PAF provides direct funding support to the COs for implementing their programs upon submission their community action plan (CAP) to PAF. This is such a strategy which ensures efficiency, transparency and ownership. The Partner Organizations (POs) comprises Non-governmental Organizations (NGOs), private sector organizations and local bodies including DDCs and VDCs. However, those POs provide COs with facilitation, social mobilization, technical assistance and capacity-building in organizing, planning, implementing and managing their sub-projects. The four major program components of PAF are: (i) social mobilization (ii) income generation (iii) small community infrastructure, and (iv) capacity-building. PAF has covered 25 out of 75 districts of the country and is all set to scale up its programme in all the 75 districts from this fiscal year. Grant fund is received from the World Bank and IFAD to launch PAF interventions in Nepal.

PAF is working to contribute directly to attain the level of poverty to 10 percent by 2020 in pursuant with the long term goal of Government of Nepal; and to reduce poverty by half by the year 2015 as per the Millennium Development Goals (MDGs).

As PAF is targeting to the poorest group, it requires vigorous mobilization, capacity building and empowerment. PAF program is demand-driven. COS prepare their program themselves. Community is mobilized, trained and provided information for making informed choices. Each household of the CO prepares their income-generation program. Based on this, Community Organizations prepare their income-generation sub-project proposal. PAF appraises it and provides fund directly to the Community Organization (CO) for its implementation. Community Organization itself implements and manages their program. In addition, PAF further provides small community infrastructure support on the basis of demand of COs, which enhances livelihood options they have chosen earlier. POs facilitates, builds capacity and provides technical support to the COs, who are capacitated in handling their business and managing the program on their own.

2. Reaching the Poor

2.1 PAF Targeting the Poor

As PAF is targeted program, it is crucial for PAF to identify the poor as beneficiary of the program. PAF has developed the targeting tools in reaching the poorest of the poor. PAF first reached the poorest districts as categorized by the National Planning Commission (NPC) /Centre Bureau of Statistics (CBS) based on the composite indices of 28 different poverty related socio-economic indicators. Within the district, VDCs have been prioritized based on similar socio-economic indicators available from CBS and then secondary information available in the district. As PAF accords top priority to the inclusion of poor and socially excluded groups, higher weightage is given in prioritization to those VDCs where high density of those groups such as *Dalit*, *Janajati* and other deprived groups persist. Settlements resided by large numbers of socially excluded poor within the VDC will then be mapped by participatory discussion at VDC level.

Following the selection of the settlement, PAF targets the poor households through Participatory Social Assessment and community well-being ranking method. First of all, participatory community mapping will be carried out showing each and every households in the settlement. Each household will then be numbered and the whole economic and social condition of the household will be documented by participatory method. Based on these information obtained, it will be determined whether particular household is poor or not according to food sufficiency and other criteria as determined by the community during participatory process. PAF categorizes three types of poor, which are follows:

1) The household that has food self- sufficiency below three months is “Ka” category. (Hardcore poor)
2) The household that has food self- sufficiency more than three months but below six months is “Kha” category. (Medium poor)
3) The household that has food self- sufficiency above six months but below twelve months is “Ga” category. (Poor)
4) The household that has food self- sufficiency more than twelve months is “Gha” category. (Non-Poor)

PAF targets only first three groups of households for its program intervention. The fourth group is not entitled to capture PAF resources for income-generation activities. Community Organization or Group will be formed with only poor households and one member from each household. It means the client's assessment will be carried out after the reassessment of the asset and income. PAF has, so far, been able to cover through its program intervention, to altogether 334,000 poor household members of 25 poorest districts in 11,500 community organizations/ groups. Of which, 65.8% are hardcore poor, 25.5% are medium poor, 8.5% are poor and 0.2% are marginal Non –poor category. Of these, gender wise 71% are female, ethnicity wise 30% Dalits, 29% Janajati and rest are from other ethnic groups.

Further to the above, among the COs, 206 are federated to carry out the sub-projects in joint venture. Likewise, 100 COs have established networks of their own and over 50 multi purpose as well as savings and credit cooperatives are registered and functional. Several COs are heading towards amalgamating into cooperatives.

2.2 Community Managed Revolving Fund

It is provisioned that the fund provided exclusively for income-generation will remain as revolving fund within the COs. CO itself prepares terms and condition of loan. There is flexibility to formulate as easy loan mechanism congenial to the poor. This mechanism builds confidence of the poor in handling business with loans.

PAF, through PO, provides technical training on operation and management of Revolving Fund to household members to undertake income-generation activities they have chosen successfully. Out of total PAF investment in income-generation, Rs. 400 M is set aside in revolving fund and it is mobilized by 11,500 Community Organizations.

As Fund revolves for second third time and business further cultivates, CO members need more funds. However, COs are well experienced in handling and managing Revolving Fund. Similarly, they also need to organize for linking with markets. Communities are forming Networks and Co-operatives to take care of financial needs, market linkage and other services.

PAF has already implementing the 'Revolving Fund Management Guidelines' that has all essential elements of microfinance, which is presumed to be the best practices of microfinance in the present context. Some of the essential elements of PAF COs are described below:

1. Exclusively targeting to the ultra poor so that they are capacitated by small grants, training and human resource development.

2. The CO is registered with a formation of 25 to 35 target members. For loan administrative point of view, a sub group of 40%, 40% and 20% is sub-divided. Such type of grass-root level organization may help administer the loan properly.

3. The interested members to take loan from revolving fund should compulsorily attend minimum of 7 days' Revolving Fund Management training and should face the test. The training and test pass is the gate way to receive loan from Revolving Fund.

4. The loan process is simple and loan will be suitable to their income generating project decided by community members themselves.

5. Loan is small and quickly income generative. Maximum loan term may be not more than 1.5 years. The repayment system will be monthly in equal installment of interest and principal.

6. The project is selected by the loanee himself/herself. Whatever the member has survival skill; they capitalize it or expand for further income generation. PAF tries to find out the way to develop the skill even for micro-entrepreneurship for further income generation to push them out of poverty trap.

7. The staggered loan disbursement in cash (Cheque) will be made from Revolving Fund in the community at the door steps. It means, the first priority to receive the loan is the hard core poor (Ka group), after that the medium poor group is entitled to receive the loan, lastly the poor will get loan. The difference of the loan period will be of two months. It means, when the first loanee group attends the meeting regularly, pay installments timely and maintains CO discipline properly then the

second group would be entitled to take loan. Similarly, second groups should also follow the same to disburse loan for last group. It means 40%+40% +20% or 2+2+1 method is followed.

8. The business must be transparent in the CO's regular meeting. The loanee should open his/ her business proposal in the CO meeting and all the members should unanimously support the proposal to sanction the loan. This peer support will guide them to make proper repayment. The peer should be responsible for the proper use of loan and timely repayment. Instead of non utilization, the report will be presented in the CO meeting and peer pressure will be created either for proper use or repay the whole amount.

9. Saving mobilization is although not compulsory but in practice all the members are adopting compulsory savings. Five percent of the loan amount is also deducting from the loan amount and collecting in the saving fund for emergency and consumptive purpose.

10. Rigorous practical training to the PO staffs is given compulsorily recently that they may prepare the client members and test made to the clients so that their quality is maintained.

3. Scope for linkage COs/SACCOs with MFIs

The demand of community for additional fund is increased to invest in their growing business. In this context, micro finance institution can play important role whereas PAF makes the landing path to flow the loan. Thus, loan can be flown directly to COs from microfinance institution. These Community Organizations are trained and practicing systematic loan processing, loan sanction, loan disbursement, loan repayment, loan utilization, loan monitoring system and collection of revolving fund. Eventually, these strong grass-root level organizations of poor could be presumed as good client for Micro-finance Institutions.

3.1 PAF develops market for MFIs

Micro-finance is viewed as an important tool for poverty reduction in the developing countries. These services are mostly confined in the Terai regions of Nepal and they have not been able to reach adequately in the hilly regions so as to cater the financial needs of the poor communities. However, hardcore poor people are particularly deprived from this access, since they are not credit worthy. In view of this fact, Poverty Alleviation Fund (PAF) is implementing demand-driven community based targeted program in Nepal since five years. It is absolutely a targeted program of Nepal government which focuses poor and socially excluded groups such as women, *dalits*, *janajaties*, and other marginalized groups who are deprived poor. PAF has provided support to these targeted groups of poor in order to implement their income generating activities and to develop their institutions by themselves in a sustainable manner. As their income generating activities are up scaled, there is the demand of additional fund to grow their business. It has, henceforth; to fulfill the demand of this poor group they should be linked with micro-finance institutions.

Till date (As of Jan 14, 2010), altogether 11,500 Community Organizations (COs) are functional with income-generating activities by involving 334,000 poor household members. These COs are managing Revolving Fund of about NRS. 4000 M. and carrying out income-generating activities in 25 poorer districts of the country viz. *Darchula, Mugu, Ramechhap, Pyuthan, Kapilbastu, Siraha, Achham,* *Baitadi, Bjhang, Bajura, Dailekh, Dolpa, Doti, Dadeldhura, Humla, Jajarkot, Jumla, Kalikot, Mahottari, Rautahat, Rasuwa, Rolpa, Rukum, Sarlahi, Sindhuli*. Each household is undertaking its income generating activities in accordance with its community action plan (CAP) prepared by them. In addition to direct community fund support, PAF is providing technical support and building the capacity of household and group to run their business effectively and productively.

PAF also supports small community infrastructures including micro-irrigation, roads, bridges, culverts, ropeways, micro-hydro, alternative energy, water supply, among others, which are directly linked with the livelihood of the poor community through the augmentation of their IG business. As IG business is escalated, COs felt necessity to federate and develop network among themselves for market linkages to develop the institution to sustain the programme. PAF is also providing support to COs for their institutional development, so that these community institutions of poor are enabled to manage and run their business sustainably. COs' aforementioned revolving fund amount and their regular savings amount is maintained as their equity , which will be a strong collateral to get access with MFIs and banks to cater their further financial needs. As considerable numbers of trained bankable groups are now available, the overhead cost of MFIs will also be reduced considerably. Of these, most are in hilly regions providing opportunity for MFIs to reach these regions also.

3.2 Possible Methods to establish linkages of COs/SACCOs with MFIs

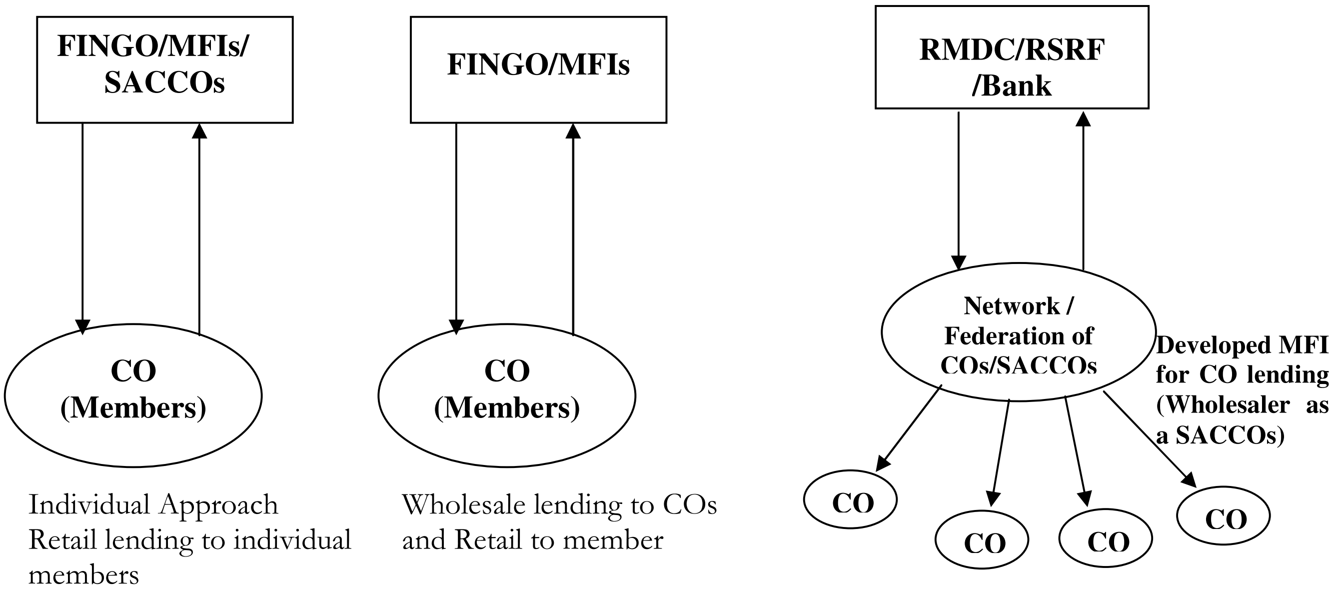
The following are possible methods to establish linkages of Cos/ SACCOs with MFIs.

1: Community Organization members with doable business and good repayment record can be linked with Financial Intermediary (FINGO), Micro-Finance Institutions (MFIs), Local Co-operatives.

2: Community Organizations with strong organizational base, maintaining proper financial recording system, good repayment rate with majority women member can be linked with Financial Intermediary (FINGO), Micro-Finance Institutions (MFIs), Local Co-operatives with wholesale lending.

3: When credit worthy COs federate into network or co-operatives and receive institutional recognition, they could receive fund from wholesale lender i.e. Rural Micro-Finance Development Centre (RMDC) and Rural Self-Reliance Development Fund (RSRF) of Nepal Rastra Bank. However, it needs to explore more avenues on this viability so that Community Organizations developed by the PAF can create good base for micro-finance institutions to operate. A diagrammatical method is illustrated below:

Linkage modalities of COs and SACCOs with MFIs



Individual Approach Retail lending to individual members

Wholesale lending to COs and Retail to member

Federation as a SACCO to get wholesale loan from Banks for relending to CO members

5. Conclusion

Since inception to date, altogether 11,500 Community Organizations (COs) promoted by PAF are functional with income-generating activities by involving 334,000 poor household members with the support as revolving fund NRs. 4000 M. for further investment in their own groups. PAF builds platform for MFIs to reach the marginalized poor communities of rural remote area. PAF program interventions districts are supposed to be the most viable areas for MFIs in providing micro finance services, since the strength of the COs is based on their own ownership.

CO members are capacitated to take microfinance service from the microfinance market. The targeted members are trained as if microfinance best practices do to their member-clients. In this backdrop, COs could be linked up with the microfinance institutions for their required additional loan demand. In doing so, the social cost of the microfinance institutions as they are at the moment disbursing could be minimized in a greater extent.

In the perspective of deprived sector, from this fiscal year, in the wholesale lending of commercial banks, the rate is increased immensely so as to raise the interest rate in retail market. The impact of this rise raise in retail interest rate may certainly make embarrassment in the rural community. The PAF funded COs have subsidized fund so they could balance the actual interest rate in order to restrain unrest in the rural area. Therefore, COs will be appropriate clients for the microfinance providers, from lending perception.

To develop the strong linkage of COs/SACCOs with MFIs/Banks the above mentioned model can be instrumental for economic development of rural poor as well as poverty alleviation from the country.

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