REVIEW FOR IMPROVING MICROFINANCE SERVICES IN BHUTAN

Submitted by:
Bishnu Prasad Pathak
Microfinance/Agriculture Credit Consultant
Kyingkhor Consultancy Services, Thimphu, Bhutan
July 2010

Contents

Acknowledgements

Here, I would like to acknowledge the contribution of certain individuals who have made this study possible. First of all I express my special gratitude to Ms. Tshering Yangchen, Chairperson Kyingkhor Consultancy Service, Thimphu for the confidence she entrusted me with this challenging but interesting.

I am grateful to Mr. Dorji Dradhul (Director, Department of Agricultural Marketing and Cooperatives) for continuous kind cooperation regardless of the busy schedule. I express special thanks to G.B. Chettri (Project Director, ASSP), Harry Franks (Project Advisor, ASSP), Kailash Pradhan (Principal Research Officer, CoRRB), Karma Thinley Dorji (Project Manager, BDFC), Ugyen Lhyam (MSME Development Expert, Ministry of Economic Affairs), Dr. Rob Erskine-Smith (International Market Brokering Specialist, Thimphu, SNV, Bhutan) and Ms.Tshering Zam (Royal Monetary Authority) for sharing their opinion. I would like to express my special graduate to my counterpart Ms. Sonam Wangmo (Marketing Officer, DAMC) for her kind cooperation during my entire review period.

Finally, I am very much grateful to all branch managers, staff and clients of BDFC who spared their time to respond my questions and queries during the field visit.

Acronyms and Glossary

ASSP:	Agriculture Sector Support Project
BOB:	Bank of Bhutan
BDFC:	Bhutan Development Finance Cooperation
BDS:	Business Development Service
BLSS:	Bhutan Living Standard Survey
BNB:	Bhutan National Bank
CAL:	Commercial Agriculture Loan
CRR:	Cash Reserve Ratio
CORRB:	Council of RNR Research of Bhutan
DAMC:	Department of Agricultural Marketing and Cooperatives
DTY:	Dzongkhag Yargye Tshogchung (District Development Committee)
Dzongkhag:	District
Dzongdag:	District Administrator
FINGOs:	Financial Intermediary NGOs
GGLS:	Group Guarantee Lending and Saving
GUP:	Individual elected body of the block
GYT:	Geog Yargye Tshogde (Block Development Committee)
IFAD:	International Fund for Agriculture Development
MOA:	Ministry of Agriculture
MOEA:	Ministry of Economic Affairs
NABARD:	National Bank for Agriculture and Rural Development
NWAB:	National Women's Association of Bhutan
Nu.	Ngultrum (Bhutanese currency pegged to the Indian Rupee)
RICB:	Royal Insurance Corporation of Bhutan
RNR:	Renewal Natural Resources
RGOB:	Royal Government of Bhutan
RMA:	Royal Monetary Authority of Bhutan
SCARDB:	State Cooperative Agricultural and Rural Development Bank
SFDP:	Small Farmers Development Program
SFCL:	Small Farmers Cooperative Limited
SIL:	Small Individual Loan
SNV:	Netherlands Organization for Development
TYT:	Thromde Yargye Tshogde (Municipal Development Committee)
UNCDF:	United Nations Capital Development Fund
UNDP:	United Nations Development Program
UNICEF:	United Nations International Children's Emergency Fund

Executive Summary

Microfinance in Bhutan is still as nascent stage. Bhutan Development Finance Corporation, a government owned, the only one organization has been involved in agriculture credit/microfinance sector since its establishment in 1988. However, to date less than 20% agriculture households has been covered by the program. BDFC was established to promote and finance industrial, agricultural and commercial enterprises as well as microfinance services. Regardless of continuous effort the multi-sector activities of BDFC has highly affected agriculture credit/microfinance program in the country. In addition, scattered low population, the rural-to-urban migration of youth, small landholdings, drudgery of farm work, unproductive agriculture, crop damages by wild animals and natural calamities and inadequate infrastructure have contributed for worsening the situation. Most of BDFC rural branches are operating at loss and non-performing loan in agriculture is as high as 30%. BDFC is surviving from the income earned on lending other than agriculture/microfinance. The three indicators outreach growth, portfolio quality and return on assets is below the accepted level. This has highly affected agriculture growth and micro-enterprises development. Bhutan being an agrarian country with 69.1% population engaged in agriculture, the country's overall economy has been affected because of unavailability of affordable loans on time for agriculture.

Nevertheless, at present there is no alternative in the country other than BDFC in agriculture credit/microfinance as it has long experience and good net-working in the country. The present need is to develop separate three departments in BDFC; each for microfinance, commercial agriculture and other commercial sectors at the head office and branches so that all sectors, particularly small farmers could have access to loans. In addition, BDFC may need to review on procedure, change the collateral mindset of staff, expand net-working, initiate interest rebate system, increase productivity of staff and develop client's friendly savings products.

The second strategy for improving agriculture credit/microfinance in Bhutan is to open door for financial intermediary which could be CSOs/NGOs, to provide retail microfinance business in the rural areas. In the long run this financial intermediary can be developed as microfinance bank.

The third strategy is to develop existing self-help groups into savings and credit organizations then to register as savings and credit cooperatives to impart community based cost effective and sustainable financial services in rural areas. The civil society organizations/NGOs can be used for the capacity building of the self-help groups and savings and credit organizations. The National Women Association of Bhutan and The Tarayana Foundation have experience working with self help groups.

The MOAF is interested and committed to provide credit services matching with the improved technologies not on the cost of any financial institution but by developing policy which could be beneficial to farmers and lending organizations. In case of Bhutan, RGOB shall make provision of interest subsidy for disadvantaged dzongkhags. In addition, MOAF shall work with RMA to issue refinance and for the management of soft loans to financial

institutions for agriculture/microfinance on-lending. Furthermore, RMA shall take lead for the formulation of "National Microfinance Policy" and "Microfinance Regulation" in consultation with BDFC, DAMC and other stakeholders which could create conducive environment for the growth of microfinance sector in the country. For rendering effective professional financial services in agriculture sector, MOAF and RMA shall take initiative for the establishment of separate "Agriculture Development Bank".

For monitoring, globally accepted indicators such as scale and depth of outreach, productivity and efficiency, portfolio quality, financial viability and profitability is measured monthly in the microfinance institution/branch and shared quarterly with the stakeholders. Regarding the impact, it is measured in a more indirect way by assessing to what extent the clients repeatedly take out, and repay loans over the time. However, changes in nutritional intake, educational enrollment, health status, housing pattern and increment on overall income and assets over a period are assessed. But there are several other factors which play crucial role in changing livelihood of the clients.

Chapter I: Introduction

1.1. Background and Context

Bhutan is predominantly agriculture based country with 69.1% people engaged in agriculture. The most of settlements are in rough terrains and valleys. The farmers practice subsistence integrated farming due to small land holding (the average land size of the farm is 4.3 acre)[1], lack of resources to invest and market. There is high potential of agriculture growth in the country with the emergence of concept on commercial agriculture. Ministry of Agriculture and Forests (MOAF) has been working for the conversion of subsistence integrated farming into commercial farming. But for this three things are essential; i) investment on infrastructure such as farm roads which is generally performed by the government ii) technology transfer which is also done by government through agriculture extension and iii) management of inputs such as seeds, fertilizers, insecticides, pesticides etc. which farmers have to manage themselves. In most of the cases farmers don't have cash flow for investment. Easy access to institutional credit is prerequisite to convert agriculture enterprise into profitable activity. However, regardless of the continuous attempt of the government, agriculture credit is a major constraint in Bhutan. Less than 20% of farmers (total estimated farm households is 87,500) have access to credit so far. The coverage of small farmers is estimated less than 10%. The scattered low population, mountainous terrain, low infrastructure development, low loan recovery rate, high risk and high overhead cost have discouraged financial institutions to involve in rural areas. Bhutan Development Finance Corporation is only organization involve in agriculture credit. But being a corporate financial institution it might has compulsion to comply prudential norms of RMA in one hand and in other hand it has also mandate to function as social financial institution. The dual role of BDFC has made confusion to BDFC itself and other stakeholders. Nevertheless, at present, Bhutan does not have specialized financial institution for agriculture credit/microfinance. The CSOs/NGOs are working with self-help groups but mostly in other than financial sectors and promotion and development of cooperatives have just started. There are many issues from the clients prospective such as limited institutions involve in rural lending resulting less access to loans, long unfriendly procedure, mortgage requirement even for small loans, under-financing and present interest rate of agriculture credit. There is high concern of MOAF on the present agriculture credit delivery system. The ministry is committed to improve the credit system geared towards the vulnerable groups. The interest of the MOAF is to build a financial system for ensuring easy access to affordable agriculture credit to farmers not on the cost of financial institutions but with the support of government which may require at the initial stage and in the special situation. Furthermore, in the tenth plan (2008-2013) Royal Government of Bhutan has given major thrust to poverty alleviation. The government has planned to reduce poverty level to 15% by the end of 10th plan and achievement of Millennium Development Goals. Accordingly, The Vision 2020 as planned by MOAF has given priority of increasing rural income by targeting a three-fold increase in real income of the farmers by 2012. Keeping in view, to match the improve technologies provided by the MOAF with an appropriate rural credit mechanism this strategies paper has been prepared. This paper has tried to keep balance in between development and agriculture credit/microfinance business.

1.2 Geographical Background

Bhutan is surrounded by Indian states Arunchal Pradesh in the east, West Bengal and Assam in the south, Sikkim in the west and Tibetan autonomous region of China in the north. The country total area is 38,394 sq.km. having 300 km. east-west and 170 km. north-south dimension. Of the total area, 72.5% is covered by forest, 10% with round year snow and glaciers, approximately 8% by permanent cultivation and habitant, 3.9% meadow and pastures and rest either barren or rock[2].

[1] Compendium of RNR statistics 2008

[2] Statistical yearbook of Butan 2009

The terrain is mostly mountainous; altitude increasing from south to north; the Sub-Himalayan foothills 1500 to 2000 meters above sea level, The Inner Himalayas with 2000 to 4000 meters altitude and The Greater Himalaya lie over 4000 meter (up to 7000 meters). Climatically, the country can be divided into three broader zones: Sub-tropical Zone, the Temperate Zone and the Alpine Zone[3].

Figure 1: Map of Bhutan

1.3 Population

Total population of the country is 671,083 with an average 5 members per household (approximately 125,000 households). The population growth rate is 1.8% having density of 17.8 per km^2 is thinly populated. Age group of 15-65 comprises 65% of the population. Over 69% population resides in the rural areas. Bhutanese average life expectancy is 66.1 yrs, infant mortality 60.5 per thousand live births and maternal mortality 255 per 100,000 live births[4]. The overall literacy rate is 56%. Gender disparity can be noticed in education because only 46% women are literate compare to 66% literate male. Approximately one third of Bhutanese households are women headed.

1.4 Administrative Setting

There are twenty Dzongkhags (Districts), each governed by an administrator (Dzongda), appointed by the government who is responsible for civil administration and developmental activities. Dzongda is assisted by a Dzongrab who is responsible for planning, development and civil administration. The larger Dzongkhags are sub divided into Dungkhags headed by a Dungpa. A Group of villages form a Gewog (Block), the lowest administrative unit. Each Gewog has a elected headman called the Gup. There are 205 Gewogs. Dzongda is assisted in his development function by the Dzongkhag Yargye Tshogchung (District Development Committee) and Gup by Geog Yargye Tshogde (GYT, block development committee) and Thromde Yargye Tshogde (TYT, municipal development committee) which consists of people's representatives and government officials for planning and implementation of development activities. The Royal Government of Bhutan has put in place successive five-year plan since beginning of the 1960 which has reinforced the administrative and political decentralized organization.

[3] RNR Sector Tenth Plan (2008-2013)
[4] National Health Survey 2000

1.5 Socio-Economic Background

Bhutan's economic development policy is guided by the overarching philosophy of Gross National Happiness based on the four pillars of sustainable economic development; preservation and promotion of culture and tradition; conservation of environment; and good governance. The per capita income of Bhutan is US$2152[5]. The people below poverty line has been calculated in two categories; those consuming less than the food poverty line, Nu.698.96 per person per month are considered subsistence poor and households consuming less than the total poverty line, Nu. 1096.94 per person per month are considered poor. It is estimated that people below total poverty line and subsistence poverty is 23.3% and 5.9% respectively[6]. In 2007, GDP improved by 21.4% at constant prices because of 52.8% growth in the secondary sector (+121% for the electricity sub-sector). But the growth in the RNR over the last few years has been on an average less than 3% per year. Share of agriculture in GDP was recorded 18.7% in 2008 a decreasing trend because of the increasing contribution of hydroelectricity in the revenue. However, overall GDP growth rate in the past six years was 7.9%.

Nevertheless, Bhutan is still agrarian country because 69.1% of the population engaged in agriculture. The agriculture development has been limited due to terrain mountainous, scattered population, lack of inputs and lack of access to roads. In addition, due to lack of access to formal financial services income generating activities are limited in rural areas. Out of the existing labor force, unemployment rate in Bhutan is 3.7%[7].

1.6 Goals and Objectives

The overall goal of this task is to: improve the existing agriculture credit/microfinance services in Bhutan through provision of easily accessible, affordable and sustainable financial services for rural households. However, specific objectives are:

- review the agriculture credit/microfinance products, services and methods currently implemented in Bhutan
- analyze the strengths, weakness and issues related to the current services,
- develop practical strategies/models which could increase access to affordable loans for small farmers and reduce the cost of delivering organization
- develop monitoring and evaluation tools

1.7 Methodology

The review task was assigned to Kyingkhor Consultancy Services, Thimphu, Bhutan by ASSP. Mr. Bishnu Prasad Pathak, Microfinance Specialist from Nepal was assigned as a consultant from Kingkhor. Due to the establishment of the DAMC, the mandates on Cooperatives along with rural finance have been transferred from CoRRB, so the consultant had worked in close collaboration with DAMC. The station of consultant was at the DAMC office, Thimphu. DAMC had assigned a counterpart for the facilitation. The methodology involved were meetings with CoRRB, ASSP, DOA, MoEA, DAMC, BDFC and other stakeholders to familiar with the present challenges in agriculture credit/microfinance. The past documents and secondary data were reviewed related to agriculture credit/microfinance. BDFC branches were visited and interaction was done with clients, staff and members of the line agencies. In the field present delivery system was analyzed. A checklist was used for collecting data from field. The findings of the field were used to analyze the issues raised. In addition, success models/cases in the neighboring countries have been referred for preparing

[5] Economic Development Policy of The Kingdom of Bhutan, 2010
[6] Poverty Analysis Report 2007
[7] Bhutan Living Standard Survey (BLSS) 2007

the strategies. The first draft report was shared with in-house staff of DAMC then after incorporating feedback of DAMC in-house staff, the final draft report was presented to the stakeholders. The comments and feedback of the stakeholders have been incorporated in this report.

1.8 Structure of the Report

This report consists ten chapters. First chapter consist introductory part such as background, geography, socio-economic background, goals and objectives and methodology. Second chapter has described situational analysis which includes history, microfinance players in the market and present regulatory environment. The third chapter has thoroughly analyzed issues to be addressed. Microfinance in the context of poverty reduction has been elaborated in the fourth chapter. The concept of agriculture development bank and some cases of the neighboring countries has been cited in the fifth chapter. Findings of field observation have been described briefly in the sixth chapter. The seventh chapter is the output of review which has described strategies needed for the improvement of agriculture credit/microfinance in the country. The eight chapter explained implementation arrangement of strategies with time frame. Ninth chapter has attempted to give guidelines for monitoring and evaluation of the strategies. The specific recommendations are highlighted in the tenth chapter.

Chapter 2: Situational Analysis

2.1 History of Agriculture Credit/Microfinance

In the early years agriculture development in Bhutan was characterized by the introduction of modern farming system and provision of free inputs such as fertilizers, pesticides, seeds and extension services. Since the Sixth Five Year Plan (1987-1992), the RGoB has placed greater emphasis on the liberalization of markets and self-reliance, resulting in the reduction and eventual withdrawal of most subsidies. With farmers no longer to rely on subsidies for modern inputs, the need for rural credit to enable farmers to improve farming practice was considered essential for agriculture development. However, rural credit in Bhutan was started in 1980. There was mandated for Bank of Bhutan to lend 20% of its portfolio in rural credit but it lent less than 1% of its portfolio. The reasons were farmers unable to meet the collateral and guarantee requirement of the BOB and RICB. Then, rural lending program was entrusted to Food Corporation of Bhutan in 1980. Food Corporation of Bhutan borrowed money at 14% interest from BOB and RICB and re-lend at 6-10% to farmers. This program lasted only for two years. Then program was shifted to Royal Monetary Authority (the central bank of Bhutan). As BOB and RICB was found biased towards general trade, transport and real estate, necessities was felt to establish separate financial institution to provide loans for industrial and agriculture related activities. In this context, with signing of Royal Charter (RC) on January 31, 1988, Bhutan Development Finance Corporation Ltd.(BDFC) established. Then the program was handed over to BDFC. Since then BDFC has been implementing Agriculture Credit in Bhutan. Its main mission is to extend financial services to the greatest majority of families living in the rural areas, play a lead role in supporting micro, small and medium scale enterprises and help rural agriculture become commercially viable, thereby uplifting the rural economy[8]. For this purpose, BDFC has established agriculture lending department in the head office which includes microfinance. However, In Bhutan, the concept of microfinance came into existence only in 1998 with the implementation of the project entitled

[8] BDFC website: www.bdfcl.com.bt

"Strengthening Capacities for Sustainable Microfinance' signed between the RGOB, UNCDF, SNV and BDFC as implementing agency.

2.2 Agriculture Credit Vs. Microfinance

In Bhutan, contrary to elsewhere, agriculture credit and microfinance is taken as similar. Microfinance refers to the provision of financial services to low-income groups which does not limit to savings and credit services but also other financial services such as micro-insurance (health and enterprise), payment services and money transfer etc. for developing self-employment and various income generating activities. Microfinance is characterized by:

- free of physical collateral
- quick services at the door steps
- small savings and loan size
- short term loan
- savings as integral part
- diversified utilization
- free choice of activity to clients
- focus to vulnerable groups
- preferably women as clients

The above definition has focused to the particular class of the people (could be absolute or relative poor) and size of the services rather than purpose. The credit flow under microfinance could be for agriculture or micro-enterprises. Microcredit flow for agriculture purpose to small farmers falls under microfinance. But if the clients are well-off and loan volume is high, then, it is not microfinance. It is treated as commercial agriculture lending. The indicators to identify the target groups of microfinance vary with the country. Some has taken per capita income as indicator and others as housing index and land holding. In Bhutan, to date loan ceiling (maximum loan ceiling for GGLS Nu.100,000/-) has taken for microfinance purpose. However, poverty analysis report 2007 has defined the extreme and total poor[9].

2.3 Financial Players in the Market

Like in other countries, Bhutan has also three major players in the financial market i) Formal which constitutes banks and financial institutions ii) Semi-formal which includes self-help groups and iii) the Informal which includes money lenders, shop keepers and monastic bodies .

2.3.1 Formal Financial Institutions

- The Royal Monetary Authority of Bhutan is the central bank established in 1982 to issue bank notes, banking license, provide monetary advisory service to RGoB and regulation of financial institutions of the country
- Commercial banks
    - i. Bank of Bhutan
    - ii. Bhutan National Bank
    - iii. Druk Punjab Bank
    - iv. Tashi Bank

- Development Bank
    - i. Bhutan Development Finance Company

[9] Poverty Analysis Report 2007

- Insurance Companies
    - i. Royal Insurance Corporation of Bhutan
    - ii. Bhutan Insurance Company
- Other related are National Provident and Pension Fund Bureau and Royal Securities Exchange.
- Regardless of many players in the market, most of the commercial banks are concentrated in urban areas and dealing with big and non-agriculture activities
- The government has given mandate to BDFC for micro, small and rural agriculture lending. However, share of BDFC is less than 3% of the total financial assets in the country with a total gross loan portfolio of only Nu.2546 million (December 2008), which makes BDFC a relatively small part of Bhutan's financial system and has not been able to grow fast as other financial institutions, because it's low portfolio quality and low profitability[10]. Of the total investment, its share in agriculture/microfinance is less than 20%
- The assets and loan portfolio of the total financial institutions including BDFC grew to Nu.33.5 billion and Nu.19.02 billion respectively at the end of June 2008. In the same period the total assets and loan portfolio of BDFC alone was Nu.2.67 billion and Nu. 2.44 billion respectively.
- Sector-wise distribution of the investment of the total financial institutions indicates the largest share of the credit portfolio continued to be the building and construction (34.45%), followed by personal and other loans (23.22%), manufacturing (18.49%), trade and commerce (15.15%), transport (6.50%) and agriculture (lowest share 2.11%). Of the total investment in agriculture BDFC alone has 99.21% share.

2.3.2 Semi-formal Financial Institutions

- The semi-formal largely includes producers' self-help groups who have been engaged in collection of savings in addition to core activity and lend the money among the members promoted mostly by Ministry of Agriculture and Forestry or by CSOs/NGOs
- The National Women's Association of Bhutan was one of the first NGOs established in Bhutan (April 1981) in order to promote the socio economic status of rural Bhutanese women. In 1983, it received funds from UNICEF for implementing its smokeless stove project. NWAB received significant support from UNCDF, SNV and IFAD during the 1999-2002 period to lend group loan schemes and to develop training. However, 50% of the loans went bad because people considered them as "kidu"[11]. At present, NWAB is working for the promotion of economic opportunities for disadvantaged women among the others are:

    i) Community development projects in eastern Bhutan (rural credit and savings schemes to develop income generating activities),
    ii) Self help groups for mushroom, ginger, herbal cultivation in central and south east districts
    iii) Promotion of weaving and vegetable dying process
- The Tarayana Foundation is a non-profit organization established in 2003 by Her Majesty the Queen Ashi Dorji Wangmo Wangchuck. The Foundation with its following core functions is also interested to initiate savings and credit program in the self-help groups;

    i) Support vulnerable individuals to achieve greater socio-economic security
    ii) Sponsorship to disadvantaged students
    iii) Support needy patients to receive medical care
    iv) Promote relevant artisan skills and
    v) Improve socio-economic security of rural community through housing program

[10] Rural and Microfinance in Bhutan by Dr. Pema Choephyel, Agri. Advisor, BDFC
[11] Dominique Bastine, An assessment of the microcredit situation in rural Bhutan, conducted by Helvetas, Bhutan 2009

- The Tarayana clubs are a key element of Tarayana expansion throughout the country. Their 4,000 members (students and teachers) are in charge of identifying target groups for community based activities that are then discussed with the Gups of the respective Geogs.
- Helvetas had also initiated National Fodder Seed Production Center which later transferred to BDFCL in 1994.

2.3.3 Informal Sectors

- It is estimated that approximately informal sector has 30% share in the financial market
- The well to do families or persons used to lend poorer in the rural area since time immemorial and it is still in practice in many parts of the country
- They used to charge 15 to 25% p.a. and some time up to 5-10% per month
- Most take loans from money lenders during emergency such as sickness, death, crop failure and buying agriculture inputs
- Many of the borrowers use money lenders as they do not qualify for SIL or GGLS, either they do not have mortgage or they could not find other households to form group
- The monastic institutions that had substantial revenue collections of its own had the practice of lending money, grains, and diary produces to certain creditworthy individuals or families
- Informal sector take relatively less time and loan product is flexible but with the emergence of formal sector the share of informal sector has been declining because of exorbitant interest rate and under financing nature

2.4 Regulatory Environment

- Financial Institutions Act of Bhutan 1992 regulates all types of financial institutions of Bhutan. Under the act, RMA has issued "Prudential Regulation 2002"

Table 1: Minimum capital requirement

Type of financial institution	Required paid-up capital
1. Bank	Nu.300
2. Non-bank financial institution	Nu.200
3.Non-bank finance company	Nu.100

Table 2: Required capital adequacy, CRR and SLR

Norms	Bank	Non-financial institution
1.Capital adequacy ratio		
1.1 Total	10%	10%
1.2 Core	5%	5%
2. Cash reserve ratio (CRR)	17%	17%
3. Statutory liquidity requirement (SLR)	20%	10%

Table 3: Required Loan Loss Provision

Category	Principal or interest payment overdue period	Provisioning requirement
Standard	Up to 30 days	1.5%
Watch	31 to 60 days	1.5%
Sub-standard	61 to 90 days	20%
Doubtful	91 to 180 days	50%
Loss	More than 180 days	100%

- Bhutan does not have "National Microfinance Policy" and separate "Microfinance Regulation". The regulatory environment is not conducive for the development of microfinance in the country. Some relaxation on prudential and non-prudent norms may be necessary
- There is no provision for the entrance of private sector such as CSOs/NGOs in the microfinance sector. In many countries including Bangladesh, India and Nepal, NGOs involvement in rural/microfinance has been found effective
- The Cooperative Act (Amendment) 2009 has been enacted and DAMC is towards preparing strategies and finalizing the regulation for registration of cooperatives
- Considering the urgent need to improve the present rural credit system, it is high time to change the regulatory policy which could attract specialized financial institution in the sector including cooperatives and financial intermediary NGOs. Professional microfinance institutions only can deliver competent and sustainable microfinance services at the affordable rate.

2.5 Existing Agriculture Credit/Microfinance in Bhutan

At present BDFC is only one organization in the country working in agriculture credit and microfinance. BDFC has been operating under Company Registration Act 2000 and Financial Institution Act 1992. BDFC provides rural credit for farmers at 10-13% p.a. It has 25 branches and three regional offices in the country. In rural areas, under agriculture lending, BDFC has three products;

- *Small individual loans (SIL):* A one-to one mortgage is required means collateral such as land or house having value at least 1:1 of loan amount is compulsion, loan size < Nu. 100,000/- and interest rate 12-14% p.a. Loan terms and ceiling vary with the purpose of loans. For example, potato loan need to pay within one year but loan borrowed for apple orchard need to be repaid in 3 years with quarterly installments. If the performance of SIL is good, they will be eligible for commercial agriculture loans with the same interest rate. SIL has maximum share in BDFC agriculture credit/microfinance program.
- *Commercial agricultural loans (CAL):* This product has been designed for commercial farmers and graduated clients of SIL. Mortgage value having 1:1.5 times of loan amount is mandatory. Loan size is >Nu.100,000 and interest rate ranges 13-15% p.a. The borrowers of this loan product have been found mostly graduated clients of SIL product.
- *Group guarantee lending scheme (GGLS):* This product is adaption of Grameen model designed especially for small farmers and micro-entrepreneurs. No collateral is required and maximum loan size was Nu.50,000/- now increased to Nu.100,000/- but in practice loan size is <Nu.5000/- which is very small. A solidarity group of 3-7 members is formed and loan is disbursed on group guarantee to the members. In this scheme, clients need to deposit Nu. 50/- per month as compulsory savings and 5% of every loan is also deposited in compulsory savings account. Client can also participate in voluntary savings account and other schemes. Under this scheme a total of 1356 groups were formed between 1999 to 2003 with a total disbursement of Nu.4.2 million and a total savings 1.4 million for the same period[12]. GGLS product has not been functioning as expected in Bhutan could be due to scattered low population, inadequate social mobilization, more importance given to the mortgage and lack of specialized agency. BDFC has recently initiated piloting on joint liability model under group guarantee in five branches.
- *Mobile banking:* BDFC mobile banking does not mean the use of cellular mobile phone in banking. It refers to the collection of loan applications forms, loan collections installments and savings amount by BDFC staff at the fixed venue on the fixed date monthly. It is not the separate product but appreciable attempt of the BDFC to deliver services at the door steps.

[12] Annex 3, page 269: Microfinance in Bhutan, Report on Macroeconomic of Poverty Reduction UNDP, Regional Center in Colombo , August 2007

Table 4: BDFC Loan Schemes

Type	Ceiling (Nu.)	Repayment	Debt: Security Ratio	Interest rate	Debt-equity ratio
GGLS	<100,000	12-36 months	Group guarantee	10% p.a.	3:1
SIL	<100,000	36	1:1	12-14% p.a.	3:1
CAL	>100,000	>36	1:1.5	15% p.a.	3:1

- BDFC has tried to reach the poor and small farmers by introducing GGLS but SIL having 90% share in the ALD portfolio is still popular (GGLS with less than 10% share in the portfolio). This scenario shows that small farmers have been excluded from the program.
- When analyzing the BDFC data, its share is more in Paro and Chhukha (18%) compare to a total disbursement of 15% in Gasa, Pemagatshel, Lhuntse, Zhemgang, Trongsa and Samdrupjongkhar the disadvantaged dzongkhas. Similarly, data of two district unit of BDFC, Trashigang and Mongar shows that 68% loans have been disbursed for rural housing trend being decreased in agriculture lending (20%)[13]. Moreover, despite in loan size outreach growth is slow (7%).
- Sector-wise distribution shows out of total loan receivable of BDFC as of 31 December 2008 was Nu.2499.00 million with industrial lending 17.03%, agriculture lending 22.87% and service and tourism 25.26%.
- RMA has allowed BDFC to collect public deposits but the savings is only 6% of total loan portfolio. At present, resources of BDFC are external soft loans, grants, internal borrowings and government capital infusion. BDFC is facing fund crisis for on-lending.
- RGoB has exempted tax to BDFC and it is receiving support from ADB, UNCDF, UNDP and equity infusion from RoGB. Nevertheless receiving support from various agencies, BDFC has been facing following constraints/obstacles for offering small and micro loans smoothly in rural areas[14]
    - i) High Cost of Administration
    - ii) Low Recovery Rate
    - iii) Low Population Density
    - iv) Lack of Adequate Infrastructure
    - v) Poor Market Linkage and Entrepreneurship
    - vi) Low Literacy Rate
    - vii) Low Recycling of the Fund
    - viii) Lack if national microfinance policy
- Nevertheless, the overall financial performance of BDFC is encouraging. It has achieved 28.5% portfolio growth and the highest profit Nu. 93.2 million[15] in 2008 and out of total clients 18,627, a total of 16,515 belong to the branches. Non-performing loans has been reduced to 16.49% from 19.10%. Overall operational self-sufficiency has been increased to 146% in 2008 which was 145% in 2007.

[13] UNOPS supervision mission 2005
[14] Rural and Microfinance in Bhutan by Dr. Pema Choephyel, Agri. Advisor, BDFC
[15] BDFC 20th Annual Report 2008

Table 5: Indicators of coverage by BDFC

Indicators	2007	2008
Total loan disbursement (million)	938	925
Rural sector disbursement (million)	279.8	459.7
Total loan outstanding (million)	2037	2499
Rural sector loan outstanding (million)	535.6	715.0
Deposit (million)	79	137
Total number of active clients	17596	18627
Number of active clients in branches	15589	16515
Average loan size in branch (Nu.)	34361	42293
Overall Profit (million)	69.63	93.2
Overall operational self-sufficiency (%)	145%	146%
On-time recovery (%)	82.1%	93.5%
Overall non-performing loans (%)	19.10%	16.49%

Source: BDFC annual report 2008

- Under the UNCDF project entitled "Expanding Access to Savings led Financial Services in Bhutan" the Basics Ltd. India has been providing technical services to BDFC. The overall strategy of Basics Ltd. is to offer Technical Assistance (TA) support to the BDFCL and strengthen their system and procedure in microfinance and help to increase outreach in 50 months as per set target[16] . The major activities of Basic program among the other include[17]:
    - Form and nurture new groups and customers
    - Develop and promote savings products
    - Establish distribution and marketing strategy
    - Development of MSME products
    - Introduction of Ag/BDS services
    - Improvement in risk management and internal control
    - Development of proper HR system
    - Streamlining the IT and MIS for better monitoring and efficient management
    - Introduce system for financial and cost analysis
    - Introduce treasury and fund management system
    - Introducing social performance management system
    - Understanding the demand and supply of the insurance services
    - Study for microfinance sector in Bhutan
- Regardless of above activities, multi-sector lending approach (include industry, housing, trade, vehicles and agriculture) could hinder BDFC for making concentration on agriculture credit/microfinance. In addition, services to different strata of population likely to exclude poor and people living in remote areas.
- It does not mean that there is not scope of agriculture credit/microfinance in Bhutan as less than 20% have been covered so far. With the growing demand of agriculture and microfinance loans, dynamic and professional private sector groups that are expected to enter the market in near future.

[16] Disburse average USD 4,724 loans to 57,820 credit customers (In 2009 total credit customers was 18,627) by 2013. The deposit customers will be 58,554 and 11% of the total outstanding credit customers will be from groups by end 2013.

[17] Detail implementation plan on "Expanding Savings led Financial Services in Bhutan, Submitted to UNCDF by Basics Ltd.

Chapter 3: Issues to be addressed

The agriculture credit/microfinance in Bhutan has many issues related to access to loans, cost of borrowings, delivery cost of the lending institutions, time required for receiving the services, uses of the loans, collateral, exclusion of poor, awareness level and coordination among stakeholders. These issues need to be addressed for improving agriculture lending/microfinance in Bhutan. There are many formal and informal institutions such as BDFC, BOB, BNB and NGOs involved in agriculture credit/microfinance in Bhutan but BDFC alone has over 99% share in the market. BDFC has established a separate department for agriculture lending. However, its share in agriculture lending is below 20%. Furthermore, share of the loan portfolio in small farmers is very low. BDFC has been blamed for focusing more on business rather than development. The challenge for BDFC is balancing the business and development. In this context, issues of agriculture lending/microfinance which need to be addressed have been summarized hereunder:

3.1 Access to loans

- It is estimated that out of 86,250 families engaged in agriculture less than 20% (16,515) have been covered so far
- Households are scattered and dispersed, take over an hour and some time more than three hours one way walking to go the credit service center which is costly and time consuming for farmers
- Due to scattered low population, BDFC has not been able to expand branch net-work because of the unfeasibility for the establishment of the new branches
- BDFC has been lending in industrials, commercial enterprises, tourism, vehicles in addition to agriculture and microfinance services. The broad field of BDFC has been hindering in imparting professional services to agriculture and microfinance sector

3.2 Procedure

Procedure of BDFC is long and time taking. Generally takes 4-6 weeks and sometime more than 8 weeks. It is due to a series of steps through which loan application need to be endorsed. The procedure goes as follow:

- The farmers fill the loan application form and submit to Tshogpa (People's representative)
- Tshogpa (People's representative) submit the collected forms to staff of BDFC who visit the particular community monthly
- The loan committee meeting is held under the chairmanship of the GUP (Elected individual for a block) where loan application are processed
- The assistant GUP, clerk GUP, Tshogpa and BDFC staff are other members of the loan committee
- Loan application under Nu.5000 is approved by this committee and above that it is forwarded to concern branch office
- Branch office can approve within the limit delegated by head office (ranges from Nu.100,000 to 300,000 depending upon the volume of transaction of the branch). Above the branch limit, the loan application is forwarded to regional office. There are three regional offices in the country. The regional office can approve up to Nu.500,000. Above the limit, it is forwarded to head office
- Every loan should be endorsed with recommendation in each step starting from GUP level
- As per need, concern line agencies are invited at GUP level for technical support
- After the approval of loans, then land registration process is done. Up to Nu.50,000 concern GUP is supposed to perform registration and above Nu.50,000 it goes to dzongkhag
- After land registration loan flows to the concern clients

The process of BDFC has been found long because of three reasons:

- Involvement of GUP has been designed probably to collect information about the clients and scrutinized them accordingly. But in practice, GUP being an elected body likely to recommend for all his voters and would not force for timely payment. Involvement of GUP has unnecessary pronged the procedure
- Routine monthly meeting at GUP level has been designed to provide services at the door but it has made compulsion to all to wait for GUP meeting to start the process of the loans
- Collateral mindset in the BDFC staff. The staff prefers to lend on collateral than without collateral. Moreover, GGLS has not been working effectively could be due to inadequate social mobilization, small loan size (maximum Nu.5000. in practice), local geography, and population density. In agriculture lending, share of GGLS consists less than 10%.

3.3 Transaction cost

Transaction cost of the farmers include time consume for processing the loans, interest rates and upfront fees or service charge. The transaction cost for borrowing loans is high for Bhutanese farmers because of the following reasons:

- The process is long takes 6-8 weeks for the first loan and 4-6 weeks for repeat loans. This has increases transaction cost of Bhutanese clients compare to clients in these regions
- The farmers have to travel over an hour to three hours one way to reach the service center. In some cases clients need more than one day to go and come back from service center which has increased transaction cost
- Collateral mindset of BDFC staff has increased cost for small loans
- If a client has to spend four days for one loan, then if labor wage is Nu. 100 per day, client has to lose Nu.400. In addition if Nu.200 is on an average for transport and food, a total of Nu.600.is unseen transaction cost of the client (assuming that loan is collected in field)

3.4 Collateral

BDFC has been primarily disbursing loans based on collateral. The bank has recently increased loan limit of GGLS from Nu.50,000 to Nu.100,000 but in practice loan under GGLS is around Nu.5000. Furthermore, GGLS has not been functioning well. The collateral concept has affected BDFC program as follows:

- The BDFC staff has collateral mindset. Staff believes more on collateral than on cash flow and delivery system. This has excluded small farmers who are not able to put collateral for small loans
- Valuation of collateral is done on the basis of par value fixed by the government which is around 10-20 times less than present market price. This has made problem both for clients and institution
- The mandate made by BDFC is towards acquiring mortgage for loan disbursement. It could be due to present guideline of RMA. But for lending small loans, the delivery system may be more important than mortgage
- The failure of GGLS could be primarily because of collateral mindset of staff, lack of social mobilization and training to staff.

3.5Interest rate

- Interest rate is debatable issue in agriculture credit/microfinance. From the perspective of clients as they are poor and vulnerable, interest rate should be low but from delivery organization perspective because of high overhead cost and risk to lend small loans in rural areas, interest rate should be at least to cover overhead, fund cost, loan loss provision and to give market return to the investor
- As per annual report of BDFC 2008, the overall overhead cost is 3.30%, fund cost is 5%, loan loss provision is 1.64% making a total of 9.90%[18] of the average outstanding portfolio. If for the growth of the program 5% earning is expected, then required interest rate for BDFC is 14.90% p.a. BDFC is charging 10-15% p.a.
- However, considering the low rate of return, extreme poverty, remoteness and risky nature of agriculture, there is high concern over the present interest rate charged by BDFC in agriculture credit/microfinance
- In microfinance sector, the interest rate is around 20% in Bangladesh, India and Nepal. However, agriculture development banks of these countries have been providing loans at 7-15% p.a. for agriculture (7% by NABARD through SCARDB, 10-15% by Bagladesh Krishi Bank and 10-12% by Agriculture Development Bank, Nepal)
- If the interest rate cannot cover the operating cost then it creates problem for sustainable operation and outreach growth. In other hand, if the interest rate is high than the internal rate of return of the project, the credit will be burden for the farmers.
- Competitive interest rate can be fixed by increasing productivity of staff, improving portfolio quality and exploring soft loan for on-lending
- In case of Bhutan following strategies could help for designing competitive interest rate in agriculture credit/microfinance:
    - Introduce interest rate rebate system on payment of interest monthly
    - RGOB and RMA shall issue policy for the management of soft loan to financial institutions for on-lending in agriculture credit/microfinance
    - Refinance provision by RMA mentioning the interest rate for ultimate users
    - RMA and concern department of ministry shall monitor the proper use of subsidized soft loans and refinance
    - Increase productivity of staff by enhancing capacity of staff and reduce cost by changing delivering methodology
    - Fix separate interest rate for disadvantaged dzongkhags
    - Encourage other financial institutions to involve in rural credit for the development of competitive environment
- It is believed that only financially sound organization which is towards increasing outreach scale can cover poor and vulnerable groups

[18] Bhutan Development Finance Corporation Limited 20th Annual Report 2008

3.6 Loan utilization

- BDFC has purpose wise loan ceiling. The clients used to choose the purpose which has highest ceiling, lowest interest rate and long installment period. Under this situation loan is likely to be misused
- Monitoring and follow-up system is relatively weak. The system of post disbursement monitoring is relatively low or not in practice
- Because of long period and high loan ceiling, over 60% loans have been disbursed for rural housing
- Data revels that less focus has been made in agriculture sector. But money is highly fungible and interchangeable. Clients often use it where they think more profitable and where there is urgency. If the roof is urgent, clients use money for roof making. The important thing could be easy access to loans
- Proper use of loans can be ensured by increasing access to loans because in microfinance choice of activity goes to farmers not to lenders

3.7 Under financing

- Under financing was the voice of the farmers. Under financing could be due to lack of project appraisal technique in staff and present valuation system
- Loan approval limit at different branches is very low compare to the present market value. Clients have been compelled to demand less than required because of low limit of the concern branch
- The financing amount should be based on project cost, repaying capacity of the clients and possible risks

3.8 Share of the small farmers

- The mortgage requirement even for small loans has excluded small farmers in the program. BDFC has introduced GGLS which does not require collateral but its share is less than 10%. Moreover, loan size in GGLS is around Nu.5000/-(although limit has increased to Nu.100,000/).
- BDFC has been providing wide ranges of services which include among the others; industrial loans, agriculture and commercial enterprises both for big and small clients. In this situation because of low return, high overhead cost and more risky in small rural loans, BDFC has been found focused more on big loans and in other than agriculture sector although it has mandate to use 60% resource in branch in agriculture
- As GGLS is not working as expected, the present system is less likely to increase the coverage
- The separation of microfinance department of BDFC from whole could contribute at the moment
- Establishment of the specialized microfinance institutions such as financial intermediary NGOs/cooperative or microfinance banks may be necessary for increasing access to loans for small farmers

3.9 Awareness level

- Overall literacy level of Bhutan is 56% only (female 46%). Many Bhutanese farmers are still not aware of BDFC program
- Regardless of 25 branches net-working, medium and big farmers have been found more aware with the BDFC program. The small farmers are still unaware with the BDFC program
- In microfinance, the bank goes to people unlike the traditional bank where people go to bank because the poor and marginalized feel uneasy to deal with the formal organization
- Without massive social mobilization and awareness campaign, the outreach cannot be increased
- The awareness could be from media, mass meetings, focus group discussions and door to door visits
- The enrollment need not be necessarily only for credit but could be for savings, insurance and other financial services.
- CSOs/NGOs could be effective for increasing awareness level to vulnerable groups

3.10 Business development services

- BDFC is providing both technical and advisory services which are outside the typical mission of a financial institution. A conflict may arise if a client incurs loan arrears on an investment for which the bank has extended him technical service
- BDS which is generally provided free could affect the institutional profitability. Moreover, clients getting free BDS may expect free for borrowed loans which could jeopardize the portfolio quality
- The microfinance best practice is to perform BDS by the separate specialized institution in parallel and close coordination with financial institution. The financial institution generally works on minimalistic approach rather than integrated approach

3.11 Portfolio quality

- Overall non-performing loans of BDFC is 16.49% and as of December 2008 the Non Performing Loans stands at 33.23% for agriculture sector which is the highest among the sectors[19]
- The NPL is above the acceptable margin as per best practices in financial sector. It should be below 5%
- Because of high delinquency many clients have not been able to get the services of BDFC which has affected their enterprises
- The increasing delinquency has discouraged BDFC to lend in agriculture sector and small loans
- Suspension on loan disbursement to all households of a particular Geog because of high overdue in the concern Geog has further deteriorated the situation. The good and new borrowers have been suffered and their rights of receiving loans have been violated
- It is said "Loan is bad not loanee". This should be kept in mind and change methodology so that portfolio of BDFC could be improved. Furthermore, the experience in other countries show that portfolio quality decreases largely because of the loan administration system not because of clients

[19] Rural and Microfinance in Bhutan by Dr.Pema Choephyel, Agriculture Advisor, BDFC

3.12 Overhead cost

- Overhead cost is personnel plus office running cost divided by average loan portfolio. The overall overhead cost of BDFC is 3.30% which is not high for microfinance but overhead cost of BDFC shall go above 7% for agriculture credit/microfinance
- The cross subsidizing policy of BDFC has helped in reducing overall overhead cost but this is against best practices of microfinance. The past experience shows target groups are generally excluded in the cross subsidizing model
- Cross-subsidization is tolerable only among microfinance branches which reduces the chances of exclusion of the poor
- As the share of personnel cost alone is 65% of the total overhead cost in BDFC, staff productivity by designing appropriate model could help in reducing the overhead cost

3.13 Coordination

- The ultimate aim of both the government line agencies and BDFC is to serve the farmers. The line agencies offer technical services and financial institutions cater financial services. The strong coordination is necessary in between these agencies both at central and field level for synergic effect
- This can be assured by organizing at least quarterly meeting for sharing information at the central and field level
- The government program could have subsidy component but it would be better if the lending agencies are aware of this
- Financing and subsidy program should not be implemented by the same organization because when loans and subsidies go together, farmers used to take loans as subsidy

3.14 Microfinance policy

- Bhutan does not have "National Microfinance Policy" yet which is necessary to design road map for issuing microfinance regulation for the development of microfinance sector
- BDFC has planned to coordinate to develop national microfinance policy under the on-going UNCDF project[20]. But there are waiting directive from higher authorities
- The policy among the others is supposed to spell out government roles, RMA support, donor roles, areas of microfinance and overall road map for the growth of the microfinance sector

3.15 Microfinance regulation

- RMA has been working on preparing the draft microfinance regulation to establish apex microfinance bank which shall issue license for microfinance institutions and provide wholesale loans to MFIs (NGOs/Cooperatives) for on-lending. This shall open door for private sector in the microfinance sector
- The regulation among the others shall spell out the characteristics of the target groups, loan ceiling in microfinance and financial resources

[20] Expanding Access to Savings led Financial Services in Bhutan, Basix, India, November 2009

- It is expected that the regulation shall give relaxation on prudential norms such as capital adequacy, CRR and SLR to microfinance institutions which could help in reduction of the fund cost

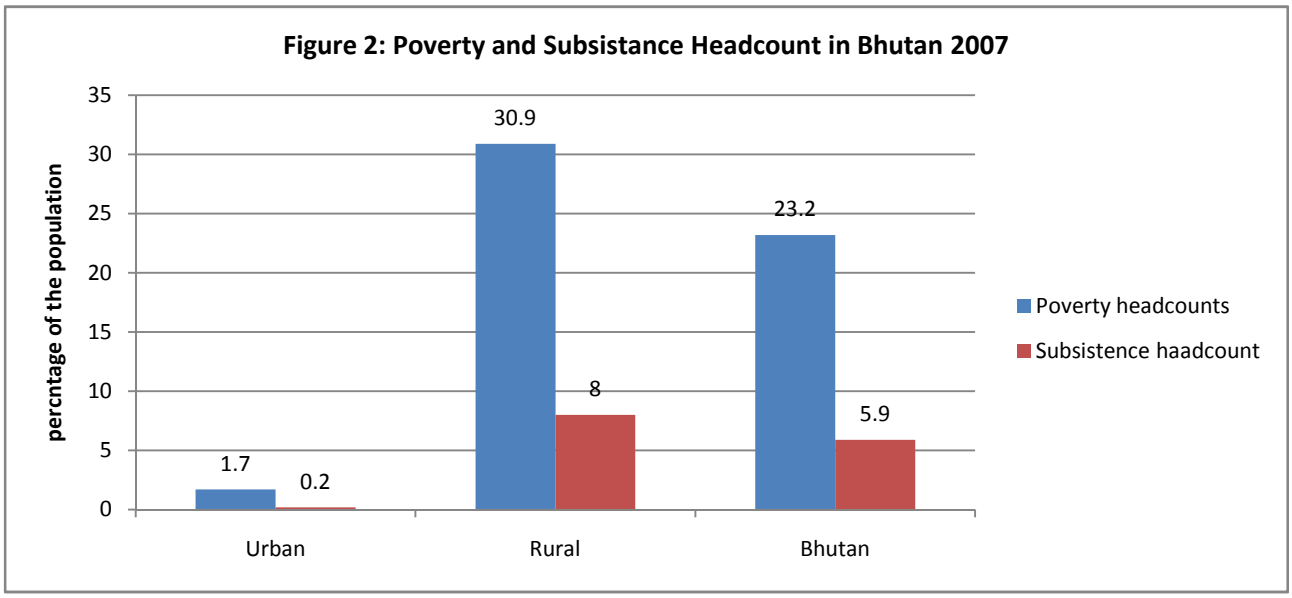
Chapter 4: Microfinance and Poverty Alleviation

4.1 Role of Microfinance in Poverty Reduction

By definition microfinance refers as one of the tools for poverty reduction. The microfinance provides capital to the poor and marginalized who have been excluded from the main stream of financial system. It creates self-employment by augmentation of income generation activities. The awareness raising and confidence building is another important role of microfinance in poverty reduction. In general it has been observed that bargaining power of the poor have been increased by microfinance. It could be due to the development of local institution in the community. Microfinance has contributed to increase disposal income of the poor which has improved nutritional level, shelter, clothes, school enrollment and health of the participating families[21]. There is general consensus in the worldwide that microfinance enhances decision making power and has found positive impact on women empowerment.

4.2 Poverty Assessment in Bhutan

Although GDP of Bhutan in the past six years has been encouraging but poverty is still rampant in the country. The people living below extreme poverty are estimated to be 5.9% and below the total poverty line 23.2%[22]. The data revels that extreme poverty is relatively small in the country as only six in hundred persons throughout the Bhutan falls in this category. Incidence of poverty is more in rural areas compare to urban. Three out of every ten persons are poor in rural area while in urban area poor population is less than 2%.



[21] Review for Microfinance Services in the Hills of Nepal, a study conducted by CMF/Nepal and SDC, August 2002

[22] Below extreme poverty: income less than Nu.688.96 per person per month which is required to purchase 2,124 Kcal per day per person and total poverty line: income less than Nu. 1096.94 per person per month; amount required including non-food items, Poverty Analysis Report 2007.

Table 6: Dzongkhag wise Incidence of Poor and Extreme Poor

Dzongkhags	Population	No. of Poor	% of Poor	No. of Extreme Poor	% of Extreme Poor
Bumthang	16000	1744	10.9	144	0.9
Chhukha	67600	13722.8	20.3	3042	4.5
Dagana	18900	5877.9	31.1	1833.3	9.7
Gasa	3800	155.8	4.1	38	1
Haa	12500	1650	13.2	637.5	5.1
Lhuntse	15700	6751	43	1758.4	11.2
Monggar	38200	16960.8	44.4	3896.4	10.2
Paro	35500	1384.5	3.9	213	0.6
Pemagatshel	23600	6183.2	26.2	1062	4.5
Punakha	25300	3946.8	15.6	480.7	1.9
Samdrupjongkhar	34900	13262	38	4257.8	12.2
Samtse	55700	26067.6	46.8	9803.2	17.6
Sarpang	40200	7798.8	19.4	1286.4	3.2
Thimphu	86700	2080.8	2.4	86.7	0.1
Trashigang	47700	13976.1	29.3	3339	7
Trashiyangtse	18200	2602.6	14.3	91	0.5
Trongsa	14600	3241.2	22.2	700.8	4.8
Tsirang	19000	2641	13.9	475	2.5
Wangdue	35900	5672.2	15.8	682.1	1.9
Zhemgang	19600	10368.4	52.9	3488.8	17.8
Bhutan Total	629600	146087.5	23.20	37316.10	5.93

Source: Poverty Analysis Report 2007

Table 7: Grouping of dzongkhag on the basis of incidence of poor

Number of Poor Population	Name of the dzongkhags
>10,000	Chhukha, Monggar, Samtse, Trashigang, Samdrupjongkhar and Zhemgang
>5000 to 10,000	Dagana, Lhuntse, Pemagatshel, Sarpang and Wangdue
>2000 to 5000	Trongsa, Tsirang, Trashiyangtse, Thimphu, Punakha
<2000	Bumthang, Gasa, Haa, Paro

As incidence of poor and population is vary with the dzongkhag. A single microfinance model may not work throughout the country. Multiple practices/models may be necessary as per the situation which could be establishment of branches of financial institution or promotion and development of community based organization.

4.3 Some Widely Practice Models of Microfinance

In every model implemented in different parts of the world have strengths and weakness. The strengths of the model can be adapted in Bhutan for designing appropriate model for the country. Features of some successful microfinance models have been described hereunder:

Grameen Model: This is very famous model world wide ranging from Bangaladesh, India, Nepal to USA especially for small and bottom poor farmers. GGLS model introduced by BDFC is a replication of Grameen. It is found successful where there is dense population. The process among the other includes:

- Area selection on the basis of poverty level using secondary data
- Mass orientation program for dissemination of program concept
- Formation of informal groups consisting 3-7 members in each group
- Conduction of compulsory group training for 7-10 days on basic rules and regulations
- Service delivery through a point where 3-8 groups meet at a fixed date
- Compulsory savings and other savings schemes
- In addition borrower deposit 5% of loan in savings account
- Loan disbursed without collateral generally on group or center guarantee

Savings and Credit Organizations/Cooperatives: It is also called credit union model. The features are:

- Members starts with savings and purchase share and mobilize the fund within the member as credit
- Initially program is started through savings and credit organizations/groups and as it matures then converted into saving and credit cooperatives
- After the formation of cooperative borrowed money from banks
- Meeting generally held once a month where transactions take place
- As grow, have office for range of financial services
- The interest rate on savings, lending rate and terms are fixed by the cooperative members as per situation
- All cooperatives are not microfinance but cooperatives can implement microfinance effectively. In India, Nepal and Sri Lanka many cooperatives have been implementing microfinance successfully

Self-Help Group: Self-help group model is more popular in India. NABARD claims that it has covered 70 million households in India, the largest microfinance program in the world. The features are:

- Self-help members of 10-20 (sometime may be more) formed a group and start savings
- Mobilize savings by providing loans within to the members
- Self-help groups are linked to bank for loans
- It is one of the cost effective model in microfinance
- The success of self-help groups largely depends upon their functional linkage with the financial institutions.

Small Farmers Development Program of Nepal: Small Farmers Development Program (SFDP) was started by Agriculture Development Bank in 1975, the first group based lending in Nepal. The features are:

- Three tiers in SFDP model i) community level solidarity groups, each group having 5-10 members ii) ward (block) level inter-groups (representation of one from each group) and iii) village development committee level main committee (representative from inter-groups)
- Previously ADB/N has SFDP unit which has been handed over to clients establishing cooperative (Small Farmers Cooperative Limited, SFCL))
- Separate small farmers' development bank has been established to provide technical and wholesale loans to SFCL
- Successfully Implemented in the hills of Nepal
- Had credit plus activities but now have focused only on financial matter

There are also other microfinance programs which have along success history in microfinance as follow:

Micro-banking of Bank Rakyat Indonesia (BRI): Government owned institution operating in highly dense population. BRI has over 40,000 permanent employees working in 4417 unit outlets and 76 village service posts. It has disbursed a total USD 4.4 billion microloans to 4.5 million customers by December 2008 with USD 50.25 billion profit. The main strength of BRI the interest rate deregulated by the central bank and easy access to rage of financial services which mainly includes credit and savings services

BankcoSol in Bolivia: BancoSol is a privately owned institution created by PRODEM, an NGO of Bolivia. It is a commercially oriented microfinance program serving over one quarter of Bolivias bank clients[23]. It strength is high penetration both in rural and urban areas

Aga Khan Rural Support program (AKRSP) of Pakistan: AKRSP is a rural development organization initiated by the Agakhan Foundation in 1982. It was started working with village level institutions and women organizations in wide range of activities which include infrastructure, natural resource management, enterprise development and microfinance. Later microfinance program was separated from other programs. AKRSP working area is primarily northern mountainous areas of Pakistan. It lends by two ways either through village/women organizations or directly to individual borrower. Now it has established 'The First MicrofinanceBank Ltd" in Pakistan for microfinance operation. The strength is establishment of specialized bank for MF operation and implementation of development program through AKRSP (foundation)

Sarvodaya Economic Empowerment Development Services (SEEDS) of Srilanka: An institution of Sri Lanka, adopting credit plus methodology and delivering microfinance services either directly or through Sarvodaya societies which are promoted and registered by the SEEDS. It has three products; a) income generation b) consumption loan and c) creation of employment. The type (a) is disbursed on group guarantee and for type (b), 2 guarantors are required but for type (c) mortgage is compulsory. The strength is development of local level institutions by registering under SEED and lending through these institutions. In addition, it has been successful with credit plus model. It was operating in Sri Lanka even at Tamil insurgency period

Chapter 5: Concept of Agriculture Development Bank

In many developing countries government has established separate Agriculture Development Bank for disbursing loans in agriculture sector. In some cases, microfinance program are also implemented by these banks. The advantages of having separate agriculture development bank are as follow:

- Being a government owned likely to be more service oriented than profit oriented,
- The government can use the bank for implementing special program in a particular area such as one geog three products in Bhutan,
- Financial institution generally measures its success on the basis of outreach and financial performance but if the organization is specialized in agriculture sector it will have also target of changes in production
- Financial institution with sole mandate generally focus more on agriculture sector resulting better accessibility, coverage and process friendly to farmers
- This type of bank concentrated in rural areas only

[23] The Microfinance Revolution, Sustainable Finance for the Poor by Marguerite S. Robinson

- Repayment period depends upon appraisal of the individual project
- As the bank is concentrated in agriculture, coordination and collaboration with MOAF and agriculture related line agencies improved
- NABARD of India, Agriculture Development Bank of Nepal and Bangladesh Krishi Bank are some examples in the neighboring countries.

5.1 NABARD of India

NABARD has been implementing several programs such as grant program for watershed area, tribal development program, farm innovation and promotion program, technology transfer program, microfinance program through various banks and microfinance institutions and research and development activity. NABARD provide refinance for production credit at 4.5% p.a. to SCARDB for lending to ultimate borrower at 7% p.a.

5.2 Bangladesh Krishi Bank

It has been implementing credit program for landless and small farmers, beef fattening joint program, small farmers and landless labors, south asia poverty alleviation program and BKF-NGOs microfinance program. In most of the cases interest rate is 10-15% p.a,. loan ceiling around TK.25,000 and repayment is weekly.

5.3 Agriculture Development Bank, Nepal

Agricultural Development Bank of Nepal (ADB/N) has three major departments for implementing the program; i) banking ii) development and iii) small farmers. The banking department has separate banking branches which collect public deposits and lend on the business farms. This department also manage fund for development department. Development department has separate branches for agriculture lending. The branches of the development department appraise and disburse loans as per project feasibility. Initially, there was small farmers department to implement microfinance program through SFDP units in the field. Now SFDP units in the field are handed over to clients by forming clients' small farmers' cooperatives limited. The bank has established Small Farmers Development Bank to provide technical support and wholesale loans to small farmers' cooperatives limited.

Chapter 6: Field Observation

This chapter is based on field visit made in four branches of BDFC located at four Zongkhags; Wangdue, Punakha, Paro and Thimphu. The checklist was used for interview with branch managers and clients.

6.1 Branch visit

- The branch has 1-2 tailors, 3-4 branch assistants (sometime called field staff) to support the branch manager as per case load. The four branches were visited and interaction was made with managers and staff. The branch managers suggestions were on increasing the loan limit approval ceiling of branch, review the mortgage valuation criteria, deformation of GUP level

committee, improvement on IT system and introduction of performance based incentive package to staff.

- The performance of the branches has been found depend on outreach, portfolio, productivity of staff and portfolio quality.

Table 6: Loan Portfolio, Savings and Portfolio at Risk of the Some Branches

BDFC Office	Number of Geogs	Savers	Savings amount	Borrowers	Loan Portfolio	Portfolio at Risk
Branch Wangdue	15	2006	34 million	1986	140 million	13%
Branch Punakha	11	579	12 million	1355	67 million	8%
Branch Paro	10	NA	14 million	1400	131 million	4.23%
Branch Thimphu	8	NA	5 million	400	20 million	15%
BDFC Total	NA	18627	137 million	16515	2499 million	16.49% NPL

- Source: BDFC branch and BDFC annual report
- NA: Not available
- NPL: Non-performing loans

6.2 Interaction with clients

Poultry farm of Tenzin Lhamo, Lango Geog, Paro

The concerned of the clients were on access to loans, loan ceiling and existing procedure. Some were unhappy with present mortgage valuation system. Clients who have other household income were found paying on time. The case of delinquency as per client was due to sickness of the family member. The summary of the clients' field interaction has been presented hereunder:

Branch Punakha						
Name of client and address	Initial loan size (Nu.)	Purpose	How long associated with BDFC	Present outstanding	Overdue	Remarks
Phub Lham, Limbukha	5,000/-	Initial for housing now for hotel business	Since 2 years, this is second cycle	50,000	Overdue had happened but now corrected	-
Passang Om, Limbukha	5,000/-	Piggery farm	Since 11 years, this is 4th cycle	50,000	On-time payment	Unhappy with valuation system

Branch Paro						
Pem Geog: Tsento	30,000/-	Horse and now for general trade	Since 10 yrs, this is 3rd cycle	Out of 100,000/- balance is 70,000/-	On-time payment	Happy with mobile banking
Tenzin Lhamo, Geog: Lango	50,000/-	Initial for house renovation and now for poultry and housing	Since 3 yrs, this is second loan	Out of 500,000/- balance is 300,000/-	On-time payment	Has been paying selling the eggs and income of husband who has driving occupation
Paro Lhamo Geog: Lango	50,000/-	Initial for general trade and now for handicrafts trading	Since 5 yrs, this is third cycle	Out of 200,000/- balance is 159,760/-	On-time payment	Has been able to increase her business scale
Rinchu Wangmo, Geog: Shori	40,000/-	Initial for apple orchard and now for extended apple trees	Since 10 yrs, this is second loan	Out of 40,000/- balance is 20,000/-	Overdue because of her husband sickness.	She has been able to establish and extend her apple farm.
Branch Thimphu						
Chimi Dorji, Geog: Mewang	50,000/-	Initial for apple orchard and now for expansion of the apple orchard	Since 10 yrs, this is 4th loan	Out of 500,000/- balance is 400,000/-	On-time payment	Collateral valuation system is far below the actual market price. Generally take one month to receive loan

Chapter 7: Strategies for Improving the Credit System

The strategies for agriculture lending and microfinance of any country depends upon market size, need of the clients, geographical situation, literacy level of the clients, culture and tradition, capital mobilization capacity of the clients and existing infrastructure. Bhutan is a mountainous country with diversified socio-economic, unequal distribution of population, low literacy level and influential culture and tradition. After reviewing past literatures and documents, conducting discussion with stakeholders, interacting with branch staff and clients, analyzing the market and local situation and taking into consideration the experience in other countries, following strategies could contribute for improving the present agriculture credit and microfinance system in Bhutan.

i) Improving the present services of BDFC
ii) Establishment of financial intermediary
iii) Promotion of savings and credit cooperatives

7.1 Strategies for improving services of BDFC

BDFC is the only one organization in the country involved in agriculture credit and microfinance with long experience and highest net-work. At present, except BDFC, other banks are not interested to lend in agriculture sector and microfinance. Moreover, self-help groups so far developed in the country don't have capacity to implement microfinance. Cooperatives Act of Bhutan 2001 and Civil Society Organizations Act of Bhutan 2007 which is recently enacted might

take time to involve actively in agriculture lending and microfinance. Furthermore, the present regulation does not allow CSOs/NGOs/Cooperatives to involve in microfinance. At present, the first choice could be to improve the present services of BDFC to resolve urgent credit need of the farmers, particularly small farmers. The strategies needed for improving the present agriculture credit/microfinance services of BDFC are as follows:

7.1.1 Improving general system

Issues	Strategies
1. Access to loans	1.1 Establish unit offices under branches for geog level field agents
	1.2 Don't stop loans to all households of geog with high overdue. This has further deteriorated the situation. The rights of good borrowers and new borrowers should not be violated
	1.3Valuation of land is done as per par value of government which is far below than present market price. Review the present mortgage valuation criteria
	1.4 Design loan products without collateral for small farmers
	1.5RGOB has provided tax holiday to BDFC. Use amount of tax holiday for the expansion of the branches in the remote areas
	1.6Conduct awareness campaign through media and focus group discussion
2.Procedure	2.1 The involvement of GUP has prolonged the process. Deformed the existing GUP level credit committee shall be deformed
	2.2 Focus more on delivery system than mortgage
3.Collateral	3.1Review the present land valuation as it is far below than the actual price of the land
	3.2 Conduct pre-enrollment training to clients and capacity enhancement training to staff for disbursing small loans without collateral
	3.3Introduce long term savings scheme such as pension savings which could work as collateral for borrowers
4.Interest rate	4.1The RMA has deregulated interest rates since 1997. At present the interest rates are allowed to determine by the market forces. As per annual report of BDFC 2008, the overhead cost is 3.30%, fund cost is 5%, loan loss provision is 1.64% making a total operating cost 9.90%[24] of the average outstanding portfolio. If 5% growth is expected, then required interest rate for BDFC is 14.90% p.a. BDFC is charging 10-15% p.a. In microfinance interest rate is around 20% in Bangladesh, Nepal and India. These countries have separate agri. Bank for agriculture financing (NABARD charges 7%, Agri. Bank of Nepal lend at 10-12% and Bangladesh Krishi Bank at 12-15%). Considering low rate of return, extreme poverty, remoteness and risky nature of agriculture, there is high concern over the present interest rate charged by BDFC in agriculture credit/microfinance. In microfinance if the operating income cannot cover the operating cost then question will be raised on sustainability and growth of program. In other hand, if the interest rate is high than the internal rate of return of the project, the credit will be burden for the farmers. In case of Bhutan, he following strategies shall contribute for providing loans at competitive interest rate: ▪ Introduce interest rate rebate system on payment of interest monthly ▪ RGOB and RMA shall issue policy for the management of soft loan to

[24] Bhutan Development Finance Corporation Limited 20th Annual Report 2008

Issues	Strategies
	financial institutions for on-lending in agriculture credit/microfinance ▪ Refinance provision by RMA mentioning the interest rate for ultimate users ▪ RMA and concern department of ministry shall monitor the proper use of subsidized soft loans and refinance ▪ Increase productivity of staff by enhancing capacity of staff and reduce cost by changing delivering methodology ▪ Fix separate interest rate for disadvantaged dzongkhags • Encourage other financial institutions to involve in rural credit for the development of competitive environment
5.Loan utilization	5.1 Keep less differences on loan ceiling, interest rate and repayment period in between different products
	5.2Establish close monitoring system
	5.3Increase access to loans for increasing the utilization
6. Portfolio quality	6.1 Introduce monthly interest collection system
	6.2 Introduce project appraisal system for loan disbursement. For this conduct loan appraisal training to loan officer
	6.2 Tie-up loan repayment period with household cash flow in addition to project income
	6.3Concentrate on credit delivery system for small loans than mortgage
	6.4 Write-off timely the unrecoverable loans
7. Internal resource	7.1Deposit portion in BDFC is 6% of total portfolio which very low. BDFC has facing fund crises in these days for lending. Conduct market research and develop savings schemes for internal resource generation
8. Project appraisal	8.1Appraise the proposed project before disbursement
8. BDS	8.1The involvement of financial institution in the selection of the lending project and providing technical skill may incurs default on failure of the invested project. BDFC shall focus exclusively on financial related matter. BDFC shall coordinate with MOA, MOEA other line agencies including private sectors for providing BDS services.
9. IT system	9.1 BDFC shall initiate in strengthening the existing IT system for smooth functioning and generation of key financial indicators in the branches
10. Coordination	10.1 Strong coordination both at central and field level shall be ensured by organizing at least quarterly meeting for synergic effect

7.1.2 Improving microfinance program

Issues	Strategies
1.Management	1.1 Establish separate microfinance department in the head office and branches with separate business plan. 1.2 Produce separate outreach and financial performance report for microfinance
2. Human Resource	2.1BDFC has recently recruited additional 47 staff (30 for branches). Assign separate staff for microfinance program both at head office and branches 2.2Organize training to the staff involve in microfinance sector particularly on fundamental operating principles of microfinance, group formation, group management and portfolio management 2.3Introduce performance based special incentive package for the staff involve in microfinance sector which shall encourage staff to involve in

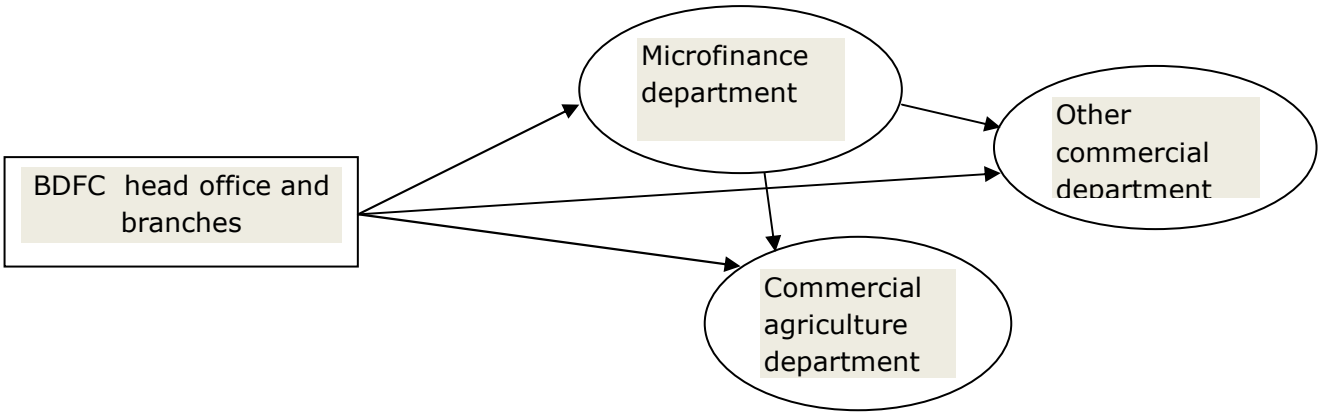
Issues	Strategies
	this sector
3.Collateral	3.1 The collateral shall be substituted by the service delivery system which includes sufficient pre-group enrollment training, loan proposal and primary process in the community meeting and ensuring dedication and commitment of staff 3.2 Organize program to change collateral mind-set of staff and provides small loans to an individual on the basis of project cash flow without collateral 3.3 Organize workshop for policy advocacy with the central bank to allow microfinance for the flow of small loans to an individual without collateral
4.Insurance	4.1BDFC shall initiate life and non-life insurance program in collaboration with the insurance companies of Bhutan. BDFC shall work as institutional agent of insurance of company by using its net-work for the clients. This could help for providing insurance services to clients and security to loans
5. Savings services	5.1 Introduce long term savings products specially targeted to rural people such as pension savings, educational savings and child savings which could also work as collateral for lending
6. Target group	6.1 BDFC has been defined microfinance clients on the basis of loan ceiling (GGLS ceiling Nu.100,000/-). In addition, unless otherwise defined by RMA, the target groups of microfinance shall be the people below total poverty line which includes both people under extreme poverty and total poverty line.

7.1.3 Improving commercial agriculture finance

BDFC has very good rapport with the farmers, long experience in agriculture lending and have good net-work in the country. Considering this, BDFC shall continue its commercial agriculture lending through agriculture lending department with the following strategies:

Issues	Strategies
1.Management	1.1Present agriculture lending department (ALD) shall work exclusively on agriculture lending with separate business plan.
	1.2Assign separate staff for agriculture lending at head office and branches
	1.3 Provide loan appraisal training to ALD staff
2. Line of credit	2.1 Introduce line of credit which ensures next loan in time upon payment of the previous loan and help in reduction of transaction cost of the farmers
3.Procedure	3.1 Establish project appraisal system for commercial agriculture farm. Repayment period and frequency of installments shall be based on project appraisal of an individual project
4.Launching special program	4.1 Launch special program to particular community in a particular area such as one geog three products in collaboration with line agencies
5. Loan sanction limit	5.1 The present loan sanction limit delegated to the branch manager shall be reviewed because the ceiling is very low for financing commercial agriculture farm.

Figure 3: Proposed departments for microfinance, agri. & other sector lending in BDFC



7.2 Establishment of Financial Intermediary

In most of the developing countries, microfinance has been started by civil society organizations or NGOs. In Bangladesh, even to date, NGOs such ASA, BRAC, SafeSave etc. have been playing leading role in microfinance. In Nepal, initially, NGOs interested in microfinance had worked as financial intermediary NGOs (FINGOs) and then converted into microfinance banks. The Aga Khan Rural Support Program (AKRSP) an NGO, with more than 20 years experience has established "The First MicrofinanceBank Ltd" in Pakistan. BancoSol is a privately owned financial institution created by PRODEM, an NGO of Bolivia serving over one quarter of Bolivia's bank clients[25].

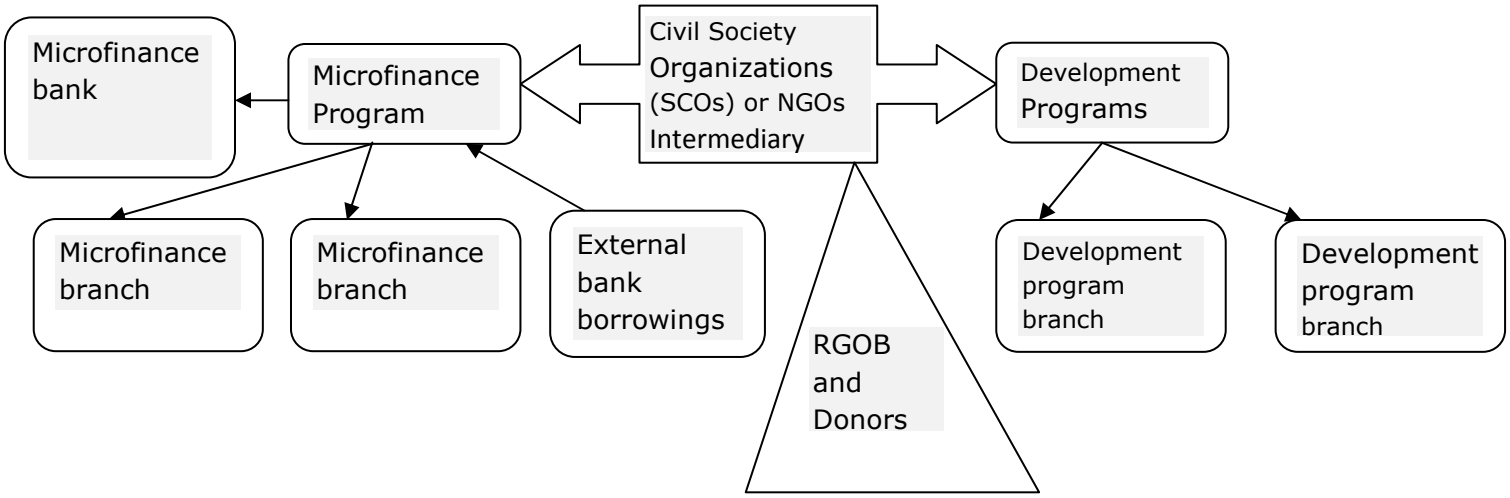
Financial intermediary means intermediation between banks and clients. It could be individual lending or by forming groups and providing savings services (if allowed by the policy). Financial intermediary is retail lender which establishes branch offices as per requirement. The financial intermediary organizations borrowed money from banks and wholesale lending organizations and re-lend to the clients. The model could be Grameen, Village Banks or other. Introduction of financial intermediary requires policy support. In case of Bhutan, it could be the new step. But the situation shows that it is high time to think over it at the policy level. This model means opening the door for new entrant in microfinance sector. The following strategies shall be necessary for promotion and establishment of financial intermediary in Bhutan:

Issues	Strategies
1.Policy	1.1 The RMA shall prepare "National Microfinance Policy" in consultation with stakeholders including BDFC and DAMC and forwarded to RGOB for approval. National Microfinance Policy could work as road map to go ahead in microfinance
	1.2 RMA shall issue microfinance regulation for the establishment of apex organization to issue limited banking license and provide wholesale loan funds to the SCOs/NGOs interested to work as financial intermediary
	1.3 RMA shall issue special prudential norms for financial intermediary which shall give relaxation on CRR, SLR, and Capital Adequacy Ratio to reduce fund cost

[25] The Microfinance Revolution, Sustainable Finance for the Poor by Marguerite S. Robinson

2. Resources	2.1RMA shall issue mandatory circular to all commercial banks in Bhutan to lend at least 3% of its loan portfolio either directly or through financial intermediary (CSOs/NGOs/Cooperatives) in microfinance sector. This would address the social responsibility of these banks in one hand and manage the soft loans for financial intermediary to re-relend to the vulnerable groups in other hand 2.2 FINGOs shall maintain followings to become eligible for soft loans from wholesale organizations • Have worked more than one year in microfinance • have at least two years audit report • have developed operational manual • have business plan for five years • towards self-sufficiency level • PAR less than 5% • at least 25% outreach and business growth • loan loss allocation made as per norms
3. Human resource	3.1 The financial intermediary shall recruit local staff for its field operation in order to reduce the personnel cost, if possible family members of the clients
4.Operational Support	4.1 The donors and RGoB shall encourage financial intermediary to open branches/services in the remote areas. For this, operational deficit for 3-6 years shall be provided as per business plan
5.Focus on poor	5.1 Collateral shall be substituted by the delivery system to increase access to loan and improve portfolio quality
6.Modality	6.1 Establish separate branch for microfinance program
	6.1 The office operating cost shall be minimized by adopting cost reduction approach such minimum investment on fixed cost, managing with simple house for office and developing simple format
7. Vision	7.1 In the long run, either in collaboration with the commercial banks or alone establish separate microfinance bank for microfinance program

Figure 4: Working Modality of Proposed Financial Intermediary



7.3 Promotion of Savings and Credit Cooperatives

Financial institutions are generally not interested to establish branches in the disadvantaged dzongkhags such as Gasa, Pemagatshel, Lhuntse, Zhemgang, Trongsa and Samdrupjongkhar because of less business opportunity. Furthermore, because of the limited business, it is very difficult to cover the cost. In this scenario, cost effective approach may be necessary. There are 483 self-help groups with a total member 14,751 which include savings and credit, farm machineries', dairy, piggery, poultry, fishery, citrus, vegetables, cornflakes, mushroom, potato seed, plant protection, nursery, oil expellers, WUA and bee keeping groups. Many of these groups have been collecting savings and lending within the members in addition to core business. Savings and credit groups can be developed as savings and credit organizations where the members of the producers group can also join for microfinance activity. At present, because of non-professional and illiterate people, technical support from civil society organization or NGO is necessary for managing these groups at the initial stage. The ultimate goal of these groups is to become savings and credit cooperatives.

The appropriate agency for technical support could be civil society organizations (CSO). As per CSO act 2007, CSO shall refer to associations, societies, foundations, charitable trusts, not-for-profit organizations or other entities that are not part of Government and do not distribute any income or profits to their members, founders, donors, directors or trustees. CSOs do not include trade unions, political parties, cooperatives or religious organizations which are devoted primarily to religious worship. For the purpose of this Act, there are two types of CSOs, distinguished by their differing objectives:

Public Benefit Organizations ("PBOs") are CSOs, which are established in order to benefit a section or the society as a whole,

Mutual Benefit Organizations ("MBOs") are CSOs which are established in order to advance the shared interests of their members or supporters, such as to advance the shared interests of people working in a particular profession, the businesses engages in a particular industry, youth studying in a university, or people who are interested in a particular cultural activity, sport or hobby.

The CSO provide technical support to self-help groups to covert first into savings and credit organizations (SCOs) and then into savings and credit cooperatives (SCCs) as per cooperative act 2009 of Bhutan. As per act, cooperative means an association of persons united voluntary to meet their common economic needs and aspirations through a jointly owned and governed enterprise (Article 2.1). A minimum of fifteen natural persons who are Bhutanese citizens with a common bond of interest in the area of operation of cooperative can apply for the registration (Article 8). The types of cooperatives mentioned in the act are primary cooperative, federation of cooperatives, union of cooperatives and special types of cooperatives such as cooperative bank and insurance cooperative. However, savings and credit groups first converted into primary cooperative. The other types shall be developed in future as per need.

In order to develop the existing self-help groups into savings and credit cooperatives, these groups shall be first need to convert into savings and credit organizations. Once it operates as savings and credit organizations, then necessary capacity enhancement activities shall be organized to register as a community based sustainable savings and credit cooperatives. The strategies for the development of savings and credit cooperatives from existing self-help groups shall be as follows:

Issues	Strategies
1.Initiation	1.1 There are over 400 farmers groups and a total members of over 14,000 (savings & lending, farm machineries, dairy, piggery, poultry, fishery, citrus, vegetable, cornflakes, mushroom, potato seed, plant protection, nursery, oil expellers, keeping). For the purpose of savings and credit activity savings and credit organization shall be formed from savings and credit groups and members in other producers groups can join as a member exclusively for financial services
	1.2 Initially, the group shall be informal. It starts savings collection from its members and lend the savings within the members
2.Capacity enhancement	2.1 At the initial stage, these savings and credit organizations (SCOs) shall need technical support from the expert which shall be provided through Civil Society Organizations (CSOs). For this CSOs shall prepare a proposal on "Promotion of Savings and Credit Cooperatives" and explore for the support from donor agencies and RGoB
	2.2 CSOs shall facilitate SCOs by organizing training on basic account, basic management, advance account and advance management. In addition, CSOs shall facilitate to prepare operational manual and business plan of SCOs
	2.3 CSOs staff shall assist for semi-annual and annual review and planning to SCOs
3. Management	3.1 SCOs shall recruit social mobilizer in part-time job for record keeping. The social mobilizer shall work for 5-10 SCOs in the vicinity
4.Resources	4.1 Initially members savings, share and profit shall be the resource for lending
	4.2 The SCOs mobilizing savings regularly and meeting following criteria shall be eligible to obtain revolving loan fund not exceeding Nu.200,000 per SCO through CSOs • Members at least 250 • Savings at least 50,000 • Share capital at least 25,000 • Portfolio at risk (PAR) Less than 5% • Net-worth Positive
	4.3 The revolving fund shall be refundable if: • not used for disbursement • PAR exceeds 5% • SCOs net-worth become negative
5. Registration	5.1 SCOs after attaining self-sufficiency or towards self-sufficiency on the basis of past one year data and meeting the criteria of registration shall apply for registration of cooperatives in the concern department. After registration it shall work as per Cooperative Act 2009
6.Product pricing	6.1 The interest rate on savings, lending rate, terms and conditions shall be decided by SCOs general assembly. The lending rate is fixed in a way that operating cost is covered by operating income.
7.External resource	7.1 Savings and Credit Cooperatives (SCCs) shall explore for whole sale soft loans to commercial banks including BDFC. For this SCCs shall submit business plan to the banks and financial institutions

Issues	Strategies
8. BDS	8.1 BDS program shall be implemented in parallel but separately by specialized organizations. SCCs shall involve exclusively in financial services and adopt minimalistic approach not integrated approach
9. Vision	9.1 A community based cost effective sustainable financial institution Developed

Figure 5: Depicting Structure of Savings and Credit Organization

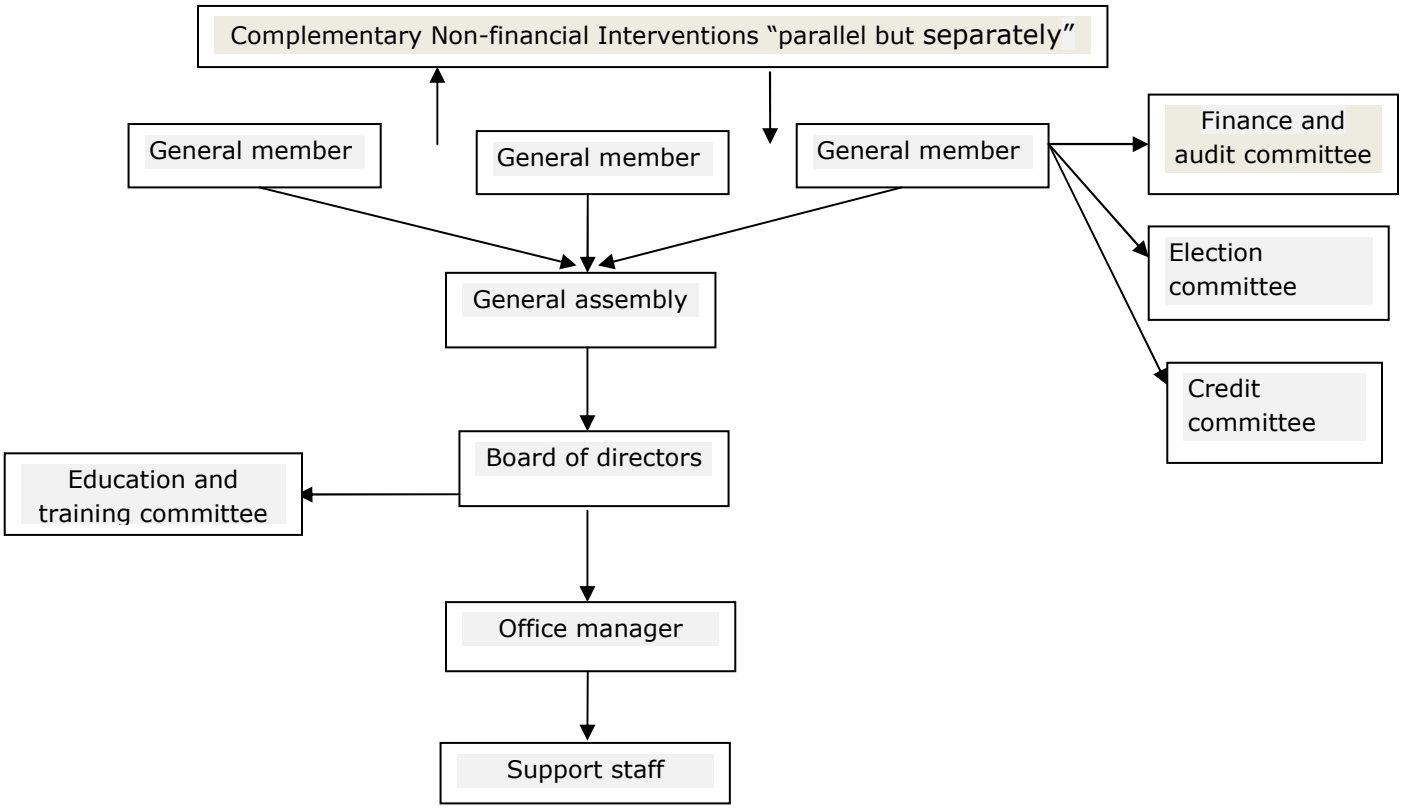


Figure 6 : Transformation process of self-help groups into savings & credit cop.

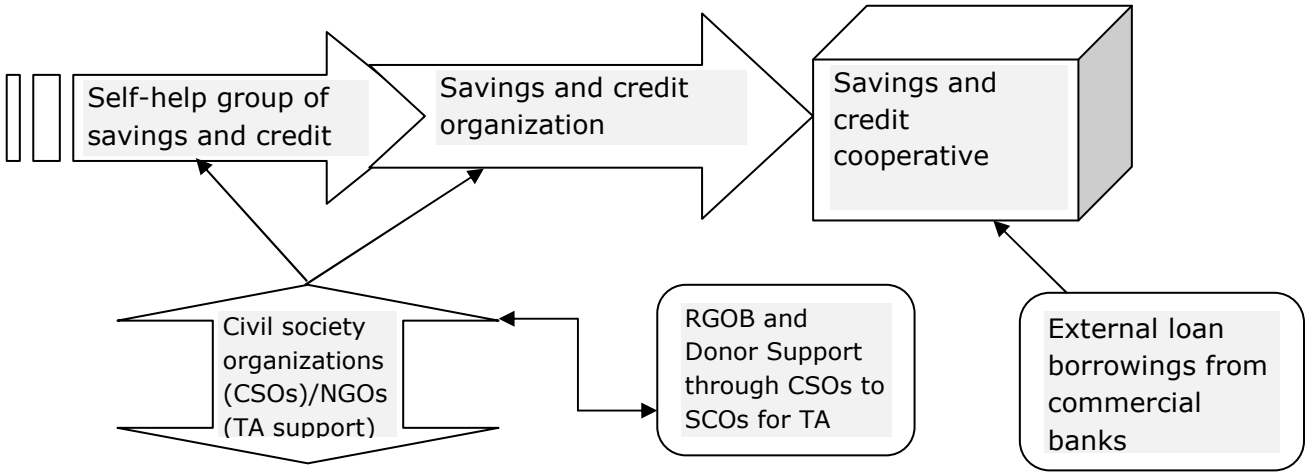


Figure 7: Proposed Framework for Microfinance in the Less Accessible Areas

National Environment and Linkage Legal Framework Policy Focus on Microfinance Building/strengthening net-work and linkages for policy advocacy Access and support for capacity building and re-financing		**Model for Microfinance** Community based Savings based Revolving loan fund Soft loan fund borrowings from banks Women as leaders
Link up ↑		
Core Intervention Strengthening Institutional Capacity and Vision of Savings and Credit Organizations Integrating Best practices Integrating Gender Best Practices Participatory Planning, Vision Building and Assessment Management Information System	→ "Parallel but separate non-financial interventions" →	**Complementary Non-Financial Interventions** Promotion of income-generating activities, particularly for women Complementary interventions, such as literacy and time saving projects, to promote the participation of socio-economically disadvantaged groups and women in particular Capacity building for local government officials to improve participation in planning and contribute for the development of community based savings and credit organizations

Chapter 8: Implementation arrangement

The involvement of different stakeholders, coordination, collaboration and well defined responsibilities with time frame is necessary for the implementation of strategies. The implementation arrangement shall also specify the name of leading organization for each activity for effective coordination. Implementation arrangement of the strategy with time frame has been given in the following table.

Activity	**Year**						**Responsible organization**
	1		2		3		
	i	ii	i	ii	i	ii	
BDFC Related							
Establishment of unit offices under branches		■		■			BDFC
Review mortgage valuation system	■						BDFC
Increase loan sanction limit to branch	■						BDFC
Deformed GUP level credit committee			■				BDFC

Activity	Year						Responsible organization
	1		2		3		
	i	ii	i	ii	i	ii	
Improve IT system							BDFC
Training to staff							BDFC
Training to clients							BDFC
Develop collateral free loan products							BDFC
Develop long term savings products							BDFC
Policy Related							
Microfinance Policy							RMA
Microfinance regulation							RMA
Establishment of separate agriculture development bank							RMA
Pocket agriculture program							BDFC and MOAF
Subsidized Credit Package							
Establish mandatory rules for banks for investment (direct/indirect via MFIs) on agri. credit/microfinance							RMA
Refinance to agri. sector /MFIs							RMA
Operational support for newly established FINGOs/Cooperatives							RGOB and donors
Savings and credit Cooperatives							
Self-help group formation							CSOs/NGOs
SCO formation							CSOs/NGOs
Capacity enhancement program							CSOs/NGOs
Revolving loan fund							CSOs/NGOs
Savings and credit cooperatives registration							DAMC
External bank borrowings							Savings & credit cooperatives
Life and non-life insurance of clients							BDFC and insurance comp.
Coordination							DAMC shall coordinate

9. Monitoring and Evaluation

9.1 Monitoring of the Program

For analyzing and monitoring the operation of microfinance institutions, among the others, there are three popular tools as follow:

CAMEL system of, ACCION: It measures in five in major areas: i) C- capital adequacy ii) A- asset quality iii) M- management iv) E-earning v) L- liquidity

PEARLS system of, World Council of Credit Union: It measures in six major areas with 39 financial ratios: i) P-protection ii) E-efficient financial structure iii) A- asset quality iv) R-rate of return and costs v) L-liquidity vi) S-sign of growth. PEARLS tool is used exclusively for credit union.

CGAP indicators: CGAP has developed fifteen indicators which have been divided into six broad groups: i) Portfolio quality indicators ii) Profitability indicators iii) Financial solvency indicators iv) Growth indicators v) Productivity indicators vi) Outreach indicators

For the purpose of monitoring and evaluation the microfinance program in Bhutan following indicators may be more applicable:

- Scale and depth of outreach
- Productivity and efficiency
- Portfolio quality
- Financial viability
- Profitability

Except impact, which is measured at 3-5 years intervals, the other indicators shall be measured preferably monthly in the MFI and share quarterly with stakeholders.

9.1.1 Scale and depth of outreach

Scale of outreach refers to the total number of clients served by an MFI and depth is calculated as an average loan size as a percentage of GDP per capita[26]. Sometimes depth of outreach can be misleading because the loans of different terms and uses may not reflect the income level of the farmers. If the target is the particular groups excluded from formal financial services then, it may be necessary to define. Most approaches to microfinance lie between the two extremes used as benchmarks—the poverty approach and the self-sustainability approach. The poverty approach assumes that great depth can compensate for narrow breadth, short length, and limited scope. The self-sustainability approach assumes that wide breadth, long length, and ample scope can compensate for shallow depth. The poverty reduction being the main objective, outreach indicators measure the MFIs capability to serve the poor. The main outreach indicators are:

[26] Sustainable Banking with the Poor, Microfinance Handbook, an Institutional and Financial Perspective by Joanna Ledgerwood, The World Bank

Area coverage
Number of dzongkhags covered
Number of geogs covered

Clients coverage
Number of savers
Percentage of women savers
Number of borrowers
Percentage of women borrowers

Savings outreach
Total balance of savings
Average savings size

Loan outreach
Total balance of loan
Average loan size
Number of loans less than per capita income

9.1.2 Productivity and Efficiency

Productivity and efficiency ratios provide information about how efficiently the resources have been mobilized to cover the cost over time. Productivity relates to the staff productivity i.e the number of clients and volume of business per credit officer. Efficiency measures the cost of providing services. The major productivity and efficiency ratios are:

Productivity ratios
Number of active clients per credit officer
Total portfolio per credit officer
Total amount disbursed in the given period by per credit officer

Efficiency ratios
Administrative efficiency (Personnel and office operating cost divided by average outstanding portfolio[27])
Operating efficiency (Administrative cost plus fund cost plus loan loss provision divided by average outstanding portfolio)

9.1.3 Portfolio quality

Portfolio quality provides information on the percentage of non-earning loans, which in turn decrease the revenue and liquidity position of MFI. The portfolio quality is important not only for MFI but also for client because overdue clients cannot receive further loans and likely to be in high chances of indebted. In microfinance, because of small loans with many clients, it is very difficult to correct if portfolio quality once deteriorate. The major indicators used to measure portfolio quality are;

[27] Average portfolio outstanding: Portfolio at the beginning of the year plus portfolio at the end of the year divided by two

Arrears Rate: It is the amount of loan installments past due as a percentage of the gross portfolio outstanding.

Portfolio at Risk (PAR): This measures the total outstanding loan balance on delinquent loans as a percentage of gross outstanding.

Loan Loss Rate: It is a historical measure of loss from unrecoverable loans. It is measures as total amount written-off (over a given period) as a percentage of average portfolio outstanding of the same period.

Repayment Rate : The repayment rate which is used by many MFIs and donors but it does not in fact indicate the quality of the loan portfolio rather measures the historical rate of recovery. It should be calculated for the specific period, preferably for quarterly or annually.

9.1.4 Financial viability

Financial viability refers to the viability of an MFI to cover its cost with earned revenue. Financial viability is necessary not to depend upon donor subsidy for the program. Furthermore, program cannot be expanded without attaining financial viability. The service to poorer section can be achieved only by increasing the outreach. There are two levels of self-sufficiency against which MFIs are measured.

Operational self-sufficiency (OSS): It is measured as operating income divided by total operating expenses (operating expenses includes personnel expenses, office running expenses, fund cost and loan loss provision). The non-operating income such as income from training etc. is not included in OSS.

Financial self-sufficiency(FSS): It also measures the extent to which operating income cover the MFI's costs. FSS, however, measures how much coverage exists on an adjusted basis. It shows what would be the picture if fund from commercial market used rather than through donor grants or subsidized capital. Adjusted operating income is divided by adjusted operating expenses to calculate the FSS.

Both OSS and FSS should be above 100%. Achieving OSS is good and moving towards FSS is better for growth and sustainable operation.

9.1.5 Profitability indicators

Profitability ratios measure MFI's net income in relation to the structure of its balance sheet. It gives picture whether the earning is adequate to the funds invested in the MFI. The profitability indicators used in microfinance are:

Return on Assets (ROA): measures how well an MFI has used its assets base to generate income. It is expressed as operating profit divided by average total assets.

Adjusted Return on Assets (AROA): The inflation decreases the value of capital and increases the value of the fixed assets. Accordingly, if MFI is using subsidized fund, then, it may need to pay more if borrowed from commercial market in the long run. Adjustment on the expenses is done to calculate AROA which is expressed as adjusted operating profit divided by average total assets.

Return on Equity (ROE): measures how well an MFI has used the equity base to generate income. It is expressed as operating profit divided by average total equity.

Adjusted Return on Equity (AROE): Adjustment is done just like in AROA. AROE is expressed as adjusted operating profit divided by average total equity.

Portfolio yield: It measures how much MFI has earned through its lending operations. Portfolio yield is calculated as income from lending divided by average outstanding portfolio. It shows the difference between the expected and actual yield of portfolio. If the difference is high it could be due to high default rate or chances of fraud.

9.2 Evaluation of the Program

Evaluation could be mid-term or after completion of the project activities. Impact assessment is done because microfinance is a program for reduction of vulnerability by improving the ability of micro-entrepreneurs to cope with shocks, diversifying their income streams, increasing household's income, building human capital and creating self-employment. It is very difficult to measure impact of the microfinance program because there are several other factors playing crucial role for the impact.

In microfinance, impact is measured assessing to what extent the clients repeatedly take out, and repay loans over the time. But the development workers don't agree with this. They like to see the changes in nutritional habit, expenditure pattern, housing, school enrollment and health status. Some MFIs maintained data of changes when client apply for the next loan. Others organize impact assessment at 3-5 years intervals.

CGAP has listed five different impact assessment methods, one quantitative and four qualitative as follow:

Impact Assessment Sample: using questionnaire, usually a 'controlled group' of non-clients is used, or a 'comparison group' of routine and new clients

Rapid Appraisal: A range of tools and techniques including group discussions, consultations of staff and external key-informants, participant observation, study of evolution of portfolio and secondary data

Participatory Learning and Action (PLA): Clients, not outsiders, are the main players in the assessment process. In this, they are assisted by an external, highly skilled facilitator who introduces a variety of quantitative and qualitative methods and tools to facilitate the assessment process.

Participant Observation: Prolonged stay in a community by field researchers using mainly qualitative techniques.

Case Studies: Detailed studies of specific clients, or groups of clients, involving open ended questioning and preparation of life stories.

Chapter 10: Recommendations

- The present situation is that financial institutions are reluctant to expand their program in rural areas because of high overhead cost and less business opportunities, particularly in disadvantaged dzongkhags. But easy access to affordable credit is must for the transformation of subsistence agriculture into commercial. In this scenario, the RGOB shall make provision of interest subsidy to the farmers of disadvantaged dzongkhags. This shall encourage financial institutions including BDFC to expand their services in these areas without loss.

- In Bhutan, lending in agriculture and livestock has not been happened smoothly because of mandatory mortgage requirement even for small loans. There is no micro-insurance system in place to mitigate the risk of lending institutions. As per clients, the premium rate of the existing insurance company is high. RGOB shall allocate fund to share 50% of insurance premium of small farmers. This shall create environment for financial institutions to lend without mortgage on individual basis.

- The personnel cost and fund cost are two items which have substantial role on deciding the lending rate. RMA in consultation with MOAF shall make refinance provision to some crops for particular dzongkhags mentioning interest rate for ultimate clients. This shall encourage other financial institutions to expand their branches in rural areas in addition to BDFC.

- The next step need to be taken is to open the door for private sector in agriculture credit/microfinance. The RMA should take lead for the issue of "National Microfinance Policy" in consultation with stakeholders such as BDFC, Department of Agricultural Marketing and Cooperatives, Department of Livestock, Department of Forest, Ministry of Economic Affairs, National Women Association of Women, Tarayana Foundation and Commercial Banks. This shall design road map for the development of microfinance industry in the country. The overall government policy on microfinance, roles and responsibilities of microfinance institutions and support require for the development of microfinance shall be spell out in the policy document. Immediately after the policy, the microfinance regulation shall be issued. RMA has prepared draft microfinance regulation for the development of apex microfinance bank in the country for issuing license and providing wholesale loan fund to CSOs/NGOs/Cooperatives or other agencies interested to involve in microfinance sector. The RMA has explored for the equity support to World Bank, ADB and IMF for the establishment of apex microfinance bank. But if it takes time to manage donor fund for equity, it is suggested to RGOB for providing equity for establishment of apex body and after establishment, the apex body shall explore to donors for long term soft loan fund for on-lending to MFIs as in the neighbouring countries.

- For providing microfinance services in the less accessible areas, the development of community based financial institution is only one option for sustainable operation because it is found most cost effective than other models. The capacity building program of savings and credit self-help groups shall be initiated immediately for the conversion of saving and credit self-help groups into savings and credit organizations. A series of training is necessary, particularly on management, account and business plan. RGOB shall entrust department of agricultural marketing and cooperatives to mobilize CSOs/NGOs for the promotion of cooperatives in the country. At the first phase, it is suggested to plan for the establishment of at least three savings and credit cooperatives. Then, it is expected that these three shall work for spill and spread out of the model in other communities.

- MOAF shall work with Royal Monitory Authority of Bhutan for the establishment of separate "Agriculture Development Bank" in near future which shall be specialized, dedicated and committed exclusively for the development of agriculture in the country.

Annex 1: Formula for the calculation of key financial indicators

Indicator	Formula	Goals
Clients per credit officer	No. of clients/no. of credit officer	Equal or above the average of the nation
Portfolio per credit officer	Total portfolio/no. of credit officer	Equal or above the average of the nation
Clients retention rate	No. of clients of the previous year who have continued business with the MFI/No. of clients at the end of the previous year*100	>95%
Loan in arrears	Total loan installments past due/Gross portfolio outstanding	Less than 5% of the portfolio
Loan at risk (PAR)	Total outstanding loan balance on delinquent loans/Gross portfolio outstanding*100	Less than 5% of the portfolio
Loan loss rate	Total amount written off (over a given period)/Average outstanding portfolio (for the same period)*100	Less than 2% of the portfolio
Loan loss reserve rate	Loan loss reserve/Gross portfolio outstanding*100	>Loan at risk
Repayment rate	Amount received (given period)/amount to be received (in the same period)*100	Above 98%
Operational self-sufficiency (OSS)	Operating income/(administrative expenses + fund cost + loan loss provision)*100	> 100%
Financial self-sufficiency (FSS)	Operating income/(administrative expenses + fund cost + loan loss provision+ imputed cost of capital) *100	>100%
Administrative efficiency	Total operating expenses - cost of fund - loan loss provision+ in-kind /Average outstanding portfolio	Lowest the possible
Operating efficiency	Operating expenses/Average outstanding portfolio	Lowest the possible
Adjusted return on assets (AROA)	Adjusted operating profit/Average total assets*100	>10%
Adjusted return on equity (AROE)	Adjusted operating profit/Average total equity*100	Market rates

Annex 2: Outreach and financial performance monitoring format

Name of the MFI/branch: Month/Quarter: Year:

Outreach		This month/quarter		Changes from previous month/quarter
S.N.	Indicator	Number/Amount in 000'	Percentage	
1	Number of working dzongkhags/Geogs			
2.	Number of savers			
3.	Number of women savers			
4.	Savings balance			
5.	Number of savings accounts			
6.	Average savings balance			
7.	Number of borrowers			
5.	Number of women borrowers			
6.	Outstanding loan portfolio			
7.	Number of loans below per capital income			
8.	Average initial loan size			
9.	Average loan size			
Financial viability and efficiency				
1.	Average total assets			
2.	Operating income			
3.	Administrative expenses			
4.	Fund cost			
5.	Loan loss provision			
6.	Computed cost of capital			
7.	Operational Self-sufficiency			
8.	Financial Self-sufficiency			
9.	Adjusted return on assets			
10.	Adjusted return on equity			
11.	Administrative efficiency			
12.	Operational efficiency			
Productivity				
1.	No. of clients per credit officer			
2.	Portfolio per credit officer			
3.	Clients retention rate			
Portfolio quality				
1.	Loans in arrears			
2.	Portfolio at risk			
3.	Written-off loans			
4.	Loan loss reserve			

Annex 3 : PEARLS RATIOS (PEARLS)

P- Protection	Goals
1.Loan losses allowances/delinq.>12 mon.	100%
2. Net loan loss allowances/WOCCU allowance required for delinq. 1-12 months	35%
3.Complete loan charge-off of delinq.>12 months	Yes
4.Annual loan charge-offs/Average loan portfolio	Minimized
5. Accum.charge-offs recovered /Accum.charge-offs	>75%
6.Solvency (Net value of assets/Total shares & deposits)	≥111%
E-Effective Financial Structure	Goals
1.Net loans/Total assets	70-80%
2.Liquid investments/Total assets	≥16%
3.Financial investments/Total assets	≥2%
4.Non-financial investments /Total assets	0%
5.Savings deposits/Total assets	70-80%
6.External credit/Total assets	0-5%
7.Member share capital/Total assets	≥20%
8.Institutional capital to total assets	≥10%
9.Net Institutional Capital/Total assets	≥10%
A-Asset Quality	Goals
1.Total loan delinquency/Gross loan portfolio	≥5%
2.Non-earning assets/Total assets	≥5%
3.Net zero cost funds/Non-earning assets	≥200%
R- Rates of Return and Costs	Goals
1.Net loan income/Average net loan portfolio	Entrepreneurial rate
2.Liquid inv. income/Avg. liquid investments	Market rates
3.Fin.investment income/Avg.fin. investments	Market rates
4. Non-fin. investment income/Avg. non-fin. Investments	≥R1
5.Fin.costs:savings deposits/Avg. savings deposits	Market rates>inflation
6.Fin.costs:External credit/Avg.external credit	Market rates
7.Fin. costs:Members shares/Avg.member shares	Market rates,>R5
8.Gross margin/Average assets	ˆE9=10%
9.Operating expenses/Average assets	≥5%
10.Provision for risk assets/Average assets	ˆP1=100%, ˆP2=35%
11. Other income of expense/Average assets	Minimized
12.Net income/Average assets (ROA)	ˆE9=10%
L- Liquidity	Goals
1.Liquid assets – ST payables/Total deposits	15-20%
2.Liquid reserves/Total savings deposits	10%
3.Non-earning liquid assets/Total assets	<1%
S-Signs of Growth (Annualized Rates)	Goals
1.Net Loans	ˆE1=70-80%
2.Liquid investments	ˆE2 ≤ 16%
3.Financial investments	ˆE3 ≤ 2%
4. Non-financial investments	ˆE4=0%
5.Savings deposits	ˆE5=70-80%
6.External credit	ˆE6=0-5%
7.Member shares	ˆE7 ≤ 20%
8.Institutional capital	ˆE8 ≥ 10%
9.Net-institutional capital	ˆE9 ≥ 10%
10.Membership	≥ 15%
11.Total assets	> Inflation + 10%

Annex 4: Impact assessment through case studies

1. Name of the client:
2. Address:
3. Number of family members: i) Male: below 18 years……..>18-60 years…….. >60 years…… ii) Female: below 18 years…….>18-60 years…..>60 years…….
4. How did you know about the MFI:
5. About the loan transaction:

Date of disbursement (Year and month)	Purpose	Disbursed loan amount	Loan paid (Principal)	Outstanding balance	Overdue installments amount

6. Changes in the livelihood before and after the credit intervention

Indicator	Unit	Before	After	Remarks
Land holding	Acre/ha			
Livestock	No.			
Other assets, specify	No./kg			
Expenses in food	Same or % increased/decreased			
School enrollment	No.			
Regular vaccination	Yes/No			
Expenses in health	Same or % increased/decreased			
Women access and control over resources	Same or % increased/decreased			
Women participation in decision making	Same or % increased/decreased			
Other changes, please explain in detail				
Problems encountered because of credit				

Remarks: explain the reasons and specify in terms of quantity and quality

7. Participation in other financial services

7.1 Do you have savings account in the MFI? Yes/No

7.2 If yes, how much savings balance do you have in the MFI ? (product wise)

7.2 Have you participated other than credit and savings program of the MFI/ If yes, please specify? (e.g. micro-insurance)

8. What is the strength of the MFI?
9. What is your suggestion to the MFI for improving the service quality?
10. Other, if any.

Annex 5: Calculation of required interest rate

$$R = \frac{AE+LL+CF+K-II}{1-LL}$$

Where:

R= Required Interest Rate
AE=Administrative Expense
LL= Loan Loss Rate
CF= Cost of Fund
K = Capitalization Rate
II= Investment Income Rate

Administrative expense represents the personnel cost and office running cost (such as house rent, stationary, communication, utility, transport, depreciation etc.) divided by average outstanding portfolio. Average outstanding portfolio means sum of the outstanding portfolio of previous year and this year divided by two.

Loan loss rate covers the cost of capital written off. This is calculated as total amount written off (over a given period) divided by average outstanding portfolio (for that same period).

CF is cost of funds rate represents the cost to an MFI of funding and maintaining its loan portfolio. This includes interest paid on savings, deposits or debt, as well as the impact of inflation on the institution's equity. The cost is divided by average outstanding portfolio to calculate cost of funds.

Capitalization represents the growth rate that the MFI would like to achieve through its net profits and growth in its own equity.

Investment income is the sum total of revenues generated from financial assets other than the loan portfolio. This is calculated as investment income (for the given period) divided by average outstanding portfolio (for the same period).

Annex 6: Capacity building of savings and credit organization

i) Basic management training

Day	First session	Second session	Third session	Fourth session
First	Definition, goal and characteristics microfinance, how MF differs from commercial finance	Three "C" in microfinance, Four pillars of microfinance, commonly used term in microfinance	What is SCO, why necessary, Vision, mission and objective setting exercise	Exercise continue…….
Second	organizational structure of SCO and role of chairperson, deputy chairperson and executive members and general members	Loan committee, audit committee other committees roles and responsibilities	Loan products (period, frequency of installments, interest rate, eligible criteria, loan limit etc.)	Savings products (Compulsory, voluntary, minimum balance, withdrawal conditions, interest rate etc.)
Third	Service delivery process (savings and loans)	Delinquency management (what is overdue, PAR, causes and cost, managing delinquency)	Exercise on delinquency management continue	Basic reporting (Outreach and transaction report)

ii) Advanced management training

Day	First session	Second session	Third session	Fourth session
First	Exercise on review and planning (semi-annual or annual) and three years program projection	Exercise continue……..	Designing demand led products and services (product characteristics and designing process)	What is cooperative, fundamental principles of cooperative, how to form cooperative
Second	Practice on preparing bylaws of cooperative	Practice continue…..	Delinquency management (overdue, PAR, aging cases, cost and control of delinquency, concept of non-delinquency tolerance)	Lending methodologies in microfinance
Third	Governance in microfinance(roles and responsibilities)	MIS in microfinance (meaning, components, uses and inter-link)	Exercise on Key financial indicators (productivity, OSS, FSS, AROA, AROE, efficiency and portfolio quality)	Exercise continue……..

iii) Training on basic accounting

Day	First session	Second session	Third session	Fourth session
First	Exercise on filling savings and loan ledger and pass book	Exercise continue……	Exercise on interest rate calculation	Exercise continue…..
Second	What is voucher? Exercise on preparing voucher	Exercise continue ……	Exercise on posting of Account ledger and side ledgers	Exercise continue…..
Third	Exercise on preparation of trial balance, income statement and balance sheet	Exercise continue…..	Exercise on preparation of financial report	Exercise continue….

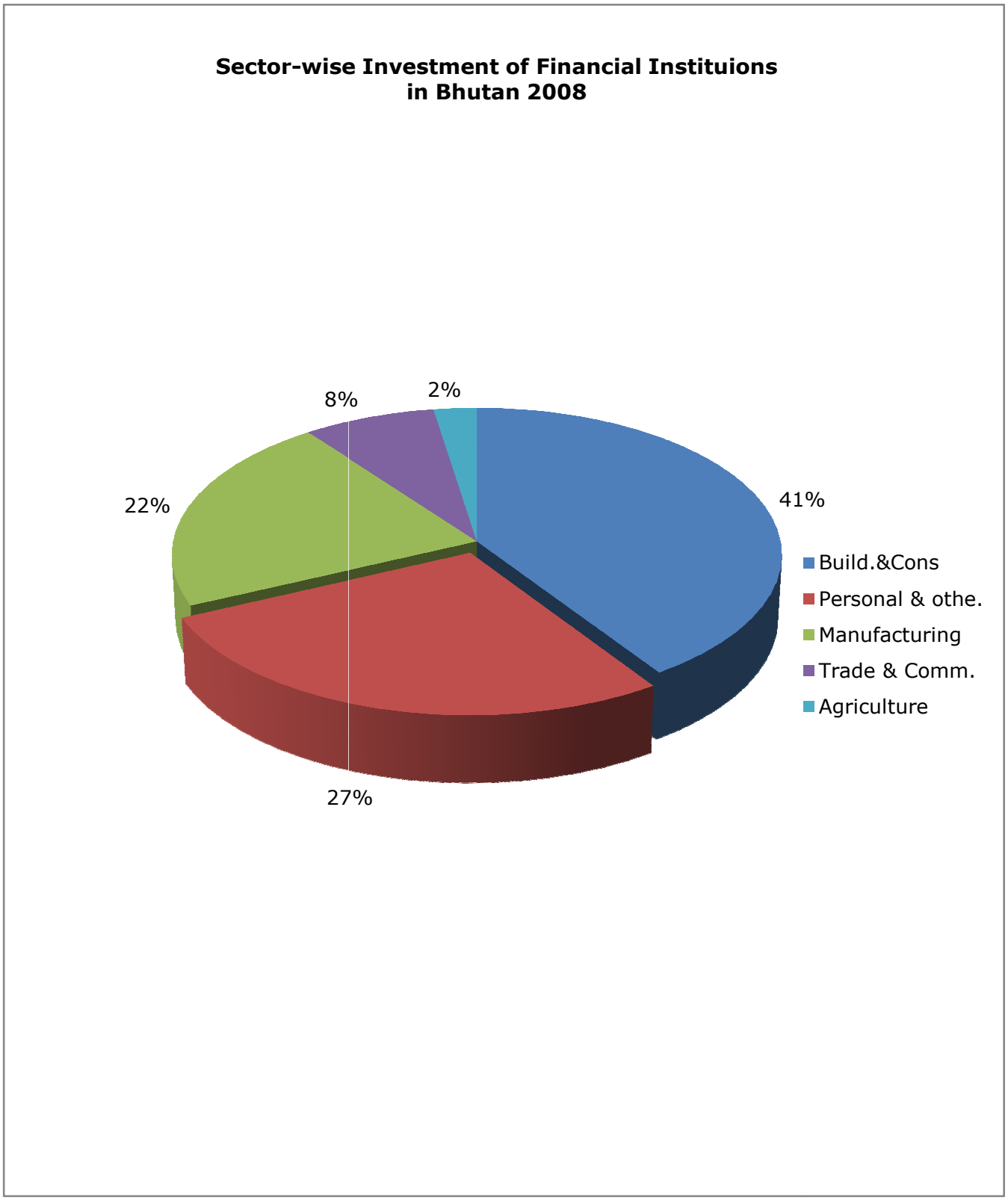
iv) Training on advanced accounting

Day	First session	Second session	Third session	Fourth session
First	Exercise on voucher preparation	Posting of voucher in AL and side ledgers	Exercise on preparation of income statement and balance sheet from account ledgers and side ledgers	Exercise continue……..
Second	Exercise on preparation of bank reconciliation statement	Exercise on preparation of financial report as per cooperative laws	Exercise continue…..	Exercise continue…..
Third	Exercise on PEARLS analysis	Exercise continue…..	Exercise continue…..	Exercise continue…..

v) Training on business plan

Day	First session	Second session	Third session	Fourth session
First	What is business plan, why necessary, vision, mission and objectives setting	Macro-economic indicators and socio-economic situation	Competition and collaborators	SWOT analysis (institutional capacity assessment)
Second	Market analysis	Exercise on market analysis (existing and future)	Marketing plan	Marketing plan continue
Third	Operational plan	Operational plan continue	Financial plan	Financial projection
Fourth	Exercise on financial projection	Exercise on financial projection continue	Calculation of key financial indicators	Exercise on calculation of key financial indicators

Annex 7: Sector-wise investment in formal sector



Annex 8: Feedback/comments of final draft presentation

Name of the commentator	Designation	Comments/Feedback
1.Ganesh Chettri	Project Director, ASSP	• Background need to elaborate to explain the context of credit from department view. • The government is not expecting from any financial institution working in loss for the sake of agri. development but MOAF is interested to know what can be done from policy/government side for easy access to credit for farmers • Specific recommendations need to be added in report
2.Karma T. Dorji	Project Manager, BDFC	• Loan to mortgage requirement for commercial agriculture loan is 1:1.5 not 1:5 • BDFC has recently recruited 47 staff, out of 47, 30 is for branches • For BDS program, BDFC will collaborate with MOAF line agencies • To date, BDFC has incentive package only for branch. Exercise is going on to develop incentive package for individual staff on performance basis • BDFC has kept 60%of resource for agri. lending but demand is not as per resource allocated in agriculture sector • BDFC has got license to collect deposit from public. The additional savings products shall be developed for internal resource generation • In insurance, farmers say premium is high for livestock insurance • GGLS program can be say success or failure. BDFC has recently piloting joint liability model in 5 branches which is group lending without collateral • RMA guideline does not allow to disburse loan without collateral for an individual is the reason for not disbursing loans without collateral to an individual
3. Ms.Tshering Zam	Representative, RMA	• Draft microfinance regulation is prepared. It may take one year to finalize it • Work on microfinance policy has not been started
4.Phurpa Dorji	Representative, DOL	• There is gap in between credit and development • Mortgage valuation system of BDFC is low, need to review • Insurance has been started in some area • In dairy group they have collected savings and lend within the group at 7% p.a. • Loan should be disbursed even without collateral if clients have good project with capacity to implement
5.Dorji Dhradhul	Director, DAMC	• Include why it is urgent to have this study and what government can do for improving agri. credit sector • Who will take lead role on the activities mentioned in the strategies paper with time line need to be incorporated • Issue in agri. credit is not only interest but also others including easy accessibility at right time

Annex 9: List of the persons met during review period

S.N.	Name	Designation	Institution
1.	Mr. Dorji Dhradhul	Director	Department of Agricultural Marketing and Cooperatives (DAMC)
2.	Ms. Sonam Wangmo	Marketing Officer	DAMC
3.	Mr. G.B. Chettri	Project Director	Agriculture Sector Support Project (ASSP)
4.	Mr. Harry Frank	Project Advisor	ASSP
5.	Mr. Kailash Pradhan	Principal Research Officer	Council of RNR Research of Bhutan (CORRB)
6.	Mr. Karma Thinley Dorji	Project Manager	Bhutan Development Finance Corporation (BDFC)
7.	Ms.Tshering Zam	Representative	Royal Monetary Authority of Bhutan (RMA)
8.	Ms.Ugyen Lham	MSME Development Expert	MSME Division, Ministry of Economic Affairs
9.	Dr. Rob Erskine-Smith	International Market Brokering Specialist	SNV, Thimphu, Bhutan
10.	Mr.Dorji Wangdi	Branch Manager, Wangdi	BDFC
11.	Mr.Sonam Phnnetsho	Branch Assistant, Punakha	BDFC
12.	Mr.Tenzin Tashi	Branch Manager, Paro	BDFC
13.	Mr.Tshawang Norbu	Regional Manager, Paro	BDFC
14.	Mr.Sangay Jamtsho	Branch Manager, Thimphu	BDFC

Annex 10: References

1. Annual Report 2008-2009, NABARD, India
2. Bhutan Development Finance Corporation Limited 20th Annual Report 2008
3. Dominique Bastin "An Assessment of the Microcredit in Rural Bhutan" April 2009
4. Detail Implementation Plan on Expanding Access to Savings led Financial Services in Bhutan, Under the support of LDC fund to Develop Savings – led Market Leaders for Inclusive Farmers, Submitted to UNCDF by BASICS Ltd. India
5. Economic Development Policy of The Kingdom of Bhutan, 2010
6. Joanna Ledgerwood, Microfinance HandBook, Sustainable Banking with the Poor, An Institutional and Financial Perspective, 1999
7. Kailash Pradhan, Dorji Dhradhul and Ganesh Chettri (CoRRB & DoA), Towards Improving Access to Rural Credit for Agriculture Development, A Concept Note for discussion
8. Marguerite S. Robinson, The Microfinance Revolution, Sustainable Finance for the Poor, Lessons from Indonesia 2001
9. Microfinance in Bhutan, Annex 3, Macroeconomics of Poverty Reduction; the case study of Bhutan by Macroeconomics of Poverty Reduction UNDP Regional Center in Colombo, August 2007
10. Microfinance in Bhutan, Report of a formulation mission, Frank W.Bakx and Rabobank Nederland, Thimphu/Utrechu, August 1998
11. Microfinance Distance Learning Course by Special Unit for Microfinance, UNCDF
12. Narahari Dhakal, Role of State for the Development of Microfinance Sector, A paper presented on Microfinance Summit 2010,Nepal
13. Poverty Analysis Report 2007, National Statistics Bureau, Royal Government of Bhutan, December 2007
14. Purshottam Shrestha, Financial performance of Microfinance Institutions with Special Reference to Small Farmers Cooperatives Limited in Nepal, 2007
15. Review of Microfinance Services in the Hills of Nepal; A Study Conducted by The Center for Micro-Finance, Nepal and Swiss Agency for Development and Co-operation (SDC), Nepal
16. RNR Sector Tenth Plan (2008 – 2013), Volume I, Ministry of Agriculture, October 2009
17. RNR Sector Tenth Plan (2008 – 2013), Volume III, Ministry of Agriculture, October 2009
18. Statistical Yearbook of Bhutan 2009
19. The Cooperative (Amendment) Act of Bhutan, 2009
20. The Civil Society Organizations Act of Bhutan, 2007
21. The Financial Institutions Act of Bhutan, 1992
22. The RMA Prudential Regulations, 2002