Benchmarking Nepal's Microfinance Banks 2006

A report from the Microfinance Information eXchange, Inc.
February 2008

In Brief

Nepal's microfinance outreach remains limited, but the sector has made tremendous strides in the face of political unrest and the challenges posed by the Maoist insurgency. Growth in the sector compares favorably with global norms yet falls behind regional trends as South Asian MFIs continue to top growth charts and pursue a rapid expansion of services. Nonetheless, the sector benefits from tight cost structures and a large pool of readily available funds that could fuel more rapid growth and help expand financial services to a larger share of the country's poor.

The following analysis draws on 2006 outreach data from 18 microfinance institutions (MFIs) in Nepal and financial performance information from a subset consisting of the nine retail microfinance banks (MFBs) – four microfinance development banks (MFDBs) and five regional rural development banks (RRDBs). The sector's performance is further contextualized against results from a broader set of 86 MFIs across South Asia.

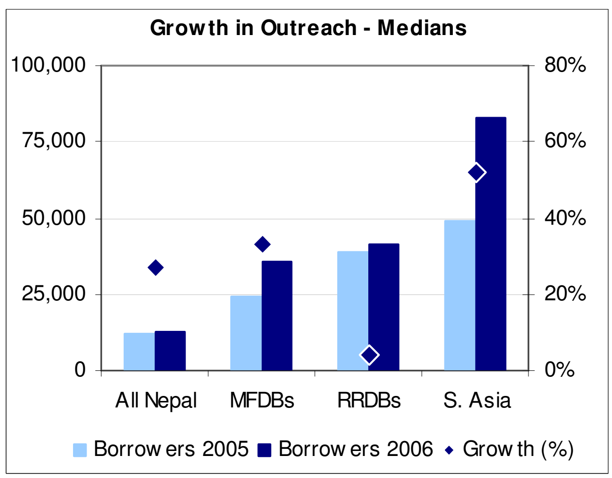
Modest outreach and growth led by MFBs

At the end of the 2006 financial year, the Nepalese MFIs surveyed for this analysis collectively reached 376,000 borrowers with USD 46 million in loans. The nine microfinance banks together accounted for an overwhelming share of this outreach and served four-fifths of all borrowers reached by sample MFIs. Thanks to their extensive branch network and strong productivity of 162 borrowers per staff member, outreach among MFBs typically exceeded the 35,000 mark and surpassed the level attained by the median Afghan and Pakistani institution.

Outside of these specialized banks, only one institution came close to serving 20,000 borrowers while the others remained well below the 15,000 threshold. With its dispersed population, difficult terrain, and numerous organizations offering microfinance services, the Nepalese sector cannot expect its institutions to attain the scale achieved by its Bangladeshi and Indian counterparts. Nonetheless, a number of the country's poor remain outside the fold of microfinance, and the sector has ample room to grow.

Yet despite fairly low penetration rates, growth in outreach remains modest by regional standards. Over the course of the year, the combined client base expanded by 22 percent, while the typical institution grew at 27 percent. The four MFDBs led the charge in sector expansion and boosted their coverage by a median 34 percent, exceeding global norms but paling in comparison to the stellar 52 percent growth achieved by the median South Asian MFI.

The RRDBs, on the other hand, saw their outreach stagnate. As a group, these institutions have generally been the largest microfinance providers in the country, but they risk falling behind MFDBs if they cannot boost their growth beyond the four percent achieved during the 2006 financial year. This sluggish growth partly stems from the privatization process that is currently underway, and it is hoped that when the restructuring is finalized growth will accelerate. These institutions, however, are also more vulnerable to the Maoist insurgency as a result of their government affiliation, exposing them to more looting, threats to personnel, and property damage than their MFDB counterparts, significantly curtailing their operations.[1] To boost their growth figures, these institutions will have to develop more effective strategies for overcoming these challenges.



Limited product and service offering

One area that MFBs could expand into is Nepal's lower-income market segments. In 2006, the average loan balance stood at USD 137 – less than one third the global benchmark. Given low living

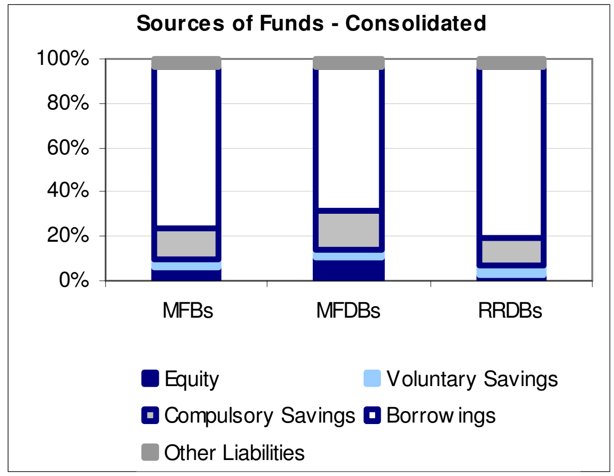
[1] World Bank, Access to Financial Service in Nepal, 2007.

standards in the country, however, this figure amounted to half of the local income level, compared to just 18 percent across the region. Whereas South Asian MFIs typically focus on serving the lower market segments, Nepal's MFBs generally target a broader population, perhaps reflecting the weakness of the banking sector outside of urban areas.

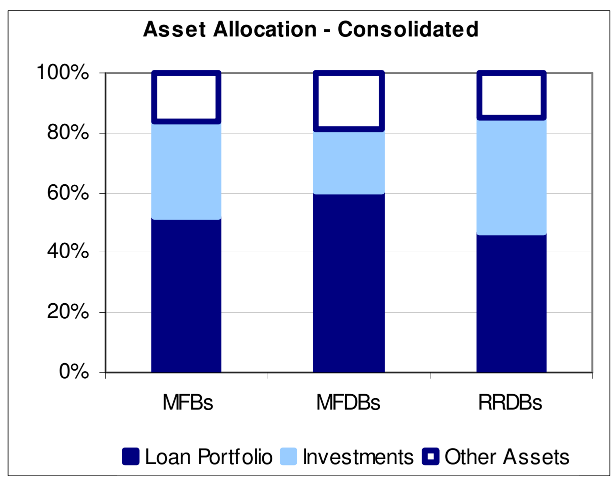
In addition to expanding services to the poorer population, Nepal's microfinance sector could significantly expand outreach by boosting deposit services. Deposit mobilization across South Asia remains limited due to legislative constraints within various countries. Yet even in Nepal, where MFBs are legally authorized to collect savings, these institutions typically reach half as many depositors as borrowers. On average, the amount of voluntary savings at an individual MFB barely exceeds USD 250,000 – less than five percent of loans under management. MFBs, however, draw a greater portion of client funds in the form of compulsory savings – an integral practice of group lending methodologies that are so prevalent in the region. Hence, MFBs collect over three times as much funds in compulsory as in voluntary savings – USD 9.8 vs. 2.8 million in the aggregate. That only 49 percent of all households in the country hold a deposit account[2] provides a significant market for MFBs, but to take advantage of this opportunity, MFBs will have to adapt their services to better meet client needs. Further tapping into the savings market would not only draw more clients into microfinance services but could also provide an additional source of funds for growth in the credit market, especially as deprived sector lending requirements are phased out.

Heavy reliance on borrowed funds

Priority sector lending requirements have thus far ensured a steady flow of funds to the sector, and Nepal's MFIs are among the most leveraged institutions in the region. The typical South Asian MFI raises 4.2 dollars in debt for every dollar in equity, compared to just 2.6 dollars at the global level. Nepal's MFBs, at the extreme, operate on very thin capital cushions and raise 13.5 times their equity in debt. Indeed, with the exception of three institutions, the amount of borrowings availed far exceeded the amount disbursed in loans. At the end of the year, outstanding borrowings amounted to 138 percent of loans managed by the typical MFB.



A large portion of assets was invested in activities other than microfinance. Two MFBs allocated as little as one-fifth of their resources to their portfolio, with the others generally staying below the two-thirds mark. Asset utilization for the loan portfolio fell significantly short of the 79 percent that is typical of the region and only exceeded the level attained in Pakistan, where a number of start-up institutions are just beginning to shore up their operations in order to more effectively channel funds to their clients. In both countries, however, the availability of other investment options works to divert funds from the provision of microfinance services.



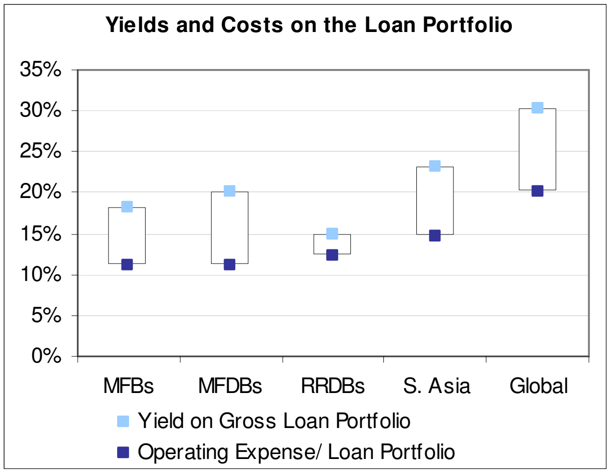
In Nepal, lenders themselves may push institutions towards these safer investment alternatives, thereby circumscribing the intended impact of deprived sector lending requirements as there are no provisions that these funds be onlent to individual

[2] World Bank, Access to Financial Services in Nepal, 2007.

clients.[3] Nonetheless, with the closing of the priority lending window, MFBs will have to bolster returns on their microfinance operations to attract investors and secure the necessary lending for future growth, a move that will require boosting revenues.

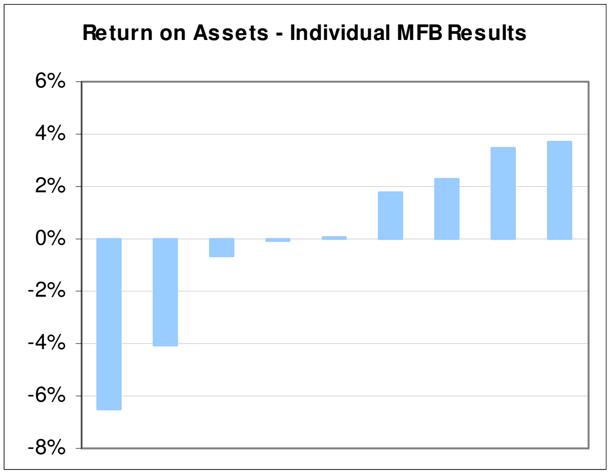
Weak, but positive returns due to low costs

MFBs generally earn the lowest revenues in the region – 12 percent compared to 18 percent of assets for the typical South Asian MFI. While part of the reason is the low allocation of funds to the loan portfolio, these institutions generally also charge their clients lower rates than their regional counterparts. Portfolio yields among MFBs typically stand at 18 percent, five points below prevalent yields in South Asia.

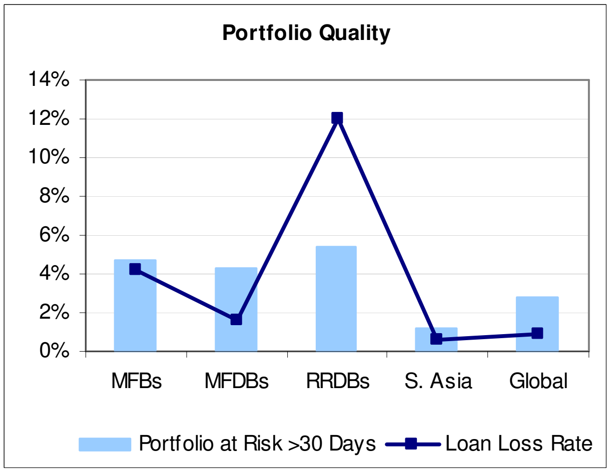


These low yields nonetheless suffice to cover operating costs on the loan portfolio due to the sector's tight cost structure. With just 5.0 percent of assets going to personnel costs and 1.3 percent used to cover administrative expenses, MFBs easily cover the operating costs associated with service delivery. Whereas the typical MFI in the region spends 17 cents on managing each dollar in loans, MFBs only spend 11 cents. Within this group, MFDBs benefit from slightly higher efficiencies than their RRDB peers, and they charge higher rates, providing them with solid margins that are sufficient to also cover financing and provisioning costs.

Most of Nepal's MFBs are either profitable or on the verge of breaking even, but typical returns stand at a fragile 0.1 percent of assets. The country's low interest rate structure ensures that financing costs do not top five percent of assets in a region where MFIs generally spend close to seven percent to secure the necessary funds for onlending, thereby reining in the costs associated with service provision.



Profits, however, would stand to benefit from improvements in portfolio quality. At 4.7 percent, portfolio at risk among MFBs is the highest of the region. With a median loan loss rate of 4.2 percent, these institutions witness a significant draining of their revenue stream due to client default. The situation is particularly acute among RRDBs, who are more vulnerable to Maoist activity and calls to farmers to default on their loans. On average, these institutions lost 12 percent of their portfolio over the course of the year, with two institutions losing over one-fourth of their loan portfolio. MFBs have little control over the political situation, but they can enhance their portfolio tracking systems and adopt best practices for writing off delinquent loans, thereby developing a better understanding of their portfolio quality and better addressing these risks.



[3] Sinha, Sanjay and Swetan Sagar, "The Regulation Muddle in Nepal", 2007.

Conclusion

Heavy portfolio risk remains one of the greatest weaknesses of Nepal's microfinance sector, diminishing its revenue streams and threatening the precarious returns achieved thus far. Short of resolving the current political conflict, MFBs would benefit tremendously from standards dissemination and technical assistance in the area of portfolio risk management. The sector already enjoys a tight cost structure that can act as a springboard for boosting profits, but institutions will have to strengthen their revenue streams to ensure the sustainability of the sector. Enhancing portfolio quality will go a long way in shoring up revenues, but MFBs, and RRDBs in particular, will also have to abandon the view of microfinance as a charitable enterprise and adopt appropriate product-pricing policies that not only cover the direct costs of service provision but also provide for provisioning and funding expenses.

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Data and Data Preparation

For benchmarking purposes, MIX collects and prepares MFI financial and outreach data according to international microfinance reporting standards as applied in the *MicroBanking Bulletin*. Raw data are collected from the MFI, inputted into standard reporting formats and crosschecked with audited financial statements, ratings and other third party due diligence reports, as available. Performance results are then adjusted, using industry standard adjustments, to eliminate subsidy, guarantee minimal provisioning for risk and reflect the impact of inflation on institutional performance. This process increases comparability of performance results across institutions. More information on MIX's methodology for benchmarking and indicator definitions can be found at: www.mixmbb.org/Templates/Methodology.aspx.

MIX thanks all institutions participating in the industry benchmarks and extends its gratitude to the Centre for Micro Finance (CMF) for facilitating data collection in Nepal and making this report possible.

MFI	Charter	Number of Active Borrowers			Gross Loan Portfolio (USD)		
		2005	2006	Growth (%)	2005	2006	Growth (%)
JVS	NGO	3,077	8,415	173%	184,580	463,793	151%
FORWARD	NGO	5,759	11,842	106%	344,864	860,911	150%
CSD	NGO	6,686	12,452	86%	605,932	1,020,967	68%
CBB*	MFDB	14,300	23,153	62%	1,673,495	2,695,146	61%
BMSCCSL	Cooperative	602	860	43%	63,851	74,386	16%
SB Bank*	MFDB	33,708	47,811	42%	3,355,907	4,345,364	29%
NRDSC	NGO	14,033	18,473	32%	872,109	1,263,798	45%
NSSC	NGO	9,359	12,284	31%	942,312	1,291,289	37%
VYCCU	Cooperative	1,898	2,447	29%	603,682	654,191	8%
DD Bank*	MFDB	12,873	16,102	25%	1,727,089	2,466,028	43%
Nirdhan*	MFDB	50,063	58,679	17%	5,909,954	7,442,059	26%
SPGBB*	RRDB	12,142	13,463	11%	1,873,159	1,712,854	-9%
BISCOL	Cooperative	879	970	10%	947,271	1,068,663	13%
MGBB*	RRDB	38,645	42,058	9%	4,102,668	4,279,130	4%
PGBB*	RRDB	39,646	41,097	4%	5,539,491	5,803,237	5%
GBNB*	RRDB	49,660	51,079	3%	7,158,558	8,004,364	12%
MPGBB*	RRDB	12,342	12,582	2%	1,537,846	1,903,577	24%
JSCCS	Cooperative	1,836	1,775	-3%	553,222	631,522	14%
Overall Sample		**307,508**	**375,542**	**22%**	**37,995,990**	**45,981,279**	**21%**

*MFI provided benchmark-level performance information in addition to outreach details.

2006 Consolidated Financial Statements for MFBs (USD)

BALANCE SHEET	UNADJUSTED ACCOUNTS	ADJUSTED ACCOUNTS
Cash and Due from Banks	8,043,077	8,043,077
Reserves from Central Bank	182,645	182,645
Trade Investments	2,952,180	2,952,180
Net Loan Portfolio	37,330,003	36,426,951
Gross Loan Portfolio	40,351,339	37,812,861
(Impairment Loss Allowance)	3,021,336	1,385,909
Interest Receivable	24,277	24,277
Accounts Receivable and Other Assets	2,364,233	2,364,233
Other Investments	18,988,188	18,988,188
Net Fixed Assets	889,376	950,842
Total Assets	**70,773,979**	**69,932,393**
Demand Deposits	12,661,695	12,661,695
Voluntary Deposits	2,824,114	2,824,114
Compulsory Deposits	9,837,581	9,837,581
Time Deposits	0	0
Borrowings	50,641,514	50,641,514
Borrowings at concessional interest rates	57,516	57,516
Borrowings at commercial interest rates	50,583,998	50,583,998
Interest Payable	1,159	1,159
Accounts Payable and Other Liabilities	2,465,814	2,465,814
Total Liabilities	**65,770,182**	**65,770,182**
Paid-in Captial	5,085,012	5,085,012
Donated Equity	781,444	781,444
Prior Years	650,072	650,072
Current Year	131,372	131,372
Retained Earnings	-1,658,392	-2,815,060
Prior Years	-2,355,577	-2,355,577
Current Year	697,185	-459,483
Adjustments to Equity	0	315,083
Inflation Adjustment	0	315,083
Subsidized Costs of Funds Adjustment	0	0
In-Kind Subsidy Adjustment	0	0
Reserves	1,128,533	1,128,533
Other Equity Accounts	-332,800	-332,800
Total Equity	**5,003,797**	**4,162,212**
Total Liabilities and Equity	**70,773,979**	**69,932,394**

INCOME STATEMENT	UNADJUSTED ACCOUNTS	ADJUSTED ACCOUNTS
Financial Revenue	7,850,732	7,850,732
Financial Revenue from Loan Portfolio	6,001,882	6,001,882
Interest on Loan Portfolio	5,951,485	5,951,485
Fees and Commissions on Loan Portfolio	50,397	50,397
Financial Revenue from Investments	1,524,971	1,524,971
Other Operating Revenue	323,879	323,879
Financial Expense	2,665,675	2,919,292
Financial Expense on Funding Liabilities	2,632,176	2,632,176
Interest and Fess Expense on Deposits	660,843	660,843
Interest and Fee Expense on Borrowings	1,971,333	1,971,333
Net Adjustment for Inflation	0	253,617
Inflation Adjustment to Equity	0	315,083
Inflation Adjustment to Fixed Assets	0	61,466
Adjustment for Subsidized Cost of Funds	0	0
	33,499	33,499
Net Financial Income	**5,185,057**	**4,931,440**
Impairment Losses on Loans	270,438	1,173,489
Provision for Loan Impairment	305,571	1,208,622
Value of Loans Recovered	35,133	35,133
Operating Expense	3,893,037	3,893,037
Personnel Expense	2,998,515	2,998,515
Administrative Expense	894,522	894,522
Rent and Utilities	99,982	99,982
Transportation	58,730	58,730
Office Supplies	53,579	53,579
Depreciation and Amortization	75,657	75,657
Other Administrative Expense	606,574	606,574
Net Operating Income	**1,021,582**	**-135,086**
Net Non-Operating Income	3,454	3,454
Non-Operating Revenue	7,827	7,827
Non-Operating Expense	4,373	4,373
Net Income (Before Taxes and Donations)	**1,025,036**	**-131,632**
Taxes	327,851	327,851
Net Income (After Taxes and Before Donations)	**697,185**	**-459,483**
Donations	131,372	131,372
Net Income (After Taxes and Donations)	**828,557**	**-328,111**

2006 MFI Benchmarks

INSTITUTIONAL CHARACTERISTICS	Nepal MFBs	Nepal MFDBs	Nepal RRDBs	South Asia	Global	Afghanistan	Bangladesh	India	Pakistan
Number of MFIs	9	4	5	86	704	12	13	37	11
Age	11	5	11	9	9	3	16	9	4
Total Assets	8,349,728	5,982,071	8,624,337	8,728,238	6,169,918	2,051,172	17,110,251	9,635,690	5,319,361
Offices	38	31	38	41	11	8	152	45	19
Personnel	194	152	216	275	94	82	1,292	303	195
FINANCING STRUCTURE									
Capital/ Asset Ratio	6.3%	9.1%	4.2%	9.3%	25.4%	17.4%	20.2%	4.3%	42.0%
Commercial Funding Liabilities Ratio	147.1%	124.0%	147.1%	59.9%	61.0%	0.0%	8.4%	81.2%	6.7%
Debt to Equity	13.5	10.7	15.2	7.5	2.6	3.3	3.9	11.9	1.3
Deposits to Loans	4.5%	6.5%	4.5%	0.0%	0.0%	0.0%	4.3%	0.0%	0.5%
Deposits to Total Assets	2.5%	3.6%	1.8%	0.0%	0.0%	0.0%	4.2%	0.0%	0.4%
Portfolio to Assets	53.9%	60.3%	50.7%	78.5%	77.9%	60.1%	85.5%	83.4%	44.5%
OUTREACH INDICATORS									
Number of Active Borrowers	35,080	35,205	35,080	49,827	10,102	7,694	173,216	82,562	20,038
Percent of Women Borrowers	100.0%	100.0%	100.0%	100.0%	65.7%	46.0%	99.3%	100.0%	51.0%
Gross Loan Portfolio	4,236,905	3,633,590	4,236,905	6,849,516	4,438,677	1,078,219	15,355,347	8,648,133	2,779,661
Average Loan Balance per Borrower	137	127	154	118	456	178	85	106	149
Average Loan Balance per Borrower/ GNI per Capita	50.9%	47.2%	57.1%	18.1%	40.3%	50.3%	18.0%	14.5%	21.6%
Number of Voluntary Depositors	19,359	41,258	9,432	0	0	0	70,659	0	2,778
Voluntary Deposits	245,791	265,647	152,613	0	0	0	514,992	0	53,899
Average Deposit Balance per Depositor	6	7	6	13	251	978	11	99	52
MACROECONOMIC INDICATORS									
GNI per Capita	270	270	270	690	1,280	354	470	730	690
GDP Growth Rate	1.1%	1.1%	1.1%	9.2%	5.1%	14.0%	6.0%	9.2%	5.5%
Deposit Rate	2.2%	2.2%	2.2%	6.0%	5.3%	6.2%	9.1%	6.0%	8.9%
Inflation Rate	7.6%	7.6%	7.6%	5.8%	6.3%	1.2%	6.8%	5.8%	7.9%
Financial Depth	39.8%	39.8%	39.8%	49.2%	37.9%	18.0%	44.5%	66.7%	49.2%
OVERALL FINANCIAL PERFORMANCE									
Return on Assets	0.1%	2.9%	-0.7%	-0.3%	0.9%	-26.9%	2.8%	0.2%	-10.1%
Return on Equity	-1.0%	27.5%	-23.7%	0.4%	4.0%	-27.3%	12.3%	18.4%	-17.4%
Operational Self-Sufficiency	119.7%	149.0%	102.0%	107.0%	115.4%	44.5%	127.1%	109.8%	69.5%
Financial Self-Sufficiency	102.3%	140.1%	94.2%	101.0%	105.7%	44.4%	114.5%	104.1%	63.9%

REVENUES	Nepal MFBs	Nepal MFDBs	Nepal RRDBs	South Asia	Global	Afghanistan	Bangladesh	India	Pakistan
Financial Revenue/ Assets	11.8%	14.7%	11.2%	17.6%	24.7%	18.5%	21.4%	17.7%	17.4%
Profit Margin	2.3%	28.5%	-6.2%	1.0%	5.4%	-125.7%	12.7%	4.0%	-56.4%
Yield on Gross Portfolio (nominal)	18.3%	20.0%	15.0%	23.2%	30.2%	29.6%	23.3%	21.7%	25.3%
Yield on Gross Portfolio (real)	10.0%	11.6%	6.9%	15.5%	22.3%	28.0%	15.4%	15.0%	16.1%
EXPENSES									
Total Expense/ Assets	11.9%	11.2%	11.9%	19.7%	24.6%	46.9%	19.5%	18.3%	27.1%
Financial Expense/ Assets	4.8%	4.7%	4.8%	6.4%	6.3%	4.5%	6.8%	6.7%	7.0%
Provision for Loan Impairment/ Assets	0.2%	0.5%	0.1%	1.0%	1.4%	1.2%	0.8%	0.9%	1.1%
Operating Expense/ Assets	6.2%	6.3%	6.2%	10.6%	15.3%	42.5%	12.2%	8.8%	19.2%
Personnel Expense/ Assets	5.0%	4.1%	5.2%	6.0%	8.3%	25.3%	8.3%	4.6%	12.5%
Administrative Expense/ Assets	1.3%	2.0%	0.9%	4.5%	7.0%	16.4%	3.6%	4.1%	6.9%
Adjustment Expense/ Assets	0.8%	0.4%	1.6%	1.0%	1.6%	0.6%	2.1%	0.3%	2.4%
EFFICIENCY									
Operating Expense/ Loan Portfolio	11.2%	11.0%	12.4%	14.6%	20.1%	70.2%	15.1%	10.4%	39.0%
Personnel Expense/ Loan Portfolio	8.8%	7.0%	10.1%	8.6%	11.0%	36.5%	10.3%	5.3%	20.6%
Average Salary/ GNI per Capita	6.9	6.9	6.9	3.2	4.2	12.7	2.3	2.3	4.6
Cost per Borrower	13	12	16	15	108	101	11	11	68
PRODUCTIVITY									
Borrowers per Staff Member	162	218	150	158	112	87	145	255	99
Borrowers per Loan Officer	240	304	234	240	216	131	202	350	183
Voluntary Depositors per Staff Member	170	261	52	0	0	0	37	0	40
Personnel Allocation Ratio	65.3%	75.6%	65.3%	67.0%	55.0%	64.3%	67.2%	72.8%	51.2%
RISK AND LIQUIDITY									
Portfolio at Risk> 30 Days	4.7%	4.3%	5.4%	1.2%	2.8%	0.6%	1.1%	0.8%	1.1%
Portfolio at Risk> 90 Days	2.8%	1.6%	4.4%	0.6%	1.4%	0.5%	0.6%	0.2%	0.4%
Write-off Ratio	4.2%	1.9%	12.0%	0.7%	1.1%	0.0%	0.9%	0.1%	0.6%
Loan Loss Rate	4.2%	1.7%	12.0%	0.6%	0.9%	0.0%	0.9%	0.1%	0.6%
Risk Coverage Ratio	0.6	0.7	0.6	0.8	0.9	2.0	1.3	0.6	1.1
Non-earning Liquid Assets as a % of Total Assets	11.7%	15.0%	7.1%	5.1%	6.5%	20.2%	4.6%	5.1%	2.5%

About MIX

The Microfinance Information eXchange (MIX) is the leading provider of business information and data services for the microfinance industry. Dedicated to strengthening the microfinance sector by promoting transparency, MIX provides detailed performance and financial information on microfinance institutions, investors, networks, and service providers associated with the industry. MIX works to achieve its mission through a variety of publicly available platforms, including MIX Market (www.mixmarket.org) and the *MicroBanking Bulletin*.

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