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MINISTRY OF
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MONTHLY PROGRESS REPORT
**NEPAL: RURAL FINANCE SECTOR DEVELOPMENT
CLUSTER PROGRAM I**
(July 2009)

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Abbreviations

ADB	Asian Development Bank
ADBL	Agriculture Development Bank Limited
AFMS	Account and Financial Management Specialist
CEO	Chief Executive Officer
CTA	Chief Technical Advisor
CBS	Core Banking System
DGM	Deputy General Manager
GBB	Grameen Bikas Bank
HRIS	Human Resource Information System
HRMD	Human Resource Management Division
HRMS	Human Resource Management Specialist
IT	Information Technology
KPIs	Key Performance Indicators
MOF	Ministry of Finance
MS	Marketing Specialist
NBA	Nepal Bankers' Association
NBTI	National Banking Training Institute
NRB	Nepal Rastra Bank
PPTA	Project Preparatory Technical Assistance
RFSDCP	Rural Finance Sector Development Cluster Program
SFDB	Small Farmers' Development Bank
STI	Second Tier Organization
TA	Technical Assistance

1. Summary

1. Most of the activities initiated under the Rural Finance Sector Development Cluster Program I (RFSDCP I) in July 2009 centered around institutional restructuring and reform of the Agriculture Development Bank Limited (ADBL) and the Small Farmer's Development Bank (SFDB) Limited; and only limited activities undertaken in other components of the Project.

2. Contract of Banking and IT Specialist ended in June 2006 and IT Project Manager was recruited in July 2009 with the responsibility to finalize Core Banking System (CBS) procurement and support its installation and operation. Other consultants namely marketing specialist (MS), accounting and financial management specialist (AFMS), human resource management specialist (HRMS) and microfinance and banking operation specialist (MBOS) recruited under project grant continued providing technical support to ADBL and SFDB.

3. PPTA team engaged on the design of RFSDP II continued their work through after mobilizing the international Team Leader and Microfinance and Bank Operation specialist; and four national consultants on (i) Financial Analysis, (ii) Management Information System, (iii) Human Resource Development and (iv) Banking Business Development. The team has completed review of RFSDCP I, submitted inception report and currently defining scope of RFSDCP II. International Microfinance and Banking Operation Specialist of the team provided technical support to Nepal Rastra Bank (NRB) to operationalize concept of Second Tier Institution (STI) and to privatize insolvent Grameen Bikas Bank (GBB) located in the far-west.

4. Technical Assistance (TA) team under TA 4857-NEP (Supplementary) were mobilized on 16 July 2009 with Team Leader, Treasury Specialist, Risk Management Specialist, Business Process and Portfolio Management Specialist and Training Specialist. The teams are currently working on site at various divisions within ADBL. Other team members provisioned under this TA namely Rural Finance Regulation Specialist (international), MIS Specialist (International) and Trade Finance Specialist (national) are yet to be mobilized.

5. Key outputs produced in July 2009 includes: (i) design of new organization structure for ADBL, (ii) concept paper for human resource information system, (iii) branch financial reporting format, and (iv) marketing plan (draft) for ADBL and draft proposal for extending microfinance services in hills and mountains for SFDB and other financial service providers.

2. Component-wise Progress

6. A discussion on status of progress under five components: (i) favorable policy environment, (ii) institutional restructuring and reforms, (iii) supportive legal and regulatory framework, (iv) sector capacity building and (v) product and process innovations of RFSDCP I in July 2009 follow hereunder.

2.1 Favorable Policy Environment

7. Discussions and dialogues with key stakeholders in the sectors continued in July 2009 on Microfinance Act drafted by NRB consistent to the Microfinance Policy 2008. The monetary policy 2009 announced by the NRB provided due importance to the need of the additional loan fund for rural and microfinance sector and made it mandatory requirement for the commercial banks to lend at least 3% of their total deposits in the deprived sector and increased the deprived sector lending requirements of the development banks from 1.5% to 2.0% of total deposits and that of the finance

companies from 1% to 1.5% of the total deposits. This policy is likely to inject additional loan fund in rural and microfinance sector. Further, budget speech of the government as well as monetary policy 2009 policy has expressed their commitment to bring huge negative net-worth of three state-owned commercial banks into positive within current fiscal year.

2.2 Institutional Restructuring and Reforms

8. RFSDCP I focused on institutional re-structuring and reforms of ADBL, SFDB and GBBs in July 2009 as outlined hereunder.

2.2.1. Agricultural Development Bank Limited

9. Reforms activities were undertaken in ADBL through the services of the consultants recruited under (i) project grant, (ii) PPTA TA 7196 NEP and (iii) TA 4857 NEP (supplementary). Activities undertaken by these consultants are discussed hereunder.

10. Under project grant, ADBL used 0.5 person month services of an international consultant [Chief Technical Advisor (CTA)] and full month services of three national consultants: Human Resource Management Specialist (HRMS), Marketing Specialist (MS), and Account and Finance Management Specialist (AFMS). Consultants were involved on assisting the bank to bring changes on various aspects of its operation.

11. The CTA continued mentoring the works performed by three national consultants (HRMS, MS and AFMS) in order to assure the quality of the outputs produced. The CTA supported the CBS installation process, mainly on negotiating a contract with the preferred bidder and supporting the recruitment of IT Project Manager. Preferred bidder agreed to extend the price validity to allow the ADB decision process by 42 days while the selected IT Project Manager will be mobilized from August 1, 2009.

12. The HRM Specialist (HRMS) completed and submitted report on rationalization of organizational structure that take into account aspects such as vision, mission, objectives and work nature, career development opportunities for employees and possible changes and reforms in future. The report contains issues and problems related to existing structure, guiding principles for new structure, key features of new structure; objectives, functions and structure of head office, regional offices and branches, classification of employee levels and positions and illustrative functional job titles. HRMS also submitted a draft report on human resource information system (HRIS) in ADBL to Human Resource Management Division (HRMD) and is currently in the process of its finalization. Regarding system development, since HRIS module is not being a part of the CBS due to price factor and developing system internally is less likely, there is a need of a coordinated effort between HRMD, IT Division and General Service Division on identifying the vendor from the market. Further, HRMS continued collecting suggestions on staff rules and also drafted the sections such as recruitment, promotion, performance evaluation, etc. to be included in the staff rules.

13. Marketing Specialist (MS) continued working with Planning Division Chief and is preparing marketing plan for ADBL in collaboration with marketing section. MS has also suggested the marketing tools for the development of new products and services better adapted to the needs of the market. The plan tries to determine the target segments the bank should address, refine this knowledge into a marketing plan to guide business managers in formulating business plans.

14. Account and Finance Management Specialist (AFMS) has drafted the Investment Policy and handed-over to the Treasury Specialist who is working under TA 4857 NEP

(supplementary) since July 16, 2009. AFMS drafted (i) branch financial reporting format considering the requirement of the commercial bank's business operation including performance monitoring aspects, (ii) finalized payment procedure manual and (iii) drafted accounting manual related to staff expenditure and advances. AFMS advised account department to book (i) additional provision amount equivalent to additional provisioning required to categorize Bank's current restructured/rescheduled loans as sub-standard loan as a cushion for Bank so as to report Bank's net profit in a comfortable manner, and (ii) preference dividend payable to the Government on redeemable preference shares of Rs. 2.30 billion which has already been approved by ALCO held on 31.7.2009.

15. PPTA (TA 7196 NEP) team continued their work through the mobilization of international Team Leader; and four national specialists on (i) Financial Analysis, (ii) Management Information System, (iii) Human Resource Development and (iv) Banking Business Development. The TA team has completed the review of RFSDCP I, are working closely in consultation with the ADBL concerned department. The team has submitted inception report and currently defining the scope of RFSDCP II.

16. Under TA 4857 NEP (supplementary) consultant team comprising of international team leader and national consultants (treasury specialist, risk management specialist, business process and portfolio management specialist and training specialist) was mobilized on 16 July 2009 and mobilization of international rural finance regulation specialist and MIS specialist and national trade finance specialist has been delayed. The consultant team met with CEO, DGM operations and DGM services, company secretary, director PIU, Division Chiefs (IT, general services, HRM, banking, credit, planning, finance and accounting). The team also discussed with PPTA team to exchange documents, information and opinions and they are provided with office accommodation and basic furniture. Each members of the TA team signed confidentiality letter and deposited in with PIU. Team members have requested essential documents from their respective Division Chiefs; in addition, a formal request to access to information, with a list of essential documents, has been made to CEO. Each team member is currently developing a picture of the position in their respective field and in Treasury and Risk Management some advance has been made to bring change and innovation into effect.

2.2.2.Small Farmers Development Bank

17. Microfinance and Banking Operation Specialist (MBOS) continued providing technical support to SFDB to implement the restructuring plan. In July 2009, MBOS presented best practices of managing community based organization (CBOs) in the workshop of weak performing and problematic SFCLs and compiled progress as of July 16, 2009 of SFDB as per the recommendations provided by restructuring plan 2005 and identified/prioritized activities to be implemented in line with restructuring plan and business plan. In addition, MBOS drafted lending guidelines that includes minimum criteria and key performance indicators (KPIs) of client MFIs to be eligible for wholesale loan from SFDB, loan approval authority, supporting documents, loan security, supervision and follow-up, etc. and shared with BOD of SFDB. Further, MBOS prepared initial draft proposal for enhancing access to financial services in the hills and mountains, which is currently being discussed on SFDB management.

2.2.3.Grameen Bikash Banks

18. Outreach related information and audited income statement and balance sheet of all five Grameen Bikash Banks (GBBs) for the FY 2005/06, 2006/07 and 2007/08 were collected in July 2009 to analyze historical trend on outreach indicators and operational and financial performances. Despite the changes in governance of these GBBs, preliminary assessment of their operational and financial analysis uncovered that there

has been marginal improvement on operational and financial performances of three GBBs even after privatization and they requires technical assistance on aspects such as productivity management, operational risk management, human resource management and diversification of products and services in order to enable them fulfill their corporate social responsibilities. International Microfinance and Banking Operation Specialist of the PPTA team provided technical support for the privatization of insolvent Grameen Bikas Bank (GBB) located in the far-west.

2.3 Supportive Legal and Regulatory Framework

19. The Government and NRB continued discussion on draft Microfinance Act on different forum among key stakeholders including creation, operation and management of microfinance fund and STI. International Microfinance and Banking Operation Specialist working in the PPTA team provided technical support to operationalize the concept of STI. Further, challenges inherent to regulation and supervision of different types of credit union (single purpose and multi-purpose) is on-going to identify the most practical and operable approaches.

2.4 Sector Capacity Building

20. The CTA has been working with the executive committee of the Nepal's Bankers Association (NBA) to recruit the Chief Executive Officer (CEO) and international training specialist for National Banking Training Institution (NBTI). In order to recruit the CEO for NBTI, advertisement was placed in local media, on non-resident Nepali websites and in the Economist on 17 July 2009. The deadline for the applications is 17 August 2009. Several applications from both locals and from overseas received at NBA. Work to recruit the international training specialist has been currently suspended until the recruitment of the CEO for NBTI.

21. The most recent NBTI Board meeting decided that application for the license to operate as an education institution be made in concern authorities and asked the CTA to make enquiries about process and cost for NBTI to obtain the license. Further, CTA was asked to draft NBTI business plan and training plans and revise earlier ADB contribution drawdown schedule. CTA has almost completed the draft business and training plans. Drawdown schedule derives from business and training plans will be revised once business and training plans are completed.

2.5 Product and Process Innovations

22. There has not been any breakthrough on product and process innovations. Microfinance and Bank Operation Specialist working in SFDB has prepared a draft proposal for extending microfinance services in hills and mountains for SFDB and financial service providers. PPTA team has identified the need for product based costing including the diversification of financial products and services suitable for inaccessible hills and mountains areas.

3. Key Outputs of July 2009

23. Key outputs produced in the month of July 2009 are the following:
- *Design of new organization structure for ADBL:* The report contains issues and problems related to existing structure in ADBL, guiding principle for new structure, key features of new structure; objectives, functions and structure of head office, regional office and branches, classification of employee levels and positions and illustrative functional job titles.

- *Concept paper for human resource information system:* The report contains system analysis and information to be included in the HRIS and challenges and way-forward for automation of HRIS in ADBL.
- *Branch financial reporting format:* The report considers requirements of the commercial bank's business operation and performance monitoring aspects.
- *Marketing plan (draft) for ADBL:* The report identifies the core-competencies of ADBL and analyse the internal and external environment under which ADBL should operate and suggest strategies for future in order to serve the market segments on which it needs to operate.
- *Draft proposal for extending microfinance services in hills and mountains for SFDB and other financial service providers:* The report documents challenges to enhancing financial services in inaccessible hills and mountains and recommends the community based banking and linkage banking scheme to be the options for expanding frontier of microfinance services in high hills and mountains for further discussion.
- *Inception Report of PPTA TA 7196 NEP:* The PPTA (TA 7196 NEP) team submitted the inception report that critically analyse the performance of the RFSDCP I and present the scope of RFSDCP II.

4. Conclusions

24. Implementation of RFSDCP I in July 2009 is generally satisfactory with the exception of components such as (i) favorable policy environment, (ii) supportive legal and regulatory framework and (iii) product and process innovations. Since the Implementing Agency (IA) for these components is NRB, there is a need to prepare time bound action plan for timely implementation of project activities under these components.

25. Technical support provided by a number of international and national consultants on different aspects of ADBL and SFDB management has not been properly absorbed and transform on their enhanced operational and financial performance. Division Chief and staff of the concerned divisions should be fully aware on the type of output that the consultant is expected to produce and extent to which this will meet their expectations and priorities. Ownership of the consultant's work by concerned divisions should be ensured for enhanced effectiveness and efficiency.

26. Both Ministry of Finance (MOF) and NRB lack clarity on operational mechanism and amount of RFSDCP support for the establishment, operation and management of NBTI. There is a need to increase awareness of the MOF and NRB on the ADB contribution drawdown schedule.

27. Despite huge demand and need for product and process innovations component to expand the frontier of rural finance services in inaccessible hills and mountains, scope of this component has been narrowly defined. Scope of work under this component should be revisited and expanded to cover activities such as new product development, diversification of products and services and expansion of services in inaccessible hills and mountains where enhancing access to financial services has been a challenge to different financial service providers.