

**Microfinance for Small Scale Tree and Forest Products Enterprises:
Opportunities and Challenges for the Local Producers in Forestry Sector**

Nepal Microfinance Case Study

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**Influencing Policy and Good Governance in NRM Sector: Focusing on
Community Forestry and NTFP Sub-sectors in Nepal**

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ABSTRACT

With 39.6% forest coverage and rich biodiversity, Nepal is promoting community-based forest management. Community forestry has been successful to protect over 1 million hectares of forests with over 13,000 community forest user groups in which more than a third of its total population of 23 million is involved. According to HMGN statistics in 2004, about 30% of the population lives below the poverty line. Among other forest resources, NTFPs are a part of livelihoods in Nepal, especially for the poor in mountains. In 2002, Nepal exported NTFPs worth over Rs. 2,546 million. A tremendous potential exists to develop small and micro-enterprises in forestry sector by linking it to microfinance services. As of mid January 2004, Rs. 24,715 million is disbursed as micro-credit to 727,000 households, which is only 45% of the estimated households below the poverty line, but not all households reached are below the poverty line.

To identify the opportunities and constraints of forest-based small and micro-enterprises and analyze the scope of microfinance in enterprise development, Parbat district, which is successful to develop many forest-based micro-enterprises, was chosen for a case study. Parbat is located in the hills of western development region of Nepal and the population of the district is 157,826 with a total GDP of Rs. 3,366 million; 90.8% of population is dependent on agriculture and the district is heavily supported with the foreign employment and pension (37.9% of the total GDP). Forestry sector, mostly NTFPs contributes 11.5 percent to its domestic GDP, which still seems to be underutilized given the vast resources of the district.

Although there are several banks, micro-finance institutions, NGOs, saving and credit groups in Parbat, a few provide credit to forest-based enterprises. MEDEP and LFP play major role in promoting forest-based enterprises in Parbat. With the support of MEDEP and a total micro-credit of Rs. 2.9 million, a total of 673 micro-enterprises have been established, of which 240 are forest-based. Similarly, with a total of Rs 458,156 micro-credit flow through CFUGs, LFP has supported to establish 73 micro-enterprises, of which 33 are NTFP-based. The total amount of micro-credit investment needed in forest-based enterprises in the district is estimated to be Rs. 23 million. Despite these efforts and micro-credit flow, the gap in demand and supply of micro-finance services is enormous. Providing micro-credit to forest-based enterprises, mostly located in rural mountains, is rather challenging due to high management cost, little experience and knowledge in forest-based enterprises, and unclear and restrictive policy provisions.

The major constraints faced by the poor entrepreneurs in accessing micro-credit is the lack of collateral and the risks associated with the forest-based enterprises, such as controlling government policy, uncertainty in supply of raw materials, difficulty in access to technology and market information. However, micro-finance is not the only constraint in enterprise development. Provision of entrepreneurship development and capacity building programs, appropriate technology, market information and linkages, and policy incentives should be accompanied with the micro-finance to promote the enterprises. In addition, linkages of CFUGs, saving and credit groups, and other MFIs to micro-entrepreneurs is required to broaden the scope of forest-based enterprises to poverty reduction while promoting sustainable forests management. It is evident from the study that the selection of right entrepreneurs and enterprise options, provision of business development services, and continuous follow up and counseling are a key to the success of enterprise development programs.

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LIST OF ABBREVIATIONS

ADBN	:	Agriculture Development Bank of Nepal
AFO	:	Administrative and Finance Officer
AIPRA	:	Appreciative Inquiry Participatory Rural Appraisal
ANSAB	:	Asia Network for Sustainable Agriculture and Bioresources
BDS	:	Business Development Service
CB	:	Commercial Bank
CBOs	:	Community Based Organisations
CEBUD	:	Centre for Business Development
CFUGs	:	Community Forest User Groups
CO	:	Community Organisations
CSD	:	Centre for Self-Help Development
CSIDB	:	Cottage and Small Industry Development Board
CSIO	:	Cottage and Small Industry Office
CSO	:	Civil Society Organization
DANIDA	:	Danish International Development Agency
DCCI	:	District Chamber of Commerce and Industry
DCSI	:	Department of Cottage and Small Industry
DDC	:	District Development Committee
DEPROSC	:	Development Project Service Centre
DFID	:	Department for International Development (UK)
DFO	:	District Forest Office/Officer
DLGSP	:	Decentralized Local Governance Support Program
DPIC	:	District Program Implementation Committee
DPIO	:	District Program Implementation Office
DPM	:	District Program Manager
EDF	:	Enterprise Development Facilitator
EDO	:	Enterprise Development Officer
EDP	:	Enterprise Development Plan
FCs	:	Finance Companies
FECOFUN	:	Federation of Community Forestry Users, Nepal
FI-NGOs	:	Financial Intermediary Non-Government
FNCCI	:	Federation of Nepalese Chamber of Commerce and
FNCSI	:	Federation of Nepal Cottage and Small Industries
GDP	:	Gross Domestic Product
HMGN	:	His Majesty's Government of Nepal
IEDI	:	Industrial Enterprise Development Institute
ILO	:	International Labour Organization
		Industry
IPO	:	Implementing Partner Organization
KW	:	Kilo Watt
LFP	:	Livelihoods and Forestry Programme
LTFB	:	Local Trust Fund Board
MA&D	:	Market Analysis and Development
MCs	:	Market Centres
MECD	:	Micro-Enterprise Creation and Development
MEDEP	:	Micro-Enterprise Development Program
MEG	:	Micro-Entrepreneurs Group

MF	:	Micro Finance
MFI	:	Micro-finance Institute
MOFSC	:	Ministry of Forest and Soil Conservation
MOICS	:	Ministry of Industry, Commerce and Supplies
MoU	:	Memorandum of Understanding
MSEs	:	Micro and Small Enterprises/Entrepreneurs
NARMSAP	:	Natural Resource Management Sector Support
NBL	:	Nepal Bank Limited
NGOs	:	Non-Government Organizations
NIDC	:	Nepal Industrial Development Corporation
NPSO	:	National Program Support Office
NRB	:	Nepal Rastra Bank
NTFPs	:	Non-Timber Forest Products
NUB	:	Nirdhan Utthan Bank
NUKCFP	:	Nepal-UK Community Forestry Project Organization
PCRW	:	Production Credit for Rural Women
PCs	:	Program Centres
PDDP	:	Participatory District Development Program
PLs	:	Program Locations
PMC	:	Program Management Committee
PRA	:	Participatory Rural Appraisal Programme
PSC	:	Program Steering Committee
RBB	:	Rastriya Banijya Bank
REDP	:	Rural Energy Development Program
RMDC	:	Rural Micro-finance Development Centre
RMFDB	:	Rural Micro-finance Development Board
RRA	:	Rapid Rural Appraisal
RRDBs	:	Regional Rural Development Banks
Rs	:	Nepalese Rupees
SCCs	:	Savings and Credit Co-operatives
SCOs	:	Savings and Credit Organisations
SDTC	:	Skill Development Training Centre
SFDP	:	Small Farmers Development Project/Program
SHGs	:	Self-Help Groups
SIYB	:	Start and Improve Your Business
SLF	:	Sustainable Livelihoods Framework
SM	:	Social Mobilizer
UNDP	:	United Nation Development Program
VDC	:	Village Development Committee
WUG	:	Water Users Group

1. BACKGROUND

The total forest area coverage in Nepal is about 39.6 percent at the end of the Ninth Five-Year Plan (NPC 2002). The Tenth Five Year Plan has recognized that not only conservation and management of forest by community is essential but also utilization of forest resources are necessary for poverty alleviation through the promotion of forest-based micro and small enterprises, and a quantitative target of establishing 500 forest-based enterprises by very poor and socially excluded families of community forest has been set for the period. The other quantitative targets set by the plan are income generation programs for 253,000 households in community forest and 25,680 households in leasehold forests generating full time employment for about 12,130 persons.

Nepal has been applying approach of community based forest management showing a successful example in the world. At present there are 13,079 community forests managed successfully by Community Forest Users Groups (CFUG), representing more than a third population of the country's 23 million people. Forest-based enterprises draw most of the raw materials from the community managed forest and adjoining government forests in Nepal.

Earlier studies of several investigators reveal that 1000 species of plants, comprising over 14% of the known vascular plant species of the country, are recorded for economic use (**Table 1**). Current estimates show that the number is still greater in Nepal. People estimate many additional number of plant species are used in Nepal. Among these over 700 species are used for medicinal purpose, 440 species for wild food, 30 species for spices, 71 species for fiber, 50 species for fish-poisoning, and over 100 species for fodder. In Mountains and other Himalayan areas of Nepal, forest and other natural vegetation have been used extensively for timber, fodder, firewood, leaf litter, medicines, foods, spices, fibers, tannins, gums, resins, fatty oils, dyes, incense, cosmetics, building materials, and agricultural implements.

Table 1. Number of Plant Species Recorded by Economic Uses in Nepal

Economic Uses	Number of species
Medicine	700
Wild food	440
Essential oils	238
Fodder	100
Fibre	71
Fish-poisoning	50
Spices	30
Total	1000

Source: Malla and Shakya 1984; HMG 1982; HMG 1982; HMG 1984.

Note: As many of the species have multiple uses, the total is 1000 though the sum is 1629.

Besides these economic uses, many plants have also been used for cultural purpose, such as parts of plants (leaves, flowers, fruits, roots and rhizomes) or standing trees in rituals and worships. For many of the uses, the local demand requires only a small amount, but many of the species are used for more than one purpose and are in high demand even at local level. For example, some commercially traded plants are also used for local medicine and incense making. The most notable products in the mountain Nepal are insect galls on *Pistacia integerima* and roots and rhizomes of *Neopicrorhiza scrophulariflora* and *Nardostachys grandiflora*. According to Subedi (2004), of the 161 NTFP species that are traded in and from the country, only few products are exported after some value-added processing and most

products without much processing except cleaning, drying and in very few cases grading. The total value of these products based on the selling price at two major cities of Nepal (Nepalgunj and Kathmandu) is estimated to be about Rs. 2.5 billion (equivalent to nearly US \$35 million) every year (**Table 2**). Of these, some notable products found in the hills and mountains include yarshagumba (*Cordyceps sinensis*, an Ascomycete fungus, grown on the head of a moth larva), dried morels (*Morchella* spp. - members of Ascomycete), handmade paper and products from lokta (*Daphne* spp), *Dactylorhiza hatagirea*, *Podophyllum hexandrum*, *Taxus* leaves, chiraita (*Swertia chirayita*), timur (*Zanthoxylum armatum*), jatamansi (*Nardostachys grandiflora*), sugandhwal (*Valeriana jatamansi*), atis (*Delphinium himalayai*), and kutki (*Neopicrorhiza scrophulariiflora*). However, many other types of NTFPs such as bamboo and rattan, allo, and tree leaves and fruits are used locally.

Table 2. Export Quantity and Value of Major NTFPs of Nepal in 2001/2002

Products	Value in '000 Rs	Volume in MT
NTFPs in crude form (43 major species)	892,519 (35%)	5009
Large cardamom	1,160,000 (46%)	5800
Lokta handmade papers and its products	275,375 (11%)	-
Pine resin	108,000 (4%)	6000
Essential oils	50,559 (2%)	23
Allo and hemp products	43,675 (2%)	-
Incense	16,503 (1%)	-
Total	2,546,631 (100%)	

Source: Subedi 2004

There are a number of financial institutions in Nepal that deal with micro-finance services, some of them are solely providing micro-finance services and others have a component of micro-finance among other services. As of mid January 2004, the total disbursed amount of micro-credit was Rs. 24,715 (US \$338.5) million to 727,000 households (Sharma 2004). Based on the one family one borrower principle of microfinance reaches 17.1 percent of the total households (4,253,000) in Nepal (CBS 2002). Out of total micro credit flow, total repayment as of January 2004 is Rs. 19,251 (US \$273.7) million (**Annex 1**). So far there is no segregated data available on how much was invested in forest-based micro and small enterprises. However, at the end of the Ninth Five Year Plan (2002) 38 percent of the population is still living below national poverty line (30% as per 2004 HMGN statistics) and that means still 1,616,140 households fall below the national poverty line. It indicates that microfinance services have reached to about 45 percent of households below poverty line and there is still the need for micro-credit to reach to remaining 55 percent of the households.

The most prominent financial institutions that deal with the micro-finance services in Nepal are listed below which are classified into three categories namely: *Formal*, *Semi-Formal*, and *Informal*. The type of participants and their numbers by category, as of mid January 2004 are as follows (see **Annex 1** for details):

Formal

- Commercial Banks: There are 17 commercial banks in Nepal and they have very small business in micro-finance.
- Development Banks: There are 11 development banks including Agriculture Development Bank of Nepal (ADB/N) and Nepal Industrial Development Corporation (NIDC). Among these only ADBN provides micro-finance services to poor households.

- Rural Micro-finance Development Banks (RMFDB): There are 11 RMFDBs including five Regional Rural Development Banks (RRDBs). RRDBs are operating mostly in Terai of five development regions of Nepal one set up in each development regions. Other RMFDBs are Deprosc Development Bank, Nirdhan Utthan Bank (NUB), Swabalamban Development Bank, Chhimeki Development Bank and Small Farmers Development Bank. All these banks are mostly trying to be the replicas of Grameen bank model of Bangladesh. However, some of them have done substantial modification in the financing systems to adapt to the local situations. All these banks provide micro-finance services to the rural poor.
- Finance Companies (FCs): There are 58 FCs in the country that provide services in finance sector but very few are oriented towards micro-finance services.
- Rural Micro-finance Development Centre (RMDC)

Semi-Formal

- Savings and Credit Cooperatives (SCCs): There are 2,800 SCCs scattered all over the country for providing micro-finance services mostly in the rural areas of Nepal.
- Financial Intermediary Non-Governmental Organizations (FI-NGOs): There are 44 FI-NGOs in Nepal recognized by and registered under Nepal Rastra Bank (NRB) under the "Financial Intermediary Society Act 1998". One of the component of activities of these FI-NGOs is to provide micro-finance services to the rural poor of Nepal.

Informal

- Savings and Credit Organizations (SCOs): There are more than 12,000 SCOs, some of which are registered and others not, but all of them provide micro-finance services.
- Shelf-Help Groups (SHGs): There are many SHGs operating in Nepal and there are no such authentic records of such groups. They provide micro-finance services mostly getting fund from the donors and their own savings.
- Dhukuti, Guthi (Trust), Dharma Bhakari, Bheja, etc: The numbers cannot be estimated and these are also non-formal financial institutions operating in a particular community for credit operation not necessarily the micro-finance services.
- Local Money Lenders, Landlords, Merchants, Traders, Goldsmiths, Friends and Relatives: Their numbers cannot be estimated but these are the most common sources of credit not necessarily the microfinance to enterprises.

Most of the micro-finance policies in Nepal are governed by the Financial Intermediary Society Act 1998 with amendments in 2004. Some of the pertinent policies adopted by the micro-finance institutions in Nepal are (Devkota 2001):

- Invest micro-credit only to the people living below national poverty line;
- Give priority to the underprivileged segment of the communities;
- Provide micro-credit based on peer lending, that is group collateral basis;
- Follow simple procedure of lending;
- Repayment of micro-credit on installment basis, for example repayment at weekly, monthly, or bi-monthly interval depending upon the nature of enterprises.
- Impart the loan as per borrowers' need in size, purpose and terms, but not exceeding the upper limit fixed;
- Fix interest rates as per guidelines and policies of the government. However, the SSCs, SCOs and SHGs fix the interest rate in their own decision.

2. INTRODUCTION OF CASE STUDY

To identify the opportunities and constraints of forest-based small and micro-enterprises and analyze the scope of microfinance in enterprise development, Parbat district, which is successful to develop many forest-based micro-enterprises, was chosen for a case study. The main reason for selecting this district as a case is that there were many NTFP-based enterprises being established and operated by below poverty line communities with the support of microfinance services. There were some innovative approaches of enterprise establishment which had both success and failure stories. Parbat district is one of the 75 districts of Nepal. It lies in the hills of Western Development Region. There are 55 Village Development Committees (VDCs) and 11 Ilaka. There are two constituencies that elect the members of the parliament (DDC 1998). The total population of the district is about 157,826 with 53.8 percent female (CBS 2001). The altitude ranges from 1,700 to 10,700 feet above mean sea level and the total area is 536.86 sq. km. The ethnic and caste diversity is high in the district. The main caste and ethnic groups are Brahman, Chhetri, Thakuri and Giri-Puri, considered to be the upper castes, Newar, Magar, Gurung, Kumal, Bote and Thakali belonging to indigenous communities, Darji, Bishwakarma and Sarki, considered to be dalits, and some Muslims.

Agriculture is the mainstay of the people of Parbat district and 90.82 percent of the total population is dependent on agriculture. The total GDP of the district is Rs. 3366.242 million and the contribution of different sectors are presented in **Table 3**.

Table 3. Breakdown of total GDP of Parbat.

S. N.	Item	Total Production	
		In Rs. millions	Percent contribution
1.	Agriculture	911.057	43.64
2.	Livestock	434.884	20.83
3.	Forest	240.000	11.50
4.	Mining	25.000	1.20
5.	Industry	50.000	2.39
6.	Construction	6.7000	0.32
7.	Electricity and Water Resources	6.000	0.29
8.	Trades	200.000	9.58
9.	Transport and Communication	8.000	0.38
10.	Financial services and Real Estate	1.000	0.05
11.	Community Services	205.222	9.83
12.	Total domestic GDP	2,087.863	100.00
13.	Domestic GDP	2,087.863	62.03
14.	Foreign Employment and Pension	1,278.379	37.97
	Total	3,366.242	

Table 3 shows that the domestic GDP is 62.03% and remittance is 37.97% indicating that the economy of Parbat is still heavily dependent on remittance. At present, the contribution of forest sector is not significant, accounting only to Rs. 240 millions, which is about 11.5% of total domestic GDP. However, taking into account of the vast forest resources available, it seems that very little efforts have been made for utilizing the forest resources. For this, the concepts of CFUGs on conservation and management would be oriented towards developing forest-based enterprises linking to formal sector micro-finance services as well as other BDS, such as entrepreneurship development, skill development, market linkages, and technology transfer.

The microfinance institutions operating in Parbat district are ADBN, FI-NGOs, SCCs, SCOs, SHGs and Commercial Banks. As is in the national context, very few institutions provide credit to NTFP-based micro-enterprises. This is mainly due to the lack of collateral available to poor entrepreneurs and a lot of uncertainties in terms of market, restrictive NTFP policy, and supply of raw materials. However, there are a number of donors funded and government supported projects and programs working in the district for poverty alleviation and a few of them are working in the area of microfinance; 15 local NGOs are actively involved in social mobilization, savings generation and credit operation, disbursing micro-finance to poor people. However, none of the NGOs were exclusively working for the promotion of enterprises. The entry of these NGOs into community typically starts with group formation and savings and credit operation, which is usually the practice of all NGOs nationwide as well. The organizations and projects and programs, which have noticeable activities on enterprise development can be categorized into the following three headings.

- Projects/NGOs: Micro-Enterprise Development Program (MEDEP), Rural Energy Development Program (REDP), Participatory District Development Program (PDDP)¹, Livelihoods and Forestry Programme (LFP), NGOs providing microfinance services.
- Government programs: Cottage and Small Industry Development Board (CSIDB), Skill Development Training Centre, Women Development Section (WDS).
- Financial institutions: Agriculture Development Bank of Nepal (ADBN), Rastriya Banijya Bank (RBN), Nepal Bank Limited (NBL).

There are two major programs aiming at enterprise development and financial services to forest dependent poor communities in the district. MEDEP exclusively focuses on enterprise development linking entrepreneurs to micro finance services. LFP is working with District Forest Office (DFO) and Community Forest Users Group (CFUG) focusing on community forest management including financial assistance to CFUGs for establishing NTFP-based enterprise development. **Table 4** provides a list of forest-based enterprise types in Parbat.

Table 4. Types of forest-based enterprises and their numbers, scale, products and sources of raw materials in Parbat district.

Enterprise Type	No. of entrepreneurs	Enterprise Category	Products	Sources of raw materials
a. Furniture industry	13	Small	Chairs and Tables, Sofa Set, Dining Table, Tea Table, Bed Palang, Almirha, Window and Door Frames, etc.	Community forests and suppliers from outside district
b. Beehive manufacturing	1	Small	Beehive main frames, queen chambers	Private and community forests
c. Allo processing	35	Micro	Cloths, West-coat, Coat, Bhangra, Bag, Sack, Table cloth, Porter Strap, Blanket, Shawl, Muffler, Cap, etc.	Community, private and national forests
d. Beekeeping	101	Micro	Honey, breeding colony, wax, etc	Forest plants and cultivated crops
e. Leaf plate making	1	Small	Large, medium and small plates (Tapari, Bota and Duna)	Leaf of Sal tree from community and national forests
f. Lapsi processing	33	Micro	Candy, Mada, Sweets, Pickle and Achar	Private land and forests

¹ Recently, PDDP's name has been changed to Participatory Decentralised Governance Program (PDGP)

g. Bamboo and nigalo Crafts	49	Micro	Furniture, Doko-Namlo, Bhakari, decorative items	Private land
h. Ketuky processing	1	Small	Natural fibre, Dori, Knot crafts, Tying rope, etc	Private marginal and barren land
i. Chiraito production	1	Micro	Dried Chiraito	Forest and cultivated lands
j. Broom making	9	Micro	Broom	Private, national and community forests
k. Pine needle crafts	5	Small	Decorative items and table plate	Community and national forests
l. Incense stick making	1	Micro	Incense sticks with different scents	Private land and local resources; the scent is imported from India
m. Lokta processing	1	Small	Nepali paper	Community and national forests
n. Soap manufacturing	1	Small	Soap	Community and national forests; Chyuri oil imported from Pyuthan and Dang districts of Nepal

As the private financial institutions find too risky to flow credit to the NTFP subsector, especially the poor, these two programs have tried different approach and strategies to extend financial services to the poor entrepreneurs in the district.

Micro-Enterprise Development Program (MEDEP): MEDEP is a program implemented by His Majesty's Government of Nepal (HMGN), Ministry of Industry, Commerce and Supplies (MOICS), with technical and financial supports of the United Nations Development Program (UNDP). The UNDP's role in the program has been to help the government in its endeavor to create income and employment generating opportunities through micro-enterprise development to reduce poverty. This pilot program was initiated in 1998 and is being implemented in 20 districts of the country, and Parbat is one of them. The primary target beneficiaries are the families living below the poverty line².

The approach to developing micro-enterprises by MEDEP has been longitudinal, that is delivering a package of services in a sequential order leading up to the establishment of sustainable enterprises operated and managed by the poor. In previously designed programs, the focus was either on training or micro-credit. The program's approach to enterprise development has been entrepreneurship development followed by market study, skill development, micro-credit, providing access to appropriate technology and business counseling. MEDEP has tried to adopt all components of business development services (BDS) such as entrepreneurship development, skill development, micro-credit, linking to market, developing sub-contracting system and policy feedback to the government. Except for the mobilizing the savings from the group members for micro-enterprise development, MEDEP practically does not have any program to mobilize voluntary savings. Though it has realized the importance of other microfinance services like micro-insurance and payment services, the program has not yet covered these services in its initial microfinance based enterprise development efforts.

In the past five years or so MEDEP in Parbat district has made good progress against the target of 600 micro-entrepreneurs. The project had established about 673 micro-entrepreneurs

² The poverty line as per definition of National Planning Commission is the per capita income of Rs. 6,400 (approximately equivalent to US \$ 88) to purchase food items that supplies 2250 Kcalorie per day and some non food items based on 2003 prices. As per international definition it is one dollar a day per capita income based on PPP.

in the rural area of the district during the five-year period (See **Table 5**). Of these, 35.6% or 240 entrepreneurs were forest-based. Except beehive manufacturing, other micro-enterprises are NTFP-based such as Allo processing³, Lapsi⁴ processing, beekeeping, Bamboo and Nigalo crafts, leaf plate making, Ketuky (Agave plant) processing, Chiraito cultivation, and incense stick making.

The total micro-credit disbursed was Rs. 2.9 million (US \$39,800) in the district and their recovery rate is 93.7%, whereas 38% of the total micro-credit was disbursed in forest-based enterprises is Rs. 1.1 million (US \$15,253) with an excellent recovery rate of 99.7 percent showing a very good prospect of promoting forest-based enterprises in the district. The all forest-based micro-entrepreneurs received micro-credit to develop or expand their enterprises. The forest-based enterprises are mostly micro in size, and received an average of Rs. 4,300 (US \$59) as micro-credit. The entrepreneurs are self employed and manage their enterprise by themselves. The average number of employment per enterprise was about 1.1 persons. **Table 6** provides the details on micro-enterprises and the micro-credit flow in the district.

Table 5: Number and type of entrepreneurs supported by MEDEP and LFP in Parbat

Programs	Total Entrepreneurs	Forest based Entrepreneurs	NTFP-based Entrepreneurs	Entrepreneurs using credit facilities (total)	Entrepreneurs using credit facilities (forest-based)	Entrepreneurs using credit facilities (NTFP-based)
MEDEP	673 (673)	240 (240)	239 (239)	673	240	239
LFP	331 (73)	210 (46)	197 (33)	331	210	197
Total	1,004	450	436	1,004	250	436

Note:

- * In case of LFP there are 13 timber based enterprises which are mostly engaged in furniture manufacturing
- * In case of MEDEP the number of entrepreneurs and enterprises are equal as they operate individually. However, to access micro-credit they form group and get micro credit on group collateral basis. For this reason there is heterogeneity of enterprises within a group also

Livelihoods and Forestry Programme (LFP): LFP aims to contribute to reduce vulnerability and improve livelihoods for the rural poor enhancing the assets of rural communities through the promotion of more equitable, efficient and sustainable use of forest resources. This ten year DFID funded and Ministry of Forest and Soil Conservation (MFSC) implemented program started in April 2001 building on lessons learned from the Nepal UK Community Forestry Project (NUKCFP) which ran from 1993 to 2001. It operates in 15 districts of Nepal, and Parbat is one of them. It has five program components: strengthening forest users groups' own management system and social process; improving forest users groups' capacity in forest management; developing more supportive policies at district level; developing more supportive policies at national level; and participatory district forest management planning and implementation of forestry program. It works on the central theme of DFID's Sustainable Livelihoods Framework (SLF) that enhances people's access to human, social, natural, physical and financial capital (LFP 2002).

³ It is an annual plant called Himalayan Nettle and natural fibre can be extracted from its bark. The fibre has good tensile strength and used for fabric purposes.

⁴ A wild fruit plant bearing berries which contain high pulp and a variety of products including candy sweet and pickle can be prepared from its fruit.

The activity of forest-based enterprise development falls under the component of improving forest users groups' capacity in forest management. LFP and DFO follow a sequential order in providing BDS to targeted beneficiaries. The step by step process of enterprise development followed by LFP are sub-group formation, feasibility study, business creation training, business plan preparation, skill development training, implementation, networking and reporting. To support the poor section of the communities, LFP provides financial assistance (seed money) to CFUGs to develop micro-enterprises. CFUGs then provide credit to their members (priority given to the poor) at 10% interest rate to establish micro-enterprises including NTFP-based. LFP in the district has established 73 different types of enterprises of which 33 are NTFP-based enterprises with 197 entrepreneurs involved.

LFP has provided a total of Rs. 458,156 (US \$6,276) micro-credit to 331 entrepreneurs out of which Rs. 304,000 (US \$4,164) to 210 forest-based entrepreneurs. However, they have not maintained the record on repaid, outstanding and default amounts, which are very important for looking into the prospect of investment in forest-based enterprises. **Table 5 and 6** summarize the number of entrepreneurs and micro-credit investment facilitated by LFP as well.

Table 6. Amount of micro credit investment facilitated by MEDEP and LFP in Parbat

Program/ Source	Type of enterprise	No. of entrepreneurs	Amount disbursed (Rs.)	Amount repaid (Rs.)	Amount outstanding (Rs.)	Default amount (Rs.)
MEDEP/ ADBN	Non forest-based	433	1,818,842	1,057,255	752,587	114,297
	Recovery (%)	93.7%				
	Forest-based					
	Allo processing	33	3,500	3,500	-	-
	Beekeeping	98	525,000	412,000	113,000	-
	Sal leaf plate making (not running)	15	24,000	-	24,000	-
	Lapsi processing	33	195,000	132,000	63,000	-
	Bamboo and Nigalo crafts	45	211,000	151,000	60,000	6,636
	Ketuki processing	7	20,000	-	20,000	-
	Chiraito production	1	-	-	-	-
	Incense stick making	1	25,000	25,000	-	-
	Soap manufacturing	6	80,000	40,000	40,000	-
	Beehive manufacturing	1	30,000	30,000	0	0
	Total forest-based	240	1,113,500	693,500	320,000	6,636
	Recovery (%)	99.7				
Total both types	673	2,902,342	1,820,755	1,072,587	120,933	
Recovery (%)	95.8					
LFP (grant & CFUG funds)	Forest-based	210	304,000	-	-	-
	Non forest-based	121	154,156	-	-	-
	Total	331	458,156			
	Grant Total forest-based	450	1,417,500			
	Grant total non forest-based	554	1,963,998			
	Overall Grand Total	1,004	3,381,498			
Overall size of micro-credit (Rs.)		Forest-based		3,150		
		Non-forest-based		3,545		
		Overall		3,368		

3. NEEDS FOR MICRO-FINANCE SERVICES

3.1. Characteristics of the forest-based micro-enterprises

The small-scale forest-based enterprises in Parbat districts can be grouped as:

- Timber based enterprises, such as furniture manufacturing and beehive manufacturing;
- Non-timber based enterprises, such as:
 - Natural fiber extraction and processing (Allo, Lokta, Argeli, Ketuki)
 - Beekeeping
 - Sal leaf plate making
 - Incense stick making
 - Bamboo and Nigalo crafts making
 - Lapsi precessing
 - Medicinal plant production, processing and marketing

The NTFP-based micro-enterprises in Parbat have the following characteristics.

- There are a wide variety of NTFPs available in the district, thereby diversity in the micro-enterprises, which leads to unorganized, fragmented, underdeveloped NTFP industry in the district;
- Forest-based enterprises are scattered throughout the district;
- NTFPs being the products from common property resources, there is a lot of uncertainty in terms of market, NTFP policy (fear of restriction), and supply of raw materials;
- Micro enterprises mostly apply labor intensive, low cost, traditional technology and manual procedures (hardly any enterprise uses electricity). Beekeeping is practiced traditionally but recently MEDEP and LFP have introduced modern beekeeping technology. The common honeybee is *Apis cerana*. Honey is produced and the crude honey is sold locally without processing;
- Most of the NTFP-based micro-enterprises are operated by the poor HHs and most of them require financial support in establishing the enterprises;
- The micro-enterprises employ mostly 1-5 persons and small enterprises employ 6-10 persons, mostly from the owner household members and relatives;
- The average size of investment per enterprise is Rs. 4,300 (US \$59) per micro-enterprise and Rs. 500,000 – 1,000,000 (US \$ 6,850 – 13,700) per small enterprise. Small enterprises are limited to furniture manufacturing;
- The products of micro and small enterprises are sold mostly in local markets;
- The quality of these enterprise products are inferior but mostly used for local consumption with the concept of "local products for consumption by poor people" who do not give priority to quality but opt for low price;
- Most of the micro-entrepreneurs are just literate and very less exposure to micro-enterprise management and modern tools and technology;
- The furniture from bamboo and nigalo has local market, but decorative items are exported to Pokahra and Kathmandu market. Allo fibres have local market, but also exported to Pokhara and Kathmandu in small quantity.

3.2. Financial resources

In Parbat, informal financial sources available for entrepreneurs include local money lenders, Dhukuti, Guthi, SSCs, SCOs, co-operatives, and formal sources include banks, NGOs, and

finance institutions. Even for the subsistence livelihoods, the poor community often have to source finance through:

- Labor work (public infrastructure development project, private agricultural activities, seasonal migration for labor work to cities in Nepal and India)
- Sales of livestock produces and livestock (in seasons, they also sometimes sell cereals and other agricultural produces)
- Loan from relatives and money lenders

Besides on their own savings, earlier from wage labor, sales, and sourcing from relatives, micro-entrepreneurs finance their commercial activities through a variety of ways as follows.

Local money lenders: The local money lender charge exorbitantly high interest rates; repayment period is seasonal or annual; easily available but only to the locally known people; the size of loan is usually small (the loan size varies from a few hundred rupees to thousands of rupees depending upon the need of the borrowers); such loans are taken by poor people for consumption purpose that means for buying food items during food shortage period; as the loan is not invested in business or enterprise the borrower has hard time to repay back and that with high interest rate the loan sometimes become lifelong burden for the borrower and can pass from generation to generation; it is one of the means of exploitation by rich people to poor in Nepalese society. As there is no such specific Act on this issue, there is no strong penalty system for the exploiters or money lenders (Mahajan or Sahu in Nepalese language). There is no information available on the amount of transaction by local money lenders as it operates very informally and confidentially.

Dhukuti: Dhukuti, which is a common traditional money collection and lending practice in Nepal, is generally observed by a group of similar interest individual in a locality. In Parbat, it is practiced mostly by business communities such as Thakali and Newar. The system is so flexible that the participants decide on the terms of the money collection and repayment. Although there is no fixed number of individual to participate and fixed amount to pledge for a particular Dhukuti, the number of participants generally ranges from 10 to 20, and amount from Rs. 100 to Rs. 10,000 per person per month. In this system, collection and repayment is done mostly on monthly installments. In some cases, it can also be on weekly interval.

Generally, a group of people with similar interest informally initiates discussion on a Dhukuti system and one member, most trusted, is nominated as a Ghopa (money manager). Sometimes, a Ghopa also initiates this process by inviting his/her friends to join a Dhukuti. The size of Dhukuti, period, and other terms are discussed and decided by the entire team on consensus basis. Ghopa generally receives a fixed amount as a management fee as decided by the team and has the opportunity to receive the first Dhukuti without auction process. This is generally an unwritten understanding among the members and is not officially registered.

Each member of the Dhukuti group has chance for participating in auction each period or the team prepares a prior understanding on who will receive the money in which round (each collection interval). In the period, a particular date is identified as a due date for deposit of installment by the all members. For example, if there are 10 members, installment amount of deposit is Rs. 1,000 each, and the collection interval is a month, the total amount collected in each round will be Rs. 10,000 and there will be a total of 10 rounds lasting for 10 months. On the due date, the team holds a meeting at a time as informed by the Ghopa to decide on the Dhukuti disbursement. Except in the case of prior fixed loanee, closed bid from interested

members is called; and who tenders the least amount receives the Dhukuti (collected money in that round). Interest rate depends on the amount of auction; that is smaller the loan received from auction higher the interest rate and vice versa. The interest earned, no matter what process is followed, is divided equally among the participants. Thus, the loan is easily available among the members. The loan is mostly invested for business purpose or any other productive purposes.

Formal sources of finance: Banks, co-operatives, NGOs, finance institutions and projects are the formal sources of finance in forest-based enterprises in Parbat district. There are three types of government undertaking banks in Parbat, which have a provision of providing loans to various types of entrepreneurs. These are Rastriya Banijya Bank, Nepal Bank Limited and Agriculture Development Bank (ADBN).

MEDEP provides micro-finance services through ADBN with special arrangements. The total micro-credit disbursed from ADBN Branch Office in Parbat as of September 2004 is about Rs. 2,902,342 with repayment of 1,820,755. The interest rate is 12 percent for forest-based enterprises. Similarly, LFP has provided 50 to 70 percent of the total amount of investment needed on demand of CFUGs as grant fund for developing forest-based micro-enterprises. The CFUGs provide remaining amount of loan requirement and invest to one or more sub-groups, which run the enterprises. In case of LFP supported CFUGs, the CFUGs were free to set interest rates between 0 to 10 percent. Other banks and financial institutions do not usually provide loans to NTFP-based entrepreneurs.

3.3. Procedures to accessing microfinance services

As mentioned above MEDEP has developed simple procedure of accessing micro-credit. The following steps are followed by the entrepreneurs in accessing micro-credit in MEDEP programs.

- The selected potential entrepreneurs form groups and named as Micro-Entrepreneurs Group (MEG);
- The entrepreneurs prepare business plan based on their own selection of enterprises and make decision on how much loan is needed from the bank;
- They fill up the loan request form provided by ADBN Branch Office in Parbat;
- The business plan, loan request application form and copies of citizenship certificate are submitted to MEDEP through Enterprise Development Facilitator (EDF);
- MEDEP verifies the documents and the entrepreneurs finally submit the documents to ADBN;
- ADBN approves the loan request and disburses loan within three days on group collateral basis. There is rare chance of rejection of loan request when an entrepreneur is recommended by MEDEP;
- The size of loan is Rs. 8,000 in the first cycle but can be received up to Rs. 16,000 upon recommendation of the District Program Implementation Committee (DPIC) depending on the nature of enterprises.
- Entrepreneurs repay the loan in one year on monthly installment basis.

The step by step process followed by entrepreneurs to access loan from LFP/DFO:

- The CFUG forms one or more sub-groups of members having interest on enterprise development and request to LFP/DFO for funding;

- LFP conducts feasibility study of the enterprise and helps the CFUG members to prepare business plan;
- The amount of investment is decided jointly by the CFUG members and LFP/DFO;
- LFP/DFO contribute 50 to 70 percent of the total investment and provides as revolving fund to CFUG;
- CFUG contribute the remaining amount of the total loan amount and disburses to the entrepreneurs either on group basis or to individuals;
- The interest rate is fixed by the concerned CFUG, which ranges from 0 – 10 percent in Parbat district;
- There is no limit to amount of grant as such. LFP has disbursed as high as Rs. 40,000 per CFUG;
- The term of loan repayment also varies from CFUG to CFUG but in most cases the repayment is done within a year.

Box 1. Bamboo craft making sub-group of Bause CFUG, Bajung-2, Parbat

4 poorest household members (Mahadatta Prasai, Yam Prasad Poudel, Bishnu Prasad Sharma, and Ratnakhar Chhetri) of Bause CFUG were identified by the CFUG based on the following criteria- poorest category, traditional skills, interest, and capacity to develop bamboo craft making micro-enterprise. With the assistance of LFP and DFO staff, the CFUG undertook a feasibility study to identify viable enterprise options which analyzed assessment of community forest resources, environmental impact of the enterprise, availability of infrastructure, beneficiaries of the enterprise, markets, and willingness of the entire CFUG members. Once the bamboo craft enterprise was found to be feasible, LFP/DFO provided business creation training, which also developed a business plan for the enterprise sub-group. A total of Rs. 6,000 was estimated by the sub-group to start up the bamboo craft enterprise. As a follow-up, a field based skills development training was provided to the 4 entrepreneurs. To support the enterprise sub-group, LFP provided Rs. 3,000 to Bause CFUG as a grant. The CFUG provided a credit of Rs. 6,000 to the enterprise sub-group with 10% annual interest rate. The enterprise sub-group purchased the required equipments and other materials (drill machine, axes, knives, plastic ropes, nails, paints) for Rs. 5,700, and started their business operations since January 2003.

The sub-group sources the raw material primarily from their community forest at free of charge. The sub-group members prepared bamboo crafts at their own premises. The major products of the sub-group were various types of bamboo baskets (Nanglo, Doko, Tokari, Dali, and Dallo), racks, stools, and syakhu (used as an umbrella). They sold their products in the local markets and towns of Parbat and Baglung, and Pokhara. The sub-group manufactured a total of 383 items and earned Rs. 36,340 till July 2004. The sub-group repaid the loan and interest within 6 months of their operations. The sub-group met before the CFUG committee meetings and presented their raw material use and sales report along with their problems mainly in raw material sourcing and market linkages. The CFUG provided assistance to the sub-group to address their problems by supporting in sourcing the raw materials and marketing their products. In exchange, the sub-group agreed to contribute 5% of the sales amount to the CFUG fund as conservation fee.

Step by step process of accessing loan in FI-NGOs and other semi-formal MFI.

- The concerned NGO forms a group of beneficiaries and involves them through the process of social mobilization. Usually the group is termed as Community Organisation (CO);
- After the CO gets maturity in a period of three to six months, they can analyze the available resources and decide to start income generating activities. Usually NGOs provide loan for income generating activities;
- Based on the feasibility of the income generating activities, the COs request loan from the FI-NGO;

- Social Mobilizer helps the group members to fill up the loan request form and submit to FI-NGO. There is no such requirement of preparing business plan. However, recently they have also started preparing business plan;
- The request is put forward to FI-NGO with the help of Social Mobilizer;
- FI-NGO approves or rejects the loan request;
- The upper limit of the loan amount is usually Rs. 5,000 – 10,000 and repayment is either on a weekly or monthly installments;
- The term of repayment is usually one year.

Small-scale forest-based enterprises access loan from the commercial bank following a lengthy and rigorous process. The step by step process in the case of furniture enterprise is as follows.

- The entrepreneur prepares business plan and requests for registration in Cottage and Small Industry Office (CSIO) located in the district headquarters. The documents needed to submit are citizenship certificate, business plan, initial environment assessment report, investment amount, etc.;
- CSIO examines all the document submitted by the entrepreneurs, approves or rejects and issues certificate of registration if it is approved;
- The entrepreneur submits an application to DFO for issuing license of getting raw timber either from the community managed forest or from outside;
- DFO conducts survey of the forest area and provides distance certificate as the policy requires that the furniture industry should not be established around the periphery of three km from the forest;
- DFO provides license of getting raw timber from the forest;
- Entrepreneur applies for loan either at commercial bank or ADBN offices with the following documents;
 - Land ownership certificate
 - Maps of the house or building belonging to the entrepreneur
 - License issued by DFO
 - Industry registration certificate issued by CSIO
 - Bills of clearance of land tax
 - Business plan
 - Citizenship certificate
- After submitting these documents the bank examines the collateral and the validity of the documents submitted, and approves or rejects the request of loan;
- Loan amount varies from Rs. 500,000 to 1,000,000 for small-scale enterprises with variable terms of repayment.

3.4. Assessment of the financial needs

There are 288 CFUGs in Parbat district alone covering 7,522 ha of land with membership of 29,668 households. There is no record available on how many households are living below poverty line in Parbat district but if we make a conservative estimate of 25 percent of households living below poverty line in the district, the total number of households with CFUG memberships are about 7,417. The average size of micro-credit disbursed in the district is about Rs. 3,100. Many of the entrepreneurs interacted opined that the size of micro-credit (Rs. 3,100) is inadequate for their enterprise development. Considering all these figures and assuming that they will be involved in forest-based micro-enterprises, the micro-credit

need for the above-mentioned number of households for forest-based enterprises in Parbat district would be Rs. 23 million. The present micro-credit investment in forest-based enterprise is only about 5 percent of it. Considering this demand of micro-credit for Parbat district (Rs 23 million per district), the national demand for 55 hill districts only could be estimated at Rs. 1,265 million indicating that there is a high potential of providing micro-finance services to forest-based micro-enterprises in Nepal. The amount of investment on medium and large forest-based enterprises has not been taken in account in this estimate. The micro-credit need of an entrepreneur is small in amount ranging from a few thousand of rupees to several thousands and usual practice of lending by MFI is limited to about Rs. 10,000 or so in the first cycle, which is very low compared to the individual need of credit for small enterprises (Rs. 500,000 to Rs. 1,000,000) as stipulated in the Industrial Enterprise Act 1992.

3.5. Issues and challenges for forest-based small and micro-enterprises

The main issues are:

- MFIs and formal sector financial institutions have not realized and recognized the vast scope of investment market for them in forest-based enterprises. This is mainly because there is less awareness among the MFIs on this issues;
- The private sector is not much interested to invest in forest-based enterprises mainly because they have to fulfill lengthy and cumbersome processes in accessing the loan from the bank;
- The policy and regulations in forestry sector are not attractive for private sector investment; and
- As the forest resources are renewable, the utilization always requires to integrate with conservation or sustainable harvesting which is difficult for the entrepreneurs and also MFIs to invest.

The challenges are:

- Creation of awareness among the MFIs and private sector or entrepreneurs to attract them for investing in forest-based enterprises;
- As the community forests are managed in a small patch of land, the amount of raw material available from such small patches of forest to run forest-based enterprise in commercial scale in many cases may be not viable;
- The coverage of MFIs at present is limited to accessible areas, such as periphery of urban areas and the extension of the MFI services to rural areas has been challenging as the overhead costs of operating micro-finance services goes high;
- The forest-based enterprises are mostly technology dependent and there are very few institutions working on appropriate technologies required for forest-based enterprises and entrepreneurs have to be dependent on import of such technology;
- The quality of products of the forest-based enterprises particularly in the case of medicinal herb processing may not need required standards and there will be difficulty in marketing such products; and
- Very limited market information is available on the products of forest-based enterprises and the entrepreneurs face difficulty to develop linkages with national and international markets.

The main objective of MF institutions is poverty alleviation. There is much debate in the field of MF. Does access to financial services really benefit the poorest of the poor? Can the real poor actually reach the MF service? Does MF really target and cater to the poorest of the poor? Though MF is a good vehicle that contributes substantially to the economic upliftment of the poor, micro-enterprises have encountered some problems in this regards, such as lack of sectoral specific acts and policies in micro-finance (Forestry, Agriculture, Tourism, etc); lack of access to non financial services for capacity building such as training; hostile policy environments; lack of information and accessibility to market linkages; and lack of basic infrastructure required for micro-finance service delivery. Therefore, in the context of growing awareness of the need to make MF more client-responsive and effective, and to respond to the greater demand in addressing the issues and solving the problems that exist in MF.

4. SOURCES OF MICROFINANCE SERVICES

4.1. Management structure

MEDEP has signed MoU with ADBN for making special provision of micro-credit on a cost sharing basis of 30% contribution from MEDEP and 70% from ADBN's own internal sources. The micro-credit component is managed jointly by ADBN and MEDEP. Simple procedure and guidelines are prepared and followed. After the entrepreneurs submit business plan and loan request forms duly filled by them MEDEP forwards it to ADBN Branch Offices and loan is approved and disbursed within three days. MEDEP and ADBN jointly monitor the entrepreneurs for repayment of the loan and submit the report to the District Programme Management Committee (DPIC), which reviews the micro-credit activities. The management structure in RRDBs and commercial banks is complex whereas in FI-NGOs, SSCs and SCOs it is simple.

Hierarchically, there are four tiers of structure of ADBN, the Central Office is in Kathmandu and there nine Supervision and Monitoring Offices are located in nine zones of the country. Under each zonal office, there are several Branches Offices. There are more than 75 Branch Offices. Under Branch Offices there are Sub-Branch Offices and Small Farmers Development Programs (SFDPs). Micro-credit delivery is done either by Branch Offices or by Sub-Branch Offices, but not by Small Farmers Development Program (SFDP). The management structures of MEDEP and ADBN are provided in **Annex 2**.

4.2. Mechanisms and linkage of credit program

UNDP, MOICS and ADBN have made an umbrella MoU at the centre for developing linkage to provide micro-finance services to the entrepreneurs. As per the MoU, MEDEP has contributed 30 percent (Rs. 7,624,285) and ADBN 70% (Rs. 16,950,000) with a total micro-credit fund of Rs. 24,214,285 available for 10 districts. Out of this fund Rs. 2,700,000 has been made available for Parbat district (MEDEP 2003). While discussing with the staff of the program this amount of micro-credit fund made available to entrepreneurs is not sufficient and UNDP, MOICS/HMGN and UNDP are considering for increasing the amount for some hill districts in its second phase (2003-2005). The total amount of micro-credit disbursed in Parbat district as of June 2004 is Rs. 2,902,342, which has already exceeded the allocated amount (Rs. 2,700,000) which has been possible from recycling of the already invested loan and its interest generated during the first phase. MEDEP also provided computers to ADBN Branch Offices to link to its Management Information System (MIS) for reporting and monitoring purposes. A simple credit operation guideline has been prepared and implemented by the district level offices.

Box 2. Pragatishil beekeeping group, Tilahar-8, Parbat

Among 9 members of Pragatishil beekeeping group, which was formed by MEDEP, Ms. Dhana Kumari Chhetri was doing beekeeping activities at subsistence level. She got entrepreneurship and skills development trainings from MEDEP program, and became more interested to expand her honey production to generate some income. MEDEP facilitated her to develop a simple business plan to expand her honey production. As she was interested to start a micro-enterprise on beekeeping, the group meeting of Pragatishil held on May 20, 2002 decided to recommend MEDEP to support her with a credit of Rs. 16,000. With the recommendation letter from MEDEP district manager, she applied to ADBN district branch, Kusma for a credit of Rs. 16,000 with the required documents (business plan, MEDEP recommendation letter, group recommendation and guarantee letter, and a copy of citizenship) on May 28, 2002. Her business plan stipulated a yearly production of 150 kg of honey and sales amount of Rs. 23,850. From the operations, it was estimated that she could make a net profit of Rs. 5,163 after deducting the expenses in raw materials, labor (own and family members time), bank interests, and depreciation.

ADBN decided to provide her a credit of Rs. 16,000 at 16% interest rate per annum (amended to 12% since 2004) with the provision of repayment in two equal installments by December 2002 and July 2003. ADBN provided her the entire amount on June 9, 2002. With the credit support, she purchased required equipments and materials (5 bee hives with queen gates and stands, safety cap, gloves, knives, bee colonies, sugar, etc.) for beekeeping. With the incomes from the micro-enterprise, she repaid the entire credit by November 2003 and has been supporting her family livelihoods. With the micro-credit support from ADBN and technical assistance from MEDEP staff, she was able to successfully run the beekeeping operations and make good incomes out of it.

The following are the step by step process of accessing micro-credit by entrepreneurs.

- Program Locations (PLs), Program Centres (PCs) and Market Centres (MCs) are selected based on the recommendations of the consultants and approved by District Program Implementation Committee (DPIC);
- Enterprise Development Facilitators (EDFs) are deputed in each PC and start conducting PRA for selection of Target Groups (TGs) who are living below the poverty line;
- The selected potential entrepreneurs form groups and named as Micro-Entrepreneurs Group (MEG);
- The entrepreneurs prepare business plan based on their own selection of enterprises and make decision on how much loan is needed from the bank;
- They fill up the loan request form provided by ADBN Branch Office in Parbat;
- The business plan, loan request application form and copies of citizenship certificate are submitted to MEDEP through Enterprise Development Facilitator (EDF);
- EDO and DPM of MEDEP verify the documents and the entrepreneurs finally submit the documents to ADBN;
- Loan Officer of ADBN reviews the submitted documents and submits to the Manager for approval or rejection. The loan is approved and disbursed within three days on group collateral basis.

The size of loan is Rs. 8,000 in the first cycle but can be received up to Rs. 16,000 upon recommendation of the District Program Implementation Committee (DPIC) depending on the nature of enterprises (**Table 6**). In most of the forest-based enterprise the size of initial investment is high because it is invariably related with technology except in collection and sun drying. The entrepreneur has to make a special request to DPIC for approval of the amount higher than the upper limit of the regular amount. The staff of MEDEP reported that if the case is genuine the DPIC recommends the higher amount without hesitation and so far there has been no delay in disbursing the credit.

Table 6: The size of micro-credit under different cycles

Cycle of credit	Amount of upper limits (Rs.)	
	Regular amount	DPIC recommendation
I	8,000	16,000
II	15,000	25,000
III	23,000	35,000
IV	31,000	45,000
V	40,000	50,000

- The credit is monitored rigorously by EDF followed by the EDO and Loan Officer;
- Entrepreneurs repay the loan in one year on monthly instalment basis; and

- Initially, the interest was fixed at 16 percent but now it has been reduced to 12 percent to make it competitive with other commercial banks.

4.3. Microfinance products, delivery and terms

The processes for finance products delivery differ among the MFIs. The process is simple and shortcut in FI-NGOs, SSCs, SCOs, co-operatives whereas it is complex and lengthy in formal MFIs such as commercial and development banks. However, for micro-credit service delivery the basic requirement is group formation and savings generation. After the micro-credit operation groups are formed each member of the group starts saving a small amount to the group fund regularly either on weekly or monthly basis. As the group matures, the size of savings fund also increases and that becomes a source of micro-credit for the group member. The saving fund is disbursed in small amount as per need and priority of the group members. The interest rates are decided in the meetings, which are at par with the interest rate fixed by the MFIs. There are basically two types of financial products most common in Parbat, namely individual lending and peer lending. Unless provided by the facilitating organization, the MFIs do not offer other services such as micro-insurance, leasing and payment services, and BDS services to their clients. In Parbat, BDS services are provided through the programs such as MEDEP and LFP.

Individual lending: It has been practiced among the village money lenders from the ancient time. Along with this philosophy, development banks and commercial banks provide micro-credit services gradually to their clients. Basic characteristics of individual lendings are to:

- Provide loan on the basis of collateral;
- Select capable clients;
- Fix loan amount as per the project or business plan analysis;
- Submit essential documents;
- Supervise and monitor project investment.

Most of the formal micro-finance institutions offer this product for small, medium and large entrepreneurs.

Peer lending: Most of the semi-formal and informal and also formal MFIs offer this product while providing micro-credit to micro-entrepreneurs. The basic characteristics of peer lending are to:

- Provide loan on the basis of group collateral or guarantee;
- Select loanee by their peer;
- Invest loan with less analysis;
- Impart loan in any activity;
- Follow very simple procedure.

This product is further categorized into two parts namely, solidarity group and community based organizations (CBOs). Solidarity groups are categorized as Grameen type which is common in Nepal.

Eligibility criteria of clients: The clients who fulfill the following criteria are eligible for the micro credit from the MEDEP supported program.

- The entrepreneur must be a poor living below the poverty line;

- The entrepreneurs must form Micro-Entrepreneurs Group (MEG) and start generating savings in the group account on a monthly basis. The amount of monthly deposits are decided by the group but in many cases it varies from Rs. 10-20 per month;
- S/he should be Nepalese citizen that should be proven by submitting the copy of the citizenship certificate;
- S/he should not have outstanding loan amount taken from other sources such as SFDP or other micro-finance service providing institutions;
- S/he should undergo entrepreneurship training package either MECD or SIYB depending upon the situation and need;
- S/he should prepare a business plan of his/her choice based on the resources (raw materials) available;
- S/he should decide and show in the business plan that how equity to invest from her/his own source and decide the total amount of micro-credit needed from the bank;
- S/he should fill up the credit demand format available in the bank and submit it to first EDF, then to EDO/DPM and finally to Loan Officer/Manager of Bank.

Usually, the clients are selected by MEDEP staff, trained, supported for business planning and linked to ADBN for micro-finance services.

Formalities needed for accessing loan: Usually, all kinds of MFIs need basic documents to have access to micro-finance services such as business plan, project proposals, copy of citizenship certificate, group memberships that should be submitted to the MFIs as evidence of eligibility for receiving the micro-credit. Sometimes interviews and group discussions are also required. For small and large entrepreneurs to get loan from commercial and development banks some additional formalities are required to be fulfilled such as collateral, guarantee, witnesses, etc.

Interest rates: The interest rates vary by the type of credit and nature of enterprise. Different MFIs set different rates of interests. Presently, the interest rates charged by ADBN in Parbat range from 8.5% to 12.5% per annum, in which NTFP-based enterprises are charged 12% (**Annex 3**). Interest rates charged by semi-formal and informal MFIs are invariably higher than those of commercial and development banks.

Box 3. A group of women in allo processing group enterprise (Hampal Allo Udhyami Group, Saliya, Parbat)

With ANSAB as a resource organization, a one-day Market Analysis and Development (MA&D) workshop was organized in 1999 at the district headquarters to orient the district level stakeholders and MEDEP staff. In addition, a 3-day field level MA&D workshop was organized for 22 women participants, who were selected by MEDEP as potential micro-entrepreneurs from Saliya VDC. Saliya is located in the remote north of Parbat with more than 95% people living on subsistence agriculture of which above 90% lives below the poverty line. From the MA&D process, the women entrepreneurs selected allo, honey, jam and jelly, NTFPs trade, handmade paper, can furniture as viable micro-enterprise options, with allo as the most preferred one. As a follow-up process, MEDEP formed a group, called Hampal allo udhyami group in August 2000 comprising of 14 interested women from the pool of the training participants. These women were then given entrepreneurship training, which resulted into preparation of a group business plan, primarily for processing of allo. The group was also provided allo processing skill development training. Due to the lack of capital, the group could not start their allo business. MEDEP linked the group to Kaligandaki Multipurpose Cooperative for accessing a credit. The group received Rs. 3,500 at the 18% interest rate. With MEDEP technological support, the group purchased manual weaving machines, wrapping drums, and other necessary accessories, and started the allo micro-enterprise in August 2000. MEDEP provided marketing orientation, exposure visits to Pokhara, Kathmandu, and other cities in Nepal, and facilitated for their market linkages.

The women themselves collected allo from their community forest and nearby farm land. They processed the allo, weave threads and cloths at their own households. The main products of the group were allo shawl, clothes, bags, mufflers, threads, and woolen mixed bag. Their products were mostly sold in the local markets, and the remaining sold to buyers in Pokhara and Kathmandu. The sales record showed a total of Rs. 622,254 as their total sales from their establishment up to November 2004 with cumulative net profit of Rs. 325,368. The group repaid the credit within 16 months, and expanded their business scale with additional sets of allo processing and weaving machines. With their reputation in the allo business and enhanced skills, Ms. Ghammaya Garbuja, Ms. Ganmaya Garbuja, and Ms. Jasmaya Purja among their group members are recognized as allo trainers and resource persons in the district, and MEDEP and other organizations are making use of their expertise to train other local entrepreneurs in their program districts. The impact study of MEDEP shows that the average per capita income of the 14 entrepreneurs increased from Rs. 4,921 (August 2000) to Rs. 6,400 (November 2004).

4.4. Risk management and outreach

Risk management of micro-credit: The following are the risk management mechanisms followed by MEDEP and ADBN in Parbat.

- Selection of proper clients, who are potential entrepreneurs and need financial support;
- Group-based or peer pressure for micro-credit, use and repayment;
- Support to business planning and loan disbursement to feasible business proposals;
- Disbursement of loan amount in several installments;
- Guarantees (provided by MEDEP to ADBN);
- Witnesses;
- Regular monitoring;
- Technical assistance from MEDEP for capacity building of entrepreneurs, enterprise management, and market information and linkages.

Collaboration with poor illiterate: MEDEP and ADBN arrangement is to work only with the households below the poverty line. This is the reason the program has grant component through MEDEP to develop entrepreneurship, strengthen the capacity of the entrepreneurs in micro-enterprise management and marketing. Similarly, LFP also focuses poor strata of CFUGs for NTFP-based enterprise development and provides capacity building support and seed capital.

Number of families reached: The MEDEP program has reached 673 entrepreneurs households below the poverty line in the district, of which about 240 are associated with NTFP-based micro-enterprises. The LFP enterprise program has reached 331 entrepreneurs, of which 197 are related to NTFP enterprises. At national level, a total number of households reached by microfinance is 727,000 households (by all organizations as of January 2004).

Action on defaulters: In micro-credit, if it was a group based credit program the defaulters were not given opportunity to participate in the group and his/her savings deposited in the group fund was seized. In small and medium enterprises, the defaulters were charged extra interest rates as in case of ADBN in Parbat. They charged extra three percent interest rate if the loanee becomes defaulter. Although the final punishment to the defaulter in case of small, medium or large enterprises was to auction their collateral properties (usually the land and building), these poor entrepreneurs were given extra time and supported by program to revitalize their micro-enterprises and repay the loan. In case of LFP supported micro-entrepreneurs, no clear provisions were found as CFUGs were given the entire grant management responsibility.

4.5. Analysis of profitability of MFIs

As there were a large number of small borrowers in this case, the operating cost of ADBN was very high. MEDEP subsidized the bank in a way by facilitating in enterprise and entrepreneurs selection, business plan development and review, and monitoring of the business operations and loan management. The operating costs of commercial and development banks are always less on per client basis since the size of loan disbursed by these banks is larger and the number of clients are less.

At present the direct costs seen in this arrangement is the salary of EDF, which is equivalent to Rs. 78,000 and the travel cost which is negligible in hill conditions say approximately Rs. 5,000 per year and the total direct cost is Rs. 83,000 per year per EDF. There were 10 EDFs in Parbat district and they were facilitating to provide the total package of BDS services and therefore, it has been difficult to make exact estimates of the micro-finance costs. In the case of ADBN the amount of micro-credit sharing with MEDEP was negligible and their annual turn over of several billion rupees. Considering the workload of EDF approximately the full time services of two EDFs would be required for providing the micro-finance services at the present level of micro-credit operation in the district and their salary, travel and daily allowances and other logistic support would be considered as the direct operation costs. Other indirect costs are the part of the salary of Loan Officer that would not exceed 10 percent of total salary and salary of Enterprise Development Officer that would not be more than 5 percent of the salary. The estimated operating cost of ADBN at present is presented in **Table 7**.

Table 7: Estimated profitability (in Rs) of ADBN in operating forest-based micro-finance services in Parbat

Items	Annual amount	Subsidy from MEDEP	Contribution to/from ADBN
Salary of two EDFs (@ Rs. 6,000 per month X 2 X 13 months)	156,000	156,000	-
Logistic support and travel and daily allowances to EDFs lump sum	20,000	20,000	-
About five percent salary and travel and daily allowances of EDO (@ Rs. 8,000/month X 13 months X 0.05 and Rs. 5,000 other costs)	10,000	10,000	
Ten percent salary of Loan Officer (@ Rs. 10,000/month X 13 months X 0.1 and Rs. 5,000 other costs)	18,000	-	18,000
Total annual costs in Parbat	204,000	186,000	18,000
Interest generated annually from Rs. 3,000,000 micro-credit flow at 12 per cent (profit to ADBN)	360,000	-	360,000
Profit to ADBN (now)	-		342,000 (11.4%)
Profit to ADBN (full costs, no subsidy available)	-	-	156,000 (5.2%)
Default risk (assuming 1% of bad loan)	30,000	30,000	-
Profit (after adjustment for credit default)	-	-	126,000 (4.2%)
Cost of funds (assuming Rs. 900,000 (30% now provided by MEDEP) is borrowed capital at 4%)	36,000	36,000	-
Net profit	-	-	90,000 (3%)

The above simple calculation shows that at present MEDEP is subsidizing the salary and other overhead costs to ADBN but the net profit from micro-finance operation earned from the interest is good compared to the costs and therefore this model has been found sustainable even after the phase out of MEDEP. After adjustment of MEDEP subsidy and loan default risk, the net profit of ADBN, Parbat would become Rs. 126,000, about 4% of the total micro-

credit flow in the forest-based enterprise sector (assuming no cost of funds). The overhead costs involved in zonal and central office is not shown here but the net profit shows that even some of the monitoring and supervision costs of higher authorities can also be covered from this net profit amount.

Generally, none of the MFI is running on profit in Nepal. All RRDBs except that in Mid Western Region are running on loss and every year government is allocating funds to rescue these banks. It is obvious that the overhead costs of MFI operation is higher if the banks are directly involved in delivering the MF services. The financial intermediary system adopted for the last several years has oriented both types of MFIs, wholesaling and retailing toward self sufficiency. However, most of FI-NGOs have non- financing services and cost of such services are covered from donors' funds and therefore, this type of MFI does not seem to run on loss. The experiences of working in collaboration among MEDEP and ADBN show that the interest generated from the micro-credit is sufficient to employ two to three EDFs in the district to supervise the micro-credit component of the bank in the district. This model shows sustainable MF service delivery in the hills of Nepal.

5. MAIN LESSONS LEARNED AND CHALLENGES AND OPPORTUNITIES

5.1. Scope of forest-based enterprises and microfinance approaches

Community forestry has been a successful program of HMGN which has been quoted as a successful example around the world. Community forestry policy and regulations have delegated authority and power to the CFUG members to conserve, manage and utilize the forest resources within the community forest boundary. Nepal is rich in many forest-based resources such as timber, non-timber forest products including medicinal and aromatic plants, , wild life, hunting resorts, and eco-tourism, and vast resources are still unexploited for the economic and social development of the people. In Terai, timber-based enterprises, such as furniture making and construction materials preparing are common.

As community forestry has been successfully practiced since long time in mountains, forest-based small and micro-enterprises, both NTFP and timber-based, are being developed and show greater potential in mountains. Thus, there is a good scope of investment in forest-based enterprises contributing to poverty reduction and economic development. However, private sector entrepreneurs are least attracted in investing in forest-based enterprises primarily due to the various risk factors such as unclear and restrictive government policy and much worst policy implementation practices, uncertainty of regular supply and consistent quality of raw materials, under developed market, and difficulty in accessing financial services. Moreover, the potential entrepreneurs are unable to start micro and small business in forestry sector mainly due to difficulty in accessing financial services, marketing information and market linkage support, and appropriate technology.

Microfinance has become a common practice in development programs particularly in poverty alleviation programs in Nepal. MEDEP and LFP approaches of supporting poor HHs for micro-enterprise development that is linked to microfinance have been found successful as it has supported to develop many micro-enterprises in even the remote districts. These approaches have been specially chosen to address the poverty reduction of the target households; to tap the local resources that have enormous potential for income generation; to build the existing institutional system through strengthening and partnering (ADB in case of MEDEP and CFUG in case of LFP); to match with the existing resource and group management system of the district (small group- traditional social system of managing their livelihoods and commercial activities); scale up the size and intensity of the micro finance (as the micro-enterprises are very small and need very little amount of cash for NTFP-based enterprises).

MEDEP and LFP follow their own process of targeting forest communities and small and micro-entrepreneurs (SMEs). MEDEP identifies the households below the poverty line who have entrepreneurial traits from household survey using several forms which measure mainly the economic status, needs, and the entrepreneurial potential of the members. LFP focuses on well being ranking through forest user groups to identify the target households for enterprise development support. In addition, traditional skills, interests, and capacity to run enterprise are considered. Both programs have exclusive emphasis on the poor households. Moreover, MEDEP has a target of bringing over 70% women in entrepreneurship development and program participation.

Both the programs provide micro-enterprise development and microfinance support through organized entrepreneurs groups. Participation in such group by poor people is the beginning

of good governance at grassroots level as every group member has equal rights of voting for electing the executive member. They can exercise their power by involving themselves in decision-making process. While working in group every group member knows his/her roles and responsibilities and obligation to group. Principally, it has been an understanding so far that every decision made by the group is known to every member of the group and therefore there is a high chance of transparency. The participation of each member of the group is ensured by conducting regular meetings and contributing a small amount of money to group savings. Each member of the group gets chance to borrow money from their savings and therefore, every member of the group has advantage of social capital formation.

However, in a large group such as CFUG in which the number of members is several hundreds, in practice the senior positions of the executive body of the group (such as chairperson, secretary, and treasurer) in most of the cases are occupied by the elite of the community and in some cases the decision of the group is not transparent to poor and socially excluded members.

5.2. Advantages and impacts of micro-enterprise development program

With their approaches of micro-enterprise development programs, the poor households have been benefiting in several ways. Microfinance delivers the services to the poor people and thus it contributes to poverty alleviation. The poor people can organize into small groups and link to this miniature form of semi-formal institution at the grassroots level. These households get access to microfinance services without any collateral to develop and expand their enterprise operations. They receive various training and capacity building opportunities, such as entrepreneurship and skills development trainings, exposure visits, market information and linkages services, and institutional development support from the programs. They can contribute small amount to their own saving fund and utilize for social or household consumption purpose which is not covered from the credit received from formal micro-finance institution. They get opportunity to receive feedback and support from their fellow members and have equal rights to participate in decision making process of their groups.

The impact of micro-finance on economic empowerment of micro-entrepreneurs has been found effective in MEDEP implemented programs (MEDEP 2002- **Annex 4**). There was no specific data available for forest-based enterprises. However, there was an average net increase of 380 percent in the income of the entrepreneurs from the 1.5 years or older enterprises. In a specific case of allo based enterprises with an average investment of Rs. 4,300 there was a good net income of Rs. 4,400 in a period of 42.5 days that means an average net income of per day is Rs. 103.5 which is significantly higher in hills of Nepal (Magar 2003). The financial analysis done by LFP in Parbat district indicates that with an investment of Rs. 5,000 in forest-based enterprises the net income was Rs. 2,153 (BK *et al.* 2004).

5.3. Key factors for a successful performance

The case study of Parbat suggests that following key factors were responsible for a success or failure of the micro-enterprise development and micro credit program. From the study, it is evident that the success of micro credit invariably associated with the performance of the micro-enterprises. In addition, synergy of the collaboration and coordination between the micro finance institution and the enterprise facilitating organization resulted to extraordinary rate of repayment (in case of MEDEP), and low management costs for the micro-enterprise institution (ADB). (ADB).

Selection of right target entrepreneurs and enterprise options: Preparing and applying appropriate criteria for selection of entrepreneurs and enterprise is crucial in forest-based enterprise development. Both MEDEP and LFP have adapted their own procedures and criteria in selecting target groups. Because of the selection of right types of entrepreneurs and enterprises, the micro-enterprises were running successfully with good credit rating. The study shows that the most of the micro-enterprises in Parbat were based on traditional skills and entrepreneurs' interest, which seemed to contribute for the success.

Proper delivery of business development services (BDS): Both programs delivered various types of the business development services (BDS). Broadly, the BDS services provided by the programs were entrepreneurship development, business management, skill development, appropriate rural technologies, micro-credit, market information and market linkage, and follow up and business counselling. The programs which have micro-finance as their main activity of enterprise development and do not consider seriously the other services such as entrepreneurship development, skill development and market promotion may not succeed.

Box 4. Sal leaf plate (Tapari) enterprise, Kusma-6&7, Parbat

Gupteshwor CFUG with 118 hectares of sal (*Shorea robusta*) forest and 171 households is one of the successful CFUGs so as to rejuvenate the degraded sal forest. A group including forest technicians, rangers, and forest user groups from other parts of the country visited the Gupteshwor to learn and observe the sal regeneration and management practices adopted by the group. During the visit, a ranger shared a success story of sal leaf plate making enterprise operated in Nawalparasi district and suggested them to make use of their abundance sal leaves for their income generation. With this information, the chairperson, secretary, and an executive member of the group consulted LFP, DFO, and MEDEP to develop a sal leaf plate enterprise. Two adjoining CFUGs (Kaligandaki with 95 hectares forest and 450 households and Bhatkhore with 57 hectares forest and 114 households) were invited to be a part of the enterprise. The executive members of three CFUGs decided to contribute Rs. 4,000 each to purchase a machine. The remaining 13,600 required for the electric dice machine for sal leaf plate making was requested and obtained from LFP. MEDEP supported to locate the machine and contributed the costs for transportation of the machine from Janakpur to Kusma. The machine was installed in the office room of Gupteshwor CFUG. The capacity of the machine was 2500 plates per day.

LFP and MEDEP supported the executive members of the groups to develop a business plan for the enterprise. The business plan identified the selling price of Rs. 0.5 for a plate, and targeted to market the plates in Kusma, Baglung, Pokhara, and Kathmandu. LFP and MEDEP facilitated to form a 11 member management committee including chairpersons of the three CFUGs as advisors to manage the enterprise operations. The enterprise started its first operation in March 2002. Unfortunately, the enterprise hardly operated for a week and produced just 1,000 plates. The enterprise record shows a total sales of Rs. 150 from selling around 300 plates to local market. Some leaf plates were distributed as samples, and around 400 plates were still found lying till mid December 2004 in the office building. According to the executive members of Gupteshwor, the enterprise could not be run properly due to the poor market linkages and marketing expertise. According to LFP, the sal leaf collection constrained the operation. They opined the leaf collection was not found remunerative to the member of the CFUGs as they could earn more from the wage labor in the nearby town. As per MEDEP, the business operation was halted as the sal leaf collection was constrained due to the insurgency and security problems in sal leaf collection from the forests. District cottage and small industry development board suggested that the selection of the entrepreneurs for enterprise operation was wrong and opined that the enterprise management committees could not act as entrepreneurs to run the enterprise. On the other hand, the district forest officer pointed out that the business plan was not realistic and could not visualize on the ground operational realities to run the enterprise. District development officer opined it as a wrong choice of enterprise due to inadequate market and feasibility analysis. However, some entrepreneurial members of the CFUG were found optimistic and seemed ready to run the enterprise if they were given the full management control and supported in marketing the products.

Response to the demand of potential entrepreneurs: Another success criterion of enterprise development is that well motivated potential entrepreneurs put their demand for BDS and the programs respond appropriately. They often demand for skill training and market information and linkages needed to run that enterprise. As the enterprise often needs technology related to

machines and tools, the programs link the entrepreneurs with appropriate technology promotion institutions and organizations. After acquiring skills on the selected enterprises the potential entrepreneurs demand for micro-credit based on the business plan developed by them.

Monitoring, follow up and business counselling: As the entrepreneurs face various challenges in managing enterprises that ranges from technological, marketing, raw material supply, enterprise operations, and financial management, they require continuous technical assistance through monitoring and counselling visits. These programs have enterprise development officers and facilitators to support these enterprises in their initial stages.

5.4. Opportunities and challenges

Opportunities

CFUGs are emerging as the grassroots level organizations to conserve, manage and utilize the forestry resources. They have increased their capacity in mobilizing the community people in conservation and management of the forest. However, the utilization of forest resources is limited to the products that are related to their daily use such as fuelwood, grass, fodder, thatching grasses, herbs and NTFPs. Their capacity to use forest resources for sale is limited; so is the value addition and marketing. Under such circumstances, there is a greater role of organizations such as government and NGOs in strengthening the capacity of CFUG members by providing technical and managerial skills to develop forest-based enterprises at community as well as household levels. The study shows most of the micro-enterprises in Parbat were operated by below poverty line households, and the enterprises were built on their traditional skills and knowledge through assistance in accessing microfinance services and technical support to enterprise planning and skills strengthening. As it is also evident in Parbat, NTFP-based enterprise activities were commonly associated with the poor. This is due to the fact that the poor do not possess adequate land to farming and have limited opportunities available around except labor intensive forestry activities. This shows that the support provided in enterprise development in forestry sector has immense potential to benefit the poor. Realizing this potential, HMGN's 10th Five Year Plan has identified NTFP sector as one of the strategic areas for the mountains to contribute to poverty reduction in Nepal.

There are many saving and credit groups with good sum of amount collected in almost every part of Nepal. However, these groups are not able to mobilize their funds in productive and enterprising activities because most of them lack awareness on enterprise potential and required skills to develop micro-enterprises. Nor do the facilitating organizations of the saving and credit provide technical assistance with this perspective. As there is some money already at disposal, linking of the saving and credit group to micro-entrepreneurs, who are constrained due to the lack of financial resources, through social mobilization and technical assistance has greater potential to promote forestry enterprise activities. As seen in the case of MEDEP, collaboration between existing MFIs and facilitating organization can support to mobilize the available financial resources, which is otherwise hardly invested in micro-enterprises, to develop micro-enterprises in rural areas of Nepal.

The CFUGs with the grant contribution of some projects and DFOs in the district have started investing on forest-based enterprises, extending their micro-finance services to the poor to establish and operate micro-enterprises. There is an opportunity to develop linkage between

the CFUGs and micro-finance institutions to promote the forest-based enterprise development and contribute to poverty reduction.

With the community forestry policy, Nepal has developed over 13,000 CFUGs comprising over one third of the total population to manage over a million hectares of forests. There is a tremendous potential to link micro and small entrepreneurs to these groups so as to source the required forest-based raw materials in a sustainable basis. To sustain the supply of raw materials and promote conservation at the same time, there needs to be an institutional arrangement between the entrepreneurs and the groups to share the benefits of natural endowment and burden of conservation.

Challenges

Although the forestry policy of Nepal is laudable to promote community based conservation and fulfillment of the subsistence needs of the communities, it is still far in terms of enterprise oriented forest management and promotion of forest-based enterprises. Moreover, the policy implementation practices are giving continuity to the legacy of the controlled regime paradigm. For example, forest-based enterprise registration is a cumbersome process which requires three party consensus (DFO, CSIDB, and Land Survey Office) on feasibility and environmental impacts of the proposed enterprise. Even the unwritten rules in terms of distance between enterprise and forests (written rules- 3km in the hills and 5km in the Terai for operating saw mills and brick kilns) are imposed on all types of enterprise establishment which is so impractical in the hills and hinders even for a micro-entrepreneur to run a NTFP-based enterprise.

Although the CFUGs are empowered with the policy to independently manage, utilize and trade the forest resources of their community forests, in practice, trade on any forest-based products is controlled by district forest office at all stages (raw material collection, processing, and sales). Furthermore, forest royalties and multiple taxation on forest-based products (by DFO, VDC/municipalities, DDC, FUG, local clubs, road check points) make the forest-based enterprises difficult to operate profitably for many entrepreneurs. This situation has favored for influential (often illegal) traders to control the trade on forest products with their capacity and ties with the concerned authorities. All this contributes to hesitation to invest in forestry sector by entrepreneurs and financial institutions. In this context, translation of the recently approved Herbs and NTFP Development Policy 2061 (2004) into the practice to promote NTFP-based enterprise development is rather challenging and demands a firm commitment from the government and other stakeholders.

On the other hand, though there are number of success indicators towards conservation by community forest user groups, very poor and socially excluded families have limited access to decision making and benefit sharing from community forest management. The potential of community forests to benefit the poor, women and disadvantaged people is not realized. This is further aggravated by the limited access of these groups to the microfinance service, which is one of the major components in enterprise development and is still at dormant stage in forestry sector (especially at commercial financial institutions).

The realization of the importance of forest-based enterprises in poverty alleviation and thus extending micro-finance services to this sector, if any, is limited to the foresters, development practitioners, planners and NGO representatives. Awareness to the concerned people and particularly to private sector has been very limited and therefore, private investment is also limited. In addition, other challenges to development of forest-based enterprises are- access to

appropriate technologies available for use in forest-based enterprise, limited knowledge on availability of the forestry resources and biology of the herbs and NTFPs, inadequate marketing information and linkages, and insufficient infrastructure to support quality control and certification (especially to facilitate international trade).

Outreach of micro-finance services in Nepal is limited to accessible areas of Terai except the few mountain regions like Parbat where various projects and programs have specific targets in enterprise development through microfinance linkages. Due to the efficient delivery mechanism and enterprise support system, micro-finance services of RRDBs and financial intermediaries such as NGOs and co-operatives in the hills are unable to reach the households of interior rural settings as the overhead cost is higher than in Terai. In Terai, a loan facilitator/supervisor can cover a large area for providing services compared to hills, and thus the number of staff required per unit area in hills goes high due to inaccessibility. On the other hand, as the small size of loan increases the management costs per rupee invested, and the loan needs to be disbursed without any collateral when investment is made for micro-enterprise sector, the commercial MFIs are not attracted to this sector for investment. Therefore, the interest rates of micro-credit are higher compared to other credit systems. For example, the micro-finance institutions particularly the Regional Rural Development Banks (RRDB) and NGO supported group members pay interest rate of as high as 20 to 24 percent which is much higher than the loan for small or medium or large enterprises.

The process is cumbersome in receiving loan from the banks. The process of accessing loan, whether it is micro-credit or credit for small enterprise, is long and the attitude of the bank officials is not supportive to micro-entrepreneurs. The poor do not have capacity to absorb larger amount of loan as compared to the resourceful people as they do not have capacity to initiate enterprises requiring large capital. This apparently makes them the least priority clients of the banks. For this reason too, micro-entrepreneurs are unable to start or expand their enterprise activities. Even some may get micro-credit, the micro-entrepreneurs do not receive other microfinance services such as micro-insurance, payment services, and business development services which often put them at higher risks to expand and operate their enterprises. Thus, the enterprise development process in forestry sector is severely constrained.

As our case analysis shows micro-finance services invariably needed for investment on micro-enterprises development. In some cases, micro-credit was not used for productive purposes and but for consumption and other social purposes, such as ceremonials and rituals. The unproductive investment resulted into difficulty in repaying the loan and the borrower becomes either defaulter or gets loan from informal micro-finance sources such as local money lenders to repay the loan. Thus, micro-credit services, if not linked with proper technical assistance and follow-up, do not automatically lead to micro-enterprise development and economic development.

5.5. Recommendations and suggestions

Based on the case study, multi-stakeholders consultations, and review of the past initiatives both in microfinance and forest-based small and micro-enterprise development in Nepal, the following recommendations and suggestions are put forward, which may be useful in developing conducive policies, designing programs, and facilitating forest-based enterprise development and micro-credit services particularly in Nepal.

- Forestry policy and associated rules and regulations should address the issues of forest-based enterprise development such as enterprise registration, supply of raw materials to the enterprises, royalties and multiple taxation, hurdles in trade of forest products, and create incentives for entrepreneurs to develop forest-based enterprises linking to sustainable resource management. The forestry policy and programs should now emphasize on enterprise oriented forest management. There is a huge potential to transform the existing community forest user groups towards enterprise oriented community forest management by emphasizing the increased production and marketing of commercial forest products without sacrificing the subsistence and conservation needs.
- For poverty reduction, priority should be given on NTFP-based enterprise development in the mountains as NTFPs are the only feasible resources for enterprise development and income generation for the poor.
- Establishment of an resource center to provide information such as availability of forest resources, knowledge on biology and sustainable harvesting of herbs and NTFPs, cultivation of high value NTFPs and other crops, technology on value addition, and facilities and knowledge on quality assurance and control is important to support development of forest-based enterprises and empower the facilitating organizations in Nepal. Similarly, marketing information system with outreach even to the remote locations will benefit the existing and potential entrepreneurs to promote their forest-based enterprises. To improve the financial situations of the SMEs entrepreneurs in forest-based enterprises need training and linkages with appropriate technology institutions, as most of the forest-based enterprises need processing technologies including equipments, machines, and tools.
- To effectively and efficiently support the micro-enterprise development in forestry sector, clusters can be identified based on enterprise feasibility criteria primarily resource base, and the potential entrepreneurs in the clusters can be targeted with microfinance and business development services. This approach reduces the costs of delivery of microfinance and BDS services. In addition, it will help make a critical mass of enterprises and forest products to gain from economies of scale in terms of service delivery and marketing of the enterprise products. Co-operatives can be linked to the wholesale lending financial institutions as per the "Financial Intermediary Society Act 1998" (NRB 2004) to deliver the microfinance services to micro-entrepreneurs in these clusters. In case of Parbat and other similar cases, such co-operatives can takeover the roles played by the organizations like MEDEP.
- As the roles of business development services have been found critical for the success of the micro-enterprises and micro-credit, microfinance should always be integrated with the business development service provisions such as entrepreneurship development, technical and managerial skills development, market information and linkages, appropriate technology transfer, and policy lobbying. Capacity building and development of entrepreneurship culture is important to create demand for micro-finance services among potential entrepreneurs and the CFUG members in the rural areas of Nepal. Linkages between existing saving and credit groups and potential micro-entrepreneurs should be developed and strengthened to mobilize the savings already collected so as to utilize it in more productive purposes. In addition, other microfinance services such as micro-insurance, payment services, and leasing should

be extended along with the micro-credit and BDS services to further develop the small and micro-enterprises in forestry sector.

- To contribute to poverty reduction and support the poor strata of the society, the delivery of micro-credit services should be simple, clear, and less time consuming. As the success stories also suggest, the credit flow to the below poverty line people should follow group or peer based lending. To further support these households, the interest rates should be rational (currently it is found high in several cases), and the size of the credit and terms should match the needs of proposed enterprises, which is to be reflected in the business plan. To focus the poor households, specific targets in terms of number of clients, amount of credit flow, and target areas should be specified in the programs and plans of the concerned organizations and MFIs.

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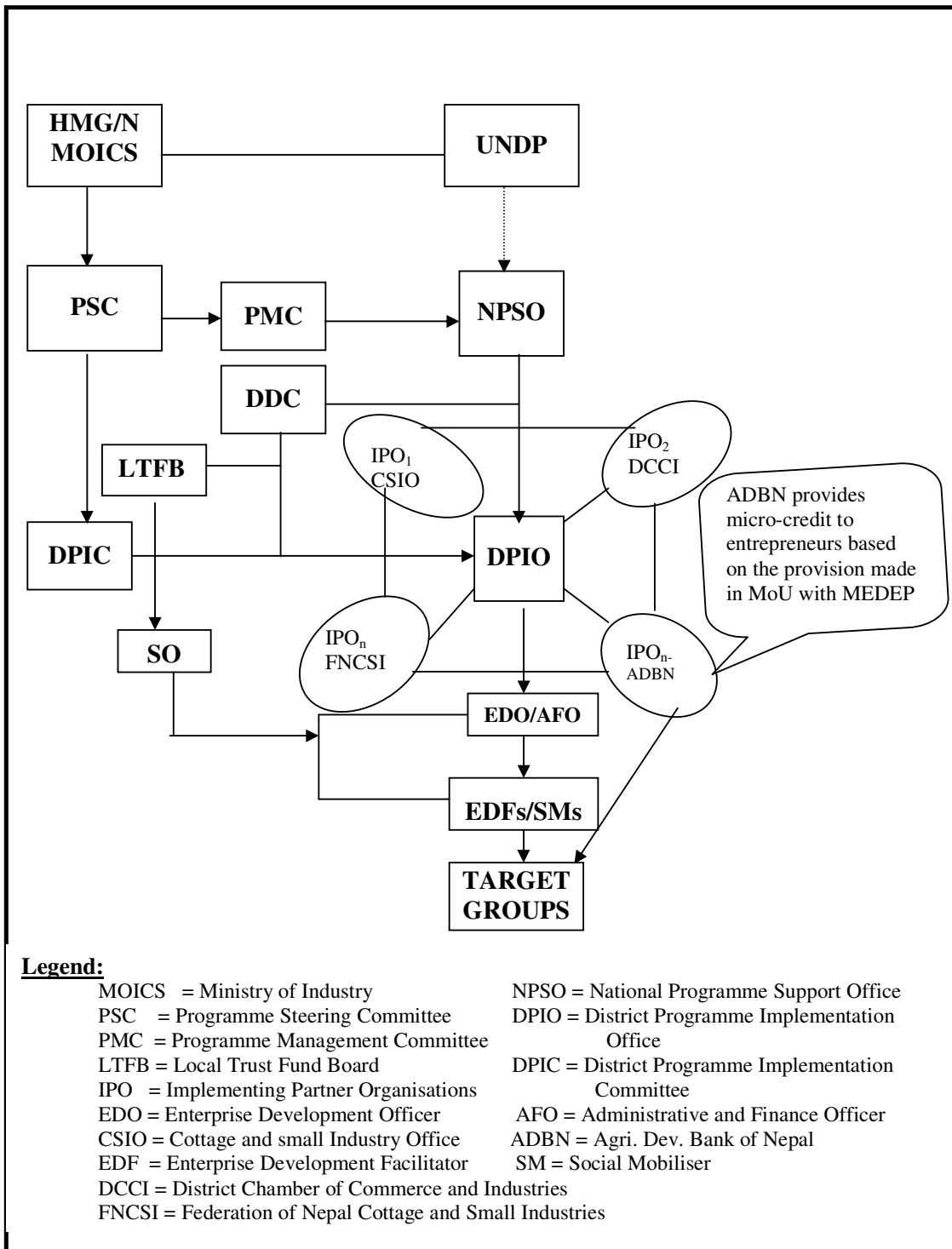
7. ANNEXES

Annex 1: Credit operations of microfinance institutions/programs in Nepal

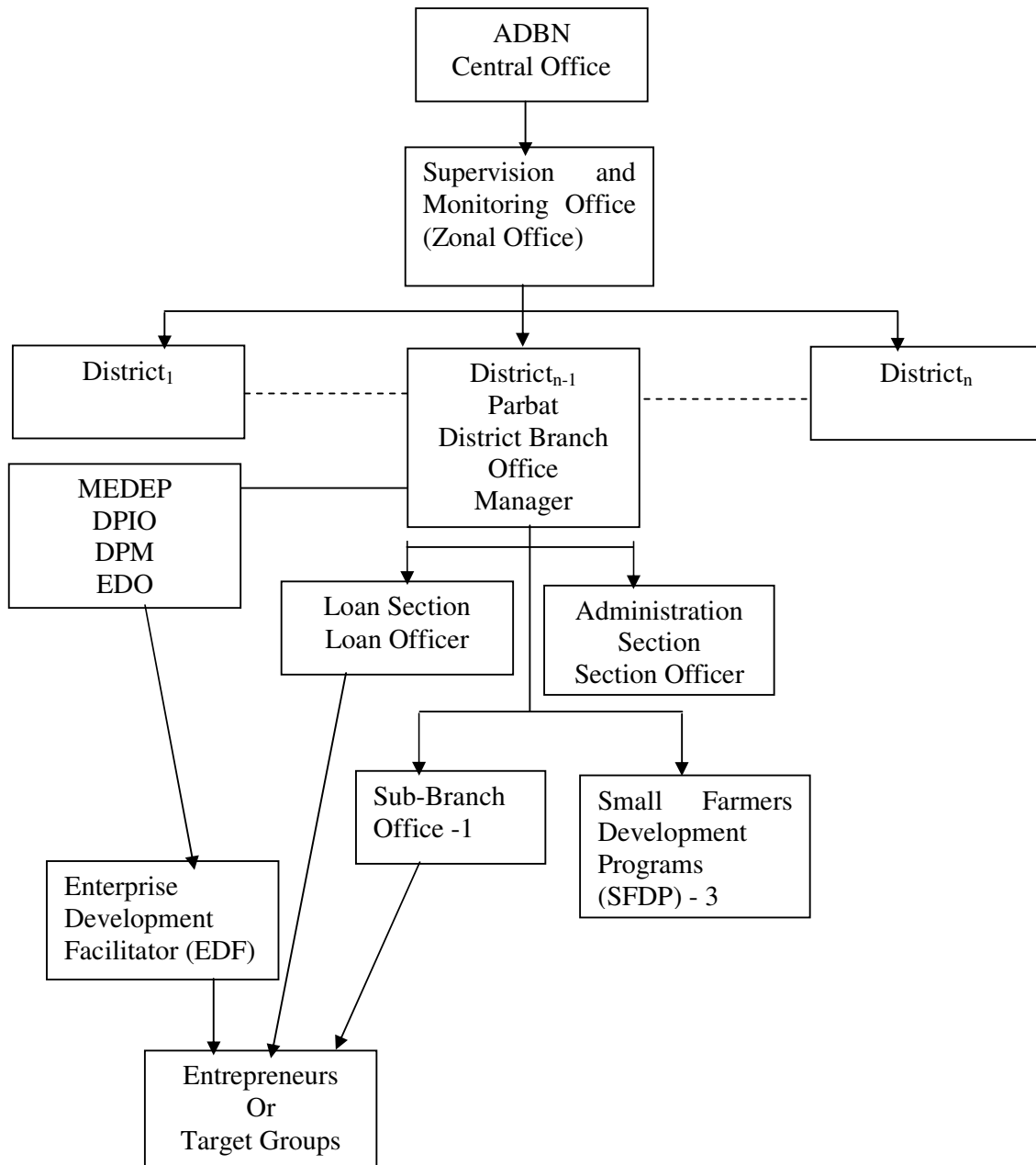
(As of mid January 2004)

S. No.	Institutions / Programs and their number	Cumulative no. of borrowers (In ' 000)	Cumulative loan disbursement (Rs. million)	Cumulative loan repayment (Rs. million)	Loan outstanding (Rs. million)	Saving Balance (Rs. million)
1	Grameen Bikas Banks (5)	150	9,868	8,523	1,345	426
2	Nirdhan Utthan Bank (1)	37	1,462	1,255	197	69
3	Swabalamban Bikas Bank (1)	27	1,653	1,464	189	90
4	DEPROSC Bikas Bank (1)	9	223	164	59	13
5	Chhimek Bikas Bank (1)	7	143	87	56	15
6	Small Farmers Cooperative Ltd. (125)	69	1,829	849	980	165
7	Savings and Credit Cooperatives (2,800)	160	1,896	701	1,195	2,237
8	FI-NGOs (44)	12	58	27	31	-
9	CSD-SBP (An NGO) (1)	3	98	83	15	7
10	DEPROSC (An NGO) (1)	6	62	38	24	6
11	Chhimek Samaj Sewa (An NGO) (1)	5	193	159	34	10
12	Small Farmer Development Program (1)	166	6,384	5,344	1,040	78
13	Direct Lending of NBL and RBB Under Deprived Sector Credit Program (1)	76	846	557	289	75
	(i) PCRW [As of mid April 1999]	50	451	287	164	25
	(ii) MCPW [As of mid July 2002]	26	395	270	125	50
14	Rural Microfinance Development Center (1)	NA	NA	NA	NA	NA
15	Sana Kisan Bikas Bank (1)	NA	NA	NA	NA	NA
16	Rural Self Reliance Fund (1)	NA	NA	NA	NA	NA
	Total [(1)+.....+(13)]	727	24,715	19,251	5,454	3,191

Annex 2a: Management structure of MEDP



Annex 2b: Management structure of ADBN and micro-credit fund flow



Annex 3: Investment portfolio and annual interest rates of Agriculture Development Bank
(Effective from 2004)

Type of enterprises	Interest rate (%)
1. Food grain crop cultivation	11
2. Cash crop production	11
3. Special crop production (Ginger, Cardamom, etc.)	11
4. Tea and Coffee production	10
5. Agricultural tools (mule, powertiller, tractor and bullock)	12.5
6. Irrigation	12
7. Livestock raising	12.5
8. Fruit production	10
9. Warehouse construction	10
10. Cold storage construction	10
11. Bio-Gas	12
12. Agro-based industry	12.5
13. Service industry – non agriculture (NTFP enterprises included)	12
14. Service industry - tourism	12
15. Service industry - others	12
16. Land development and housing	12
17. Deprived sector	8.5
18. Small Farmers Development Bank	10.5
19. Small Farmers Co-operative limited	10.5

Annex 4: MEDEP impact on poverty reduction

1	Average baseline income of the entrepreneurs (Rs.) before participation in MEDEP	4,600
2	Average family size (as per 2058 census) (members)	5.38
3	Hence, average baseline income of the entrepreneur's family	24,748
4	Per capita income at poverty line in 1996	4,404
5	Average poverty line family income per year in 1996	23,694
6	Adjusted per capita income at poverty line for the year 2001	6,090
7	Adjusted poverty line income for the year for 2001 of the entrepreneur's family (poverty line income of 1996 = Rs 4,404, and average annual inflation = 6.7%)	32,770
8	Net increase in income per entrepreneur per year (1.5 or more year old enterprises)	17,490
9	Current income status of the entrepreneur's family (average baseline income + average income from taking up an enterprise, 3+8)	42,238
10	Net increase in income of the family due to participation in MEDEP	17,490
11	Surplus income above poverty line income of the entrepreneurs family (9 - 7)	9,468
12	Average income of the entrepreneurs (Rs.) after participation in MEDEP	23,580
13	Average income of the family members after MEDEP (the net income of the entrepreneurs distributed to family members)	7,851
14	Percent increase in per capita income of entrepreneur	380%
15	Percent increase in per capita income of each family member	171%
16	Number of persons coming out of the poverty line due to participation of one member in MEDEP	19,427
17	Number of employment generated (persons)	2,745
18	Net increase in income per employee per year due to employment generation	9,937
19	Number of persons coming out of poverty line due to enterprise creation and employment	22,172